
TAX PREPARERS OUT OF COMPLIANCE:

MYSTERY SHOPPER TESTING EXPOSES VIOLATIONS OF REFUND ANTICIPATION LOAN LAWS IN ARKANSAS, NEW YORK AND NORTH CAROLINA

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**Arkansans Against Abusive
Payday Lending**



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Laws in Arkansas, New York and North Carolina

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SUMMARY

Advocacy groups in Arkansas, New York and North Carolina conducted nineteen “mystery shopper” tests of paid tax preparers. The results revealed that some preparers provided poor quality services or encouraged tax fraud. In addition, many tax preparers are failing to comply with state laws governing refund anticipation loans (RALs). Testers also reported a number of other problems in the disclosure of RAL, other tax financial products, and tax preparation fees.

A significant number of testers were the victims of poor quality tax preparation, or outright tax fraud. The most disturbing example was a preparer in New York who, when realizing the tester would only receive a \$1,000 federal refund with the standard deduction and owe state taxes, began making up deductions. A Mo’ Money Taxes preparer in Arkansas repeatedly suggested to a tester that she not include income from a second job, despite the fact the income had been reported to the IRS on a Form 1099. Another tester was forced to file an amended return and repay \$822 to the IRS due to a preparer’s mistakes. Another preparer filed a consumer’s tax return without her permission.

In Arkansas, none of the nine paid preparers subject to testing were in full compliance with the Arkansas RAL law. Most critically, six out of nine preparers (67%) charged fees that potentially violated that state’s prohibition on RAL fees other than the fees charged by the lending bank. Five out of 9 preparers (over 50%) failed to make the written disclosures required by Arkansas law, and only one preparer fully complied by making the written disclosures on color paper. Six out of nine (67%) failed to make all of the oral disclosures required by the Arkansas RAL law. Five out of nine preparers (over 50%) failed to have wall posters showing loan fees and warning statements.

In New York, only one of the six paid preparers that offered RALs or related products was in full compliance with the New York State and City RAL laws. Five out of six preparers (or over 80%) did not have the proper wall poster required by New York City law. Only one preparer made the complete written disclosures required by the New York laws, two preparers made noncompliant partial disclosures, and one preparer failed to make any disclosures. None of the four preparers who offered a RAL or a refund anticipation check (RAC) made the full oral disclosures required by the New York State RAL law. Two preparers made partial disclosures, and at least one preparer failed to make any oral disclosures, even that the RAL was a loan, despite pushing the RAL.

In North Carolina, mystery shopper testing was focused on Mo’ Money Taxes, which had been recently fined by that state’s Commissioner of Banks for failing to register as required by law. The testing revealed that Mo’ Money staff did not give two testers the Truth-in-Lending disclosures attached to the RAL checks until the testers proactively asked for them. In addition, the Mo’ Money outlets failed to provide the written RAL disclosures or have wall posters as required by North Carolina law.

In addition to legal violations, three testers in New York reported that preparers tried to convince them to obtain RALs or related products, while a tester was discouraged by Jackson Hewitt from taking one, probably because Jackson Hewitt franchises in New York

could not make RALs. Testers reported problems with preparers' failure to adequately inform them about fees for RALs or related products, or how they worked. In some cases, murky disclosure or non-disclosure of RAL fees was compounded by the preparers' failure to disclose tax preparation fees. Testers were unable to obtain estimates of tax preparation fees, which sometimes were extremely high, and they appear to be on the increase. Several preparers charged around \$400.

A. Introduction

One of the ironic facts about the American tax system is that the businesses which help Americans comply with this important legal obligation are themselves essentially unregulated. With the exception of a handful of states (Oregon, Maryland and California), there are no minimum educational standards or certification to become a tax preparer. Over eighty million Americans put their trust, their legal liability for taxes, and their financial health in the hands of unregulated paid preparers.

Fortunately, this will change soon. The Internal Revenue Service has announced plans to regulate the tax preparation industry. It has proposed regulating tax preparers by requiring paid preparers to register and pass a competency test. Preparers will also be required to take fifteen hours per year of continuing professional education, and comply with a code of ethics.

As part of this effort, the IRS is examining the role of paid preparers in promoting, selling, and arranging refund anticipation loans (RALs). RALs are one to two week loans made by banks and facilitated by paid preparers, secured by the taxpayer's refund. In 2008, RALs skimmed \$738 million from the refunds of 8.4 million American taxpayers. RALs can be expensive, with some lenders charging fees that translate into Annual Percentage Rates (APRs) of 50% to nearly 500%. They expose taxpayers to unmanageable debt if a problem with a refund results in the loan being unpaid. In addition, there has been a history of deception and misinformation about RALs.

Currently, the IRS does little to regulate RALs, with only a handful of weak disclosure requirements and prohibitions against the preparer being the actual lender. The IRS actually actively assists RAL lenders by providing the Debt Indicator, an electronic acknowledgement service provided by the IRS that tells tax preparers whether a taxpayer's refund will be paid or will be intercepted for government debts.

However, a number of states have passed laws to regulate RALs, and their experience should inform what the IRS does about RALs. Three of the states with the strongest RAL laws are Arkansas, New York and North Carolina. Each of these states requires written and oral disclosures for RALs. These disclosures, especially the oral ones, are intended to ensure that consumers have meaningful knowledge and understanding of the nature of RALs, their costs, and their risks.

Arkansas, North Carolina and New York City all require wall postings, which is another method to ensure that consumers have adequate information about RALs. Both Arkansas and New York, which passed new RAL laws in 2009, ban paid preparers from charging any fees for RALs except for the fee charged by the lending bank. Thus, these laws ban the "add-on" fees sometimes charged by preparers. In some cases, preparers have charge multiple add-on fees adding up to several hundred dollars to the price of a RAL.

Finally, New York and North Carolina also require registration of paid preparers that make RALs. This helps to ensure that the state can oversee and enforce compliance with the Act.

B. Testing Background

This tax season, three advocacy groups in Arkansas, New York, and North Carolina conducted “mystery shopper” projects to examine whether paid preparers were complying with RAL laws in those states. Testing also examined whether there were other abuses, or failure to follow other rules.

Each of the three groups had different testing protocols, described below:

Arkansans Against Abusive Payday Lending (AAAPL)

AAAPL recruited nine taxpayers to become testers. The testers were instructed to have their returns prepared and to obtain RALs from a variety of commercial preparers, including large chains, small chains, and independents.

Neighborhood Economic Development Advocacy Project in New York City (NEDAP)

NEDAP recruited seven taxpayers to become testers. The testers were instructed to have their returns prepared but did not obtain RALs. Instead, they were instructed to pay attention to whether disclosures were made. NEDAP testers went to a variety of commercial preparers, including large chains, small chains, and independents.

Community Reinvestment Association of North Carolina (CRA-NC)

CRA-NC recruited three taxpayers to become testers. CRA-NC specifically instructed testers to have their tax returns prepared at Mo’ Money Taxes. Two testers obtained a RAL, and one obtained a refund anticipation check. In February 2010, Mo’ Money Taxes was fined \$13,000 by the North Carolina Commissioner of Banks for failure to register its thirteen offices as required by that state’s RAL law.¹

Testers were recruited and briefed about the nature of project. In each locale, testers were either interviewed by the advocacy group, who wrote up narratives, or the testers wrote up the narratives themselves.

For Arkansas, AAAPL wrote a summary report of all the testers’ experiences. This summary report is attached as Appendix A. Also attached as Appendix B and C are two spreadsheets that summarize the fees charged to each tester and the violations observed for each preparer.

Testing was focused on RAL practices and compliance. However, as in similar testing conducted by advocacy groups in 2008, other issues became apparent, including poor quality tax preparation and outright encouragement of tax fraud. Testers also reported a variety of experiences on RAL solicitation, from preparers who actively discouraged testers from taking RALs to preparers who pushed testers into getting them.

¹ Consent Order, In re: Application of Mo Money of North Carolina, Inc., Docket No. 10:036:RAL (Feb. 8, 2010).

Several testers did not receive RALs, but instead received a “refund anticipation check” (RAC). With a RAC, the bank opens a temporary bank account into which the IRS direct deposits the refund amount. After the refund is deposited, the bank issues the consumer a check and closes the temporary account. At least one tester received a RAC because she was denied a RAL, as RACs are used as the default product into which consumers are “flipped” if they do not qualify for a RAL.

This was the second round of testing conducted by advocacy groups in conjunction with the National Consumer Law Center (NCLC). The first round occurred in 2008, and was conducted by CRA-NC and Community Legal Services in Philadelphia (CLS).

C. Poor Quality Tax Preparation and Tax Fraud

As in the first round of testing, a significant number of testers were the victims of poor quality tax preparation or outright tax fraud. NCLC, CRA-NC and other advocacy groups have previously documented extensive evidence indicating that RALs provide tax preparers with an incentive to inflate refunds, and aid thieves in their commission of tax fraud.²

The most disturbing example of tax fraud came from a tester (JA) in New York who described how the preparer, when realizing the tester would receive only a \$1,000 federal refund with the standard deduction and owe state taxes, began making up deductions:

JA reported that the tax preparer tried to entice her to commit tax fraud by showing her how much her federal refund would increase if she took deductions in excess of the standard deduction. JA does not attend church, but the tax preparer included a \$2,000 church donation. The preparer also deducted the cost of work clothes and laundry, then showed JA that her federal refund would increase to \$3,000 from about \$1,000. The preparer also tried to convince JA to make up a dependent as she does not have any--showing her that her refund would go up to \$5,000 if she did so. The preparer also tried to qualify her for EITC even though she is not eligible. Finally, the tax preparer deducted \$400 in 2008 tax preparation costs even after JA told the preparer that she did not pay for tax preparation last year. At the end of the preparation, the preparer told JA that taking out a RAL was the best option and recommended she avoid e-filing.

Another example of attempted tax fraud by a preparer came from a tester (KS) in Arkansas who described:

[The preparer] took the forms I had completed and requested my W2's which I gave them to him. He mistakenly thought that my 1099 was my tithing statement from my church. I told him it was my salary from my second job. He entered the amount and

² Chi Chi Wu and Jean Ann Fox, *RALs, Tax Fraud, and Fringe Preparers*, National Consumer Law Center and Consumer Federation of America, Feb. 2009; Comments submitted by Community Reinvestment Association of North Carolina regarding Advance Notice of Proposed Rulemaking - Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products, April 7, 2008.

stated that I would be really disappointed if I knew the difference in my refund now that I have this additional income reported. I asked what was the difference, he stated I went from around \$30?? To only \$15??. He wanted to know if I still wanted to report the additional income. I told him yes, I did because this income has already been reported to the IRS. Since I have been working this part time job, my refund has been less and I even have to pay State Taxes sometimes. He then told me how much I will owe the state for taxes. He again asked me if I was sure I wanted to report this. I told him again, yes, I do. I need to keep it clean. He said he had to ask because some people don't want them to report additional income because it lowers their refund amount. So he has to do what the customers tell him to do.

Other testers reported either fraud or incompetent preparation such as:

- A tester (ZK) in New York reported that a Jackson Hewitt preparer advised her not to include \$300 in income that ZK had not received a 1099 form for.
- A tester (KW) in who went to a small chain in Arkansas had her tax return double-checked by a certified VITA volunteer tax preparer. The preparer found numerous errors and KW will have to write the IRS a check for \$822 based on the preparer's erroneous refund calculation. An amended return was filed for KW. KW said the preparer mentioned to KW that there was a new education credit that would increase KW's refund but when quizzed about the specifics of the credit, the preparer expressed ignorance.
- A preparer in Arkansas included the niece of the tester (CM) as a dependent. The niece had been included as a dependent on a prior tax year return. However, the preparer included the niece without first asking CM whether the niece was still in CM's household. It turns out CM did not want to claim the niece as a dependent.
- An independent preparer in Arkansas failed to properly deal with first-time homebuyer credit for one tester (VS). VS and her husband were eligible for the credit; however, the IRS does not allow paperwork for this credit to be electronically filed. When informed, the preparer expressed surprise at this fact, removed the homebuyer credit from VS's taxes and instructed her to come back to the preparer in a month to have an amended return filed -- a follow-up visit that potentially could have cost VS additional fees.
- Five of the six testers in New York reported that the tax preparers guaranteed that the tester would receive a tax refund.

Another outrageous example of preparer abuse comes from a complaint in North Carolina against an independent preparer, Freedom Tax Services. This consumer could not participate in the testing as it turns out that her taxes already had been prepared for her without her permission.

I went to Freedom Tax Services to find out how much it would cost to get my 2009 taxes prepared. I left my information ... and was waiting on a call to confirm fees,

but the call I received was to come pick up my refund check. Since I had not authorized [Freedom Tax Services] to file my return, I refused to accept the check with preparation fees and loan fees deducted. The check was torn up and I was given no further information at that time. I then tried to electronically file my return at another site, but was informed that my return had already been filed and that my refund had already been issued on January 29, 2010.

D. Failure to Comply with State RAL Laws

The main purpose for the testing was to determine whether tax preparers were complying with the newly enacted Arkansas and New York laws. In addition, Mo' Money Taxes was tested to see if it was complying with existing North Carolina law, given its recent fine for not registering.

The tests reveal very spotty compliance with RAL laws at best. In each state, very few preparers that offered RALs were completely in compliance with the RAL law. Some preparers were seriously out of compliance.

1. Arkansas

The Arkansas RAL law, enacted in 2009, requires persons who “facilitate” RALs, generally tax preparers, to make oral and written disclosures, as well as have wall postings.³ The law also prohibits RAL facilitators from charging any fees other than the loan fee charged by the lending bank, unless the same fee in the same amount is charged to all customers, regardless of whether they are taking out a RAL or RAC. This provision prohibits add-on fees often charged by preparers, and applies to both RALs and RACs.

Mystery shopper testing revealed that none of the nine paid preparers subject to testing were in full compliance with the Arkansas RAL law. Many preparers were only minimally compliant. Most critically, the mystery shopper testing revealed extensive potential violations of the prohibition against charging add-on fees. ***Six out of nine preparers (67%) charged possibly illegal add-on fees, such as a “document preparation” “transmission,” “technology” and “service bureau” fees.*** While we do not have conclusive evidence that these fees were not charged to all customers, historically these fees are of the type usually charged to only RAL and RAC customers.

Five out of nine preparers (or over 50%) failed to have wall posters showing RAL fees and warning statements. Two preparers did have posters, but the posters were not fully compliant. Only the two preparers had fully compliant posters.

Only three out of nine preparers (33%) made the full oral disclosures required by the Arkansas RAL law. The remainder made partial disclosures, *i.e.*, they generally informed testers that the RAL is a loan but did not make other disclosures, such as the fact that, if the tester's refund was less than expected, they would be responsible for the full amount of the loan. Often the oral disclosures were confusing and after the fact. For example, one tester (VS) reported:

³ Ark. Code §§ 4-116-101 to 4-116-108.

After processing the return she asked how we wanted to get our return. We asked what are our options? She stated we could Direct Deposit [this appears to be Chase's RAC product] or Have [sic] a paper check mailed to us or do an RAL [sic] which has additional fees. In response we asked for an RAL. We were not given any paper work about the RAL or an outline of the fees before the RAL was processed. After the RAL was processed she showed us documentation with a break down of the fees and the different ways the bank distributes the check. At this point we were told this is a loan from the bank and can be denied. We were not informed in the event our refund is delayed or denied we would have to pay the money back. She didn't offer a copy of the RAL breakdown we had to request on [sic] for our records.—She stated she usually does not give a copy of the RAL out.

As for written disclosures, only one preparer fully complied by making the disclosures on color paper, as required by the Arkansas RAL law, probably to highlight the disclosure. ***Five out of 9 preparers (or over 50%) failed to make the written disclosures at all.***

Three preparers did make the written disclosures, but not on color paper. One of these preparers had the novel idea to disclose the RAL fees by handwriting them on a purple Post-it note, and to bury the formal disclosure three-quarters of the way in a 39 page packet of documents handed to the tester.

2. New York

Mystery shopper testing was conducted in New York to test paid preparer compliance with new requirements added to the New York RAL law in 2009,⁴ as well as the existing New York City RAL Ordinance.⁵ The new changes require RAL facilitators to make oral and written disclosures. They also prohibit RAL facilitators from charging add-on fees. The New York State and City laws require facilitators to have wall postings.

Of the seven paid preparers tested, only six actually offered RALs or RACs. The mystery shopper testing revealed that only one of these six paid preparers was possibly in full compliance with the New York State and City RAL laws. As in Arkansas, some preparers were only minimally compliant.

Only one preparer made the written disclosures required by the New York State and City RAL laws. One preparer failed to make the written disclosures at all. Two preparers did make the written disclosures, but those disclosures were not fully compliant with the New York RAL laws.

Only one of six preparers had the wall poster required by the New York City RAL law showing the RAL/RACs fees and warning statements. That means five out of six preparers (or over 80%) did not have the proper wall poster required by New York City law. None of the four preparers who made or offered a RAL or RAC gave the full oral

⁴ N.Y. Tax Law § 32; N.Y. Gen. Bus. Law § 372.

⁵ New York City Administrative Code §§ 20-739 to 20-741.1.

disclosures required by the New York State RAL law. Two made partial disclosures, and at least one preparer failed to make any oral disclosures, even that the RAL was a loan, despite pushing the RAL.

Because most testers did not actually take out RALs or RACs, it was difficult to tell whether there were violations of the prohibition against add-on fees. At Jackson Hewitt, the franchise charged both a \$11.95 technology fee and a mysterious \$10 fee for a RAC. The \$11.95 technology fee was paid to MetaBank so did not technically violate New York State law. Another Jackson Hewitt franchise charged a \$16 data and document storage fee to a tester who did not receive a RAL or RAC, even though that fee is usually associated with those products. A Liberty Tax Service franchise indicated that it would charge an extra \$10 fee for a RAL (which ultimately the tester did not take out), but it was unclear whether this fee was actually charged by the lending bank, which would not violate the New York State law.

3. North Carolina

North Carolina has had a RAL law⁶ on the books since the early 1990s. This law requires RAL facilitators to be registered with the North Carolina Commissioner of Banks, to make written disclosures, and to have wall postings. Unlike Arkansas and New York, the North Carolina law does not ban add-on fees.

Mystery shopper testing in North Carolina was focused on Mo' Money Taxes. In addition to having been fined by Commissioner of Banks for failing to register, Mo' Money is known for its outlandish advertisements that could be considered to include offensive racial stereotyping.⁷

The mystery shopper testing revealed that both of the Mo' Money outlets from which testers received a RAL failed to provide the written RAL disclosures required by the North Carolina law. In addition, all three outlets failed to have wall posters.

Even worse, the Mo' Money staff did not give two testers the Truth-in-Lending disclosures attached to the RAL checks. RAL lenders often provide Truth-in-Lending disclosures attached to a RAL check; in some cases, they also provide estimated disclosures at the time the borrower applies for the loan. The two testers who received RALs reported that the Mo' Money personnel detached the Truth-in-Lending disclosures from the check and put them into a file without giving them to the tester. Testers had to proactively ask for the Truth-in-Lending disclosures in order to take home a copy. If Mo' Money personnel are not giving these disclosures to other consumers who do not ask for them proactively, then they are violating the Truth in Lending Act. Furthermore, testers were not given any other documentation that normally is provided with RALs, such as a copy of the RAL contract.

⁶ North Carolina Gen. Stat. §§ 53-245 to 53-254.

⁷ Adam Rust, *Mo' Money Taxes Gets a Slap Down*, Bank Talk Blog, Feb. 12, 2010 at <http://banktalk.org/2010/02/12/mo-money-taxes-gets-a-slap-down/> (last visited Feb. 18, 2010).

E. Testers' Experiences with RAL, RAC and Tax Preparation Fee Disclosures

In the first round of testing in 2008, testers documented a lack of clear disclosure and transparency about RALs, both regarding their nature and the fees associated with them. A common theme in those testing reports was confusion on the part of testers. Similar problems were observed in this second round of testing.

Some of the testers in this second round of testing reported problems with preparers' failure to adequately inform them about the RAL or RAC process or fees. For example, a tester in Arkansas (GW) reported at a Jackson Hewitt outlet:

We are finalizing the tax return and she ask me if I wanted Direct Deposit, RAL, or the 8-10 day return. I said RAL and I wanted it direct deposit. She showed me the fees, but did not give a clear explanation about [the] RAL. Then I had to sign about 12 screens. Some of the screens were blank and I ask her to explain the blank screens, because I told her I was not comfortable signing something I could not read. So she briefly explain each screen & said she will print out copy of everything I signed. I felt like I was being rushed through it and I signed several blank screens and did not get a chance to read before signing.

In New York, a Jackson Hewitt preparer fail to adequately explain to a tester (RMH) that she was receiving a RAC. The preparer did inform RMH that Hewitt did not offer RALs, but merely left RMH with the impression that somehow Hewitt was "taking tax prep fees out of refund without RALs." The Hewitt preparer also added an unexplained \$10 charge.

In North Carolina, a tester (JJ) reported that:

An explanation of what the Rapid Refund was not given neither the process of e-filing (only that I would get it back in 8-10 days if Rapid Refund was not approved)[NB this "e-filing" was probably a RAC]. I asked if I could get a copy of everything I was being charged for (she did not explain how the charges were broken down) Again she said she would give me a copy once the check came in. She said the charges were listed on the top half of the check.

As with JJ, another tester (JS) in Arkansas reported that her preparer failed to adequately explain what would happen if she was turned down for a RAL, which did happen. JS noted:

When I called back the next afternoon about my check I was told that my loan had been denied and that it would now be 8 to 15 days for my refund. I would not have to pay the \$50.84 interest fee but everything else was the same. . . I[n] my opinion the RAL is really not worth it. It seems that the extra few days comes at too high a price & they didn't explain about what happens if your loan is not approved. [Note that JS may have been denied a RAL because she is a military dependent, and could not be charged a loan fee over 36% APR. If so, Block may have failed to inform her of the true reason for her denial.]

In some cases, confusion over RAL fees was compounded with confusion over tax preparation fees. A tester in Arkansas (GW2) noted:

When [the preparer] finished with my return I asked her the fees charged. She gave me a print out of what my prep fee covers but they were not broken down and told me I had to subtract that from my total fees to find out my bank fees. But she continued to talk about my bank charges being \$49 but when I told her my fees were more than [sic] that I never got a clear understanding on the money. I left thinking that the \$49 was the difference in getting my check next day and two weeks later, because my fees after subtracting was 146.46. I was told I could not get a brake [sic] down because that is just what the bank charged.

A tester (ZK) in New York reported that she was quoted a \$100 tax preparation fee or she could sign up for “an account” with Jackson Hewitt for a \$153 fee. The preparer implied that the IRS charged the \$53 fee, when it was likely for a RAC or prepaid card from Jackson Hewitt. In general, the tester said she felt rushed and the preparer would not tell her a price upfront.

Some preparers even had computer systems that seemed to make it near impossible to provide fee information. The tester (KS) who went to a Mo’Money Taxes in Arkansas reported:

When he finished, he asked if I needed copies of everything I had given him, I told him yes. I also requested a breakdown of my fees. He seemed to get nervous and started keying into the computer trying to see if he could print this information out for me. He stated he may not be able to print it out. I said, you just printed out my tax forms for me and you cannot print out the breakdown of fees. He said that I should receive that with a copy of my check from the bank and if he printed out something it may come up blank. I told him I would still like to see it ... He finally found what I was requesting and turned the computer around for me to look at. I again requested a print out. He was able to print out the breakdown of my fees and gave them to me.

(Note that this print out was the Truth in Lending Disclosures for the RAL)

As in the 2008 testing, a number of testers reported that preparers in general did not provide much information about the cost of tax preparation itself. A tester in New York (JA) reported that she tried to get the cost of preparation up front, but the preparer “avoided the question.” A tester in Arkansas (SB) reported that an H&R Block preparer “let her know up front that they fees were high, but couldn’t get me the exact amount.” A tester in New York (NC) similarly reported that she asked the H&R Block preparer and was told the preparer couldn't estimate fees because the "computer did it." Only at the end did NC learn the amount of the fees.

In general, several instances of extremely high tax preparation fees were observed. In the case of SB and NC discussed above, as well as RMH discussed below, the tax preparation fees were over \$400 for returns that were not especially complicated. Other testers reported fees of over \$300 (GW and KS). These amounts also appear to be on the

increase, as tax preparation fees of over \$400 were not observed in the 2008 round of mystery shopper testing.

A tester in New York (RMH) reported that she was quoted a price of \$70 for tax preparation fees by a Jackson Hewitt outlet, but ended up paying over \$400. Another NY tester (GC) reported that she had to ask that a Liberty Tax Service outlet honor a 50% off discount that it had advertised outside of its offices. The preparer charged her \$436 and encouraged her to take out a RAC for the full amount. The preparer also showed her the fees for RALs without explaining them, plus conflated the tax preparation and RAL/RAC fees. After some discussion, the preparer finally accepted a check from the tester that included the 50% discount.

Three of the seven testers in New York (JA, NC and GC) reported that preparers tried to convince them to obtain RALs or RACs. In contrast, ZK was discouraged by Jackson Hewitt into taking one, probably because Jackson Hewitt franchises in New York could not make RALs. One independent preparer in New York did advise a tester (JK) that the RAL rates were “exorbitant” and did not try to push a RAL on him.

Several preparers in both Arkansas (MR) and North Carolina (KB and JJ) refused to give the testers copies of their tax returns until the testers received their RAL checks. Presumably, the preparers did so in order to ensure that the check would arrive so that they knew they would get paid.

F. Privacy Issues

The privacy of tax return information is always an enormous concern, because tax returns contain some of the most sensitive financial information that a taxpayer may have. Tax preparers are subject to confidentiality rules under Section 7216 of the Internal Revenue Code and IRS regulation. These rules require preparers, among other things, to obtain the taxpayer’s separate consent for use of their tax information to make a RAL or RAC. 26 C.F.R. § 301.7216-3. In addition, the rules require preparers to give taxpayers a copy of these consent forms. *Id.* at § 301.7216-3(c)(3).

Testing in all three locations found widespread violation of the requirement to provide consumers with a copy of their privacy consent forms. Six out of nine preparers in Arkansas failed to provide a copy of the form to consumers. All three Mo’ Money outlets in North Carolina also failed to provide a copy of the form.

In addition, one tester (GW2) reported privacy issues, expressing concern that personal information about her taxes was being discussed in a manner in which others present could hear the conversation.

G. Conclusion

Mystery shopper testing in Arkansas, New York, and North Carolina suggest that many tax preparers are failing to comply with state laws governing RALs. Furthermore, testers reported a number of other problems in the disclosure of RAL, RACs, and tax preparation fees. The IRS, in its upcoming rulemaking to regulate tax preparers, should

make compliance with state RAL laws a condition of registration with that agency. Better yet, the IRS should prohibit tax preparers from facilitating RALs.

A significant number of testers were the victims of poor quality tax preparation, or outright tax fraud. The IRS plans to regulate the tax preparation will hopefully lessen these problems. Otherwise, millions of American taxpayers continue to be at risk for fraud, errors, and abuse.

APPENDIX A



Arkansans Against Abusive Payday Lending

www.StopPaydayPredators.org

National Consumer Law Center Refund Anticipation Loan Mystery Shopper Project

Overview

Arkansans Against Abusive Payday Lending (AAAPL) in December 2009 partnered with the National Consumer Law Center (NCLC) to conduct “mystery shopper” tests of Arkansas tax preparers that offer high-cost Refund Anticipation Loans (RALs). This report summarizes each shopper’s experience.

A key rationale for conducting the mystery shopping project in Arkansas was to test tax preparer compliance with Act 1402 of 2009 (lead sponsor State Representative Darrin Williams of Little Rock), which establishes detailed oral and written disclosure requirements for providers of RALs. Act 1402 also prohibits RAL providers from charging fees other than those associated with the bank offering the loan, unless the same fee in the same amount is charged to all customers, regardless of whether they are taking out a RAL. The Act also requires providers of RALs to disclose information to consumers that RALs are in fact loans and that the IRS can provide refunds free of charge in 8 to 15 days.

Representative Williams held a news conference on January 26, 2010, to remind tax preparers of the requirements of Act 1402, which took effect July 31, 2009. All nine mystery shopper visits took place after Representative Williams’ news conference. It is certainly worth noting that *none* of the nine tax preparers visited were in full compliance with Act 1402’s disclosure provisions. Most were minimally compliant. One preparer’s idea of disclosing the potential RAL fees was writing the fees on a purple Post-it note and burying the formal disclosure of the fees deep in a thick packet of documents handed to the mystery shopper.

Another shopper (who was denied a RAL) had to badger the preparer to turn over a single-page summary of her estimated refund and total tax preparation fees, and the preparer said he could not turn over a copy of the shopper’s filed tax return until after her refund check was deposited several weeks later.

All mystery shoppers were offered no-cost verification of their tax returns by a certified Volunteer Income Tax Assistance (VITA) preparer. For one shopper who had exercised this option as of the date this report was submitted, significant errors were discovered that will oblige her to pay \$822 of her refund to IRS to cover the difference based upon the error. An amended return was filed on this shopper’s behalf.

Of the nine mystery shoppers, all were identified prior to their visits as likely eligible for the federal Earned Income Tax Credit (EITC). Each shopper received pre-visit training and was told they would be reimbursed following their visit, with documentation, for all costs taken from their

refund, plus \$100 for their trouble. Two shoppers ultimately were denied RALs, so paid charges for tax preparation only.

Further review will be required to determine definitively whether all fees charged in connection with RALs were permissible under the Act.

Combined fees for tax preparation and a RAL for the seven shoppers who received RALs ranged from a low of \$224.34 to a high of \$487.20. As a percentage of the shopper's tax refund, fees ranged from 3.8 percent to an astounding 25 percent. Charges for the tax preparation component only of all nine shoppers ranged from \$79 to \$396.

The following summaries describe each shopper's experience. Tax preparers were surveyed in Helena-West Helena, Little Rock, North Little Rock, White Hall, and Pine Bluff. Surveys were conducted from early February to early March 2010.

Certified Public Accountant

- *Name of mystery shopper:* CM
- *Received RAL?* Yes
- *Federal refund processed by preparer:* \$5,086
- *Total charge by preparer:* \$311.81
- *Total charge by preparer as percentage of shopper's federal refund:* 6.1 percent

Summary of visit: CM reported that the preparer offered minimal disclosure of RAL terms as required under Act 1402. There was no poster displayed in a visible location enumerating RAL terms. CM said she did not receive written disclosure on colored paper separate from the RAL of the RAL terms. She received oral disclosure that the RAL was a loan and of the RAL fee only after asking the preparer. She was not told that if her refund was less than expected, she was responsible for the full amount of the loan.

The quality of tax preparation also was questionable based on CM's narrative; the preparer filled in a dependent from a previous tax year without first asking CM whether the dependent was still in CM's household. The preparer also spent about 15 minutes of the approximately 55 minute tax preparation session discussing personal issues not related to the tax preparation.

Jackson Hewitt Tax Service

- *Name of mystery shopper:* GW
- *Received RAL?* Yes
- *Federal refund processed by preparer:* \$3,978
- *Total charge by preparer:* \$430.98
- *Total charge by preparer as percentage of shopper's federal refund:* 10.8 percent

Summary of visit: GW reported that the preparer did have a poster displayed in a visible location enumerating RAL fees and sample interest rates, but the poster did not include other required information. GW said she did not receive required written disclosure of the RAL terms on colored paper separate from the RAL. She said she did receive oral disclosure that the RAL was a loan, but not oral disclosure that if her refund was less than expected, she would still owe the entire amount of the loan. GW initially asked for a copy of the customer data sheet she was asked to sign, but the preparer responded that she "did not have a copy machine."

GW reported that the preparer seemed to rush through some steps in the process and GW had to lean over the computer screen to learn what was going on. The preparer asked GW to "sign"

screens on the computer that were blank. After GW objected, the preparer agreed to explain the information being submitted and to print out copies of everything GW was asked to sign. GW learned the preparer's name only toward the end of the process when GW spotted the name on the computer screen and asked the preparer if that was her name.

H & R Block

- *Name of mystery shopper:* JS
- *Received RAL?* No
- *Federal refund processed by preparer:* \$4,739
- *Total charge by preparer:* \$333.95
- *Total charge by preparer as percentage of shopper's federal refund:* 7 percent

Summary of visit: JS reported that the preparer did comply with most of the disclosure requirements of Act 1402. There was a poster displayed in a visible location with required disclosure information. JS did receive a written disclosure of RAL terms separate from the RAL application, but this disclosure was not on colored paper as required by the Act. JS did receive oral disclosure that the RAL was a loan and that if her refund is less than expected, she would owe the entire amount of the loan.

JS was told there would be a credit check as part of applying for the RAL, and told to call back the next day. When JS did so, she was told that her application for a RAL had been denied, so she would have to wait two weeks for her refund check to be processed and ready for her to pick up at the H & R Block office. JS discovered that her bank would then hold the check for an additional 5 business days. JS was not charged the \$50.84 "prepaid finance charge" but was assessed all other charges listed on the fee breakdown she received. JS expressed particular frustration that the preparer "didn't explain about what happens if your loan is not approved."

Arkansas Select Tax Service

- *Name of mystery shopper:* KW
- *Received RAL?* Yes
- *Federal refund processed by preparer:* \$5,691
- *Total charge by preparer:* \$224.34
- *Total charge by preparer as percentage of shopper's federal refund:* 3.9 percent based on refund calculated by Arkansas Select; 4.6 percent based on correct refund identified by post-review)
- *Error identified by post-visit tax review by certified preparer:* Yes. Miscalculation by paid preparer resulted in refund \$822 too high. Amended return filed.

Summary of visit: KW reported minimal preparer compliance with the disclosure requirements of Act 1402. There was a small poster board apparently displaying some information on RALs but KW said the poster was not displayed in a visible location and the print was too small to read. KW said she did not receive any of the following required disclosures: written disclosure of the RAL terms on colored paper separate from the RAL; oral disclosure that the RAL was a loan; oral disclosure of the RAL interest rate; and oral disclosure that if her refund is less than expected, she would owe the entire amount of the loan. Lack of disclosure on this last point would have unfortunate consequences for KW (see below). KW said the preparer demonstrated sketchy knowledge of certain tax credits; the preparer mentioned to KW that there was a new education credit that would increase KW's refund but when quizzed about the specifics of the credit, the preparer expressed ignorance.

The preparer's method of disclosure was rather novel; as KW outlined in her narrative, when she asked for written documentation of RAL costs, the preparer wrote out figures by hand on a purple Post-it note which she handed to KW.

KW before she left the preparer was handed a large packet of documents including her return and related materials, and discovered that a formal, detailed disclosure of the RAL costs was present—buried approximately three-quarters of the way into in the 39-page packet.

KW's return was double-checked by a certified VITA volunteer preparer. The preparer found numerous errors and KW will have to write the IRS a check for \$822 based on the preparer's erroneous refund calculation. Luckily, KW had not spent any of the RAL proceeds before having her return double-checked. An amended return was filed for KW.

JBL Rapid Tax Refunds

- *Name of mystery shopper:* MR
- *Received RAL?* No
- *Federal refund processed by preparer:* \$7,819
- *Total charge by preparer:* \$338.95
- *Total charge by preparer as percentage of shopper's federal refund:* 4.3 percent

Summary of visit: MR reported mixed compliance by the preparer with the disclosure requirements of Act 1402. The preparer did have a poster in a visible location showing RAL fees, sample RAL interest rates and the prescribed cautionary language about a RAL being a loan, etc. However, the preparer did not provide written disclosure of the RAL terms on colored paper separate from the RAL; oral disclosure that the RAL was a loan; oral disclosure of the RAL fees/interest rate; and oral disclosure that if her refund is less than expected, she would owe the entire amount of the loan.

The preparer told MR that she would not qualify for a RAL because she was filing a Form 1099 (self-employment) and her return indicated that extending a RAL would be "too risky." MR therefore would have to wait two weeks for her check to be processed and come back to the preparer to pick up the check. The preparer in the process of doing MR's taxes showed her a breakdown of tax preparation fees. However, the preparer said he could not give MR a copy of her tax return filed with the IRS until she returned to pick up the check, and he also initially declined to give her written documentation of the tax preparation fees. MR insisted and the preparer replied that while such written documentation wasn't "normally" given, he didn't see a problem with it and did so.

Mo' Money Taxes

- *Name of mystery shopper:* KS
- *Received RAL?* Yes
- *Federal refund processed by preparer:* \$1,752
- *Total charge by preparer:* \$435.52
- *Total charge by preparer as percentage of shopper's federal refund:* 25 percent

Summary of visit: KS reported minimal preparer compliance with the disclosure requirements of Act 1402. There were large posters displayed on the wall but none with the require enumeration of RAL terms. KS said she was asked to sign two colored pieces of paper that she was told required only her signature, and one of the pages appeared to contain some information about a RAL, but it was difficult to read. KS did not receive copies of these two forms, so this does not

appear to fulfill the requirement that she receive written disclosure on colored paper separate from the RAL of the RAL terms. She received oral disclosure that the RAL was a loan but not of the RAL fee. She was not told that if her refund was less than expected, she was responsible for the full amount of the loan.

The quality (and ethics) of tax preparation received by KS appeared questionable. The preparer initially mistook KS's Form 1099 (for her second job) for a tithing statement from her church. The preparer repeatedly asked KS whether she was really sure she wanted to report income from a second job as that would reduce the amount of her refund. KS responded that she wanted to report all income truthfully.

The preparer became nervous when KS asked for a breakdown of the fees she would be charged and stated he might not be able to print out such a breakdown. KS questioned why he could print out a copy of her tax return but not a breakdown of the fees she was being charged. After several instances of printing out information that wasn't what KS had requested, the preparer finally printed out the breakdown.

KS paid the second highest combined RAL and tax preparation fees (\$435.52) and by far the highest combined RAL and tax prep fees as a percentage of her total return (25 percent).

H & R Block

- *Name of mystery shopper:* SB
- *Received RAL?* Yes
- *Federal refund processed by preparer:* \$3,845
- *Total charge by preparer:* \$487.20
- *Total charge by preparer as percentage of shopper's federal refund:* 12.7 percent

Summary of visit: SB reported mixed compliance by the preparer with the disclosure requirements of Act 1402. A poster displayed included some but not all of the required disclosure items. The preparer did provide oral disclosure that the RAL was a loan. SB received information about the fee for the RAL and the RAL interest rate at the conclusion of the tax preparation session. The preparer also did not provide oral disclosure that if SB's refund is less than expected, she would still owe the entire amount of the loan.

SB reported that the preparer's first step in initiating tax preparation was to state that the fees charged would be "high." This indeed turned out to be the case; the \$487.20 taken out of SB's refund was the highest dollar amount among the seven mystery shoppers who received RALs, and the second-highest as a percentage of the total refund.

Tax Centers of America

- *Name of mystery shopper:* GW2
- *Received RAL?* Yes
- *Federal refund processed by preparer:* \$4,946
- *Total charge by preparer:* \$401.46
- *Total charge by preparer as percentage of shopper's federal refund:* 8.1 percent

Summary of visit: Preparer compliance with Act 1402 disclosures was practically nonexistent, GW2 reported. The only reported instance of the preparer offering any of the required disclosure

was on a questionnaire GW2 filled out that had information on RAL fees; however, GW2 was not given a copy of the questionnaire for her records.

GW2 expressed concern that personal information about her taxes was being discussed in a manner in which others present could hear the conversation. GW2 said she was asked questions by the preparer to determine how GW2 should file, but GW2 was never asked which filing status she had used in the past.

GW2 also reported problems with disclosure of the total fees charged; the preparer only mentioned “bank charges” of \$49 (the finance charge for the RAL) and GW2 was only able to discern the total fees after she went home and examined the paperwork she had received in detail.

Tax Express

- *Name of mystery shopper: VS*
- *Received RAL? Yes*
- *Federal refund processed by preparer: \$6,883*
- *Total charge by preparer: \$260.78*
- *Total charge by preparer as percentage of shopper’s federal refund: 3.8 percent*

Summary of visit: VS reported that the preparer offered minimal disclosure of RAL terms as required under Act 1402. There was no poster displayed in a visible location enumerating RAL terms. VS said she did not receive written disclosure on colored paper separate from the RAL of the RAL terms. She received oral disclosure that the RAL was a loan and of the RAL fee only after her return was processed. She was not told that if her refund was less than expected, she was responsible for the full amount of the loan.

A particular item of note during VS’s tax preparation was that the preparer identified VS and her husband as eligible for the federal First Time Homebuyer Tax Credit. It is a well-known fact (at least among VITA-certified preparers) that due to fraud concerns, IRS rules do not allow paperwork for this credit to be electronically filed. The credit must be filed by mail. The preparer expressed surprise at this, removed the home buyer credit from VS’s taxes and instructed VS to come back to the preparer in a month to have an amended return filed (a follow-up visit that potentially could have cost VS additional fees).

Because we had already received necessary information from VS regarding the preparer’s compliance with disclosure requirements and the general quality of tax preparation, VS was told she could have an amended return filed for free by a certified VITA volunteer. VS selected this option. Her taxes were also double-checked for accuracy otherwise by the volunteer and no issues were reported.



APPENDIX B

Tester	Preparer	RAL Ban	Federal Refund Amount	Tax Prep Fee	RAL Fee (inc account fee)	APR (inc account fee)	RAC Fee	Doc/App Fee	Transmission Fee	Technology Fee	Other Fee	Total Fee
Arkansas												
CM	Independent	Chase	\$5,086	\$210	\$82.86	60%			\$6	\$12.95		\$311.81
GW	Jackson Hewitt	Republic	\$3,978	\$350	\$60.98	57%					\$20 Technology Access F	\$430.98
JS	H&R Block	HSBC	\$4,739	\$284	na	na	\$29.95				\$20 check fee	\$333.95
KW	Small chain	Republic	\$5,691	\$79	\$74.34	48%		\$40	\$31			\$224.34
MR	Small chain	Chase	\$7,819	\$250	na	na	\$32	\$29	\$15	\$12.95		\$338.95
KS	Mo Money Taxes	Chase	\$1,752	\$315	\$49.52	106%			\$27	\$15	\$29 Service Bureau Fee	\$435.52
SB	H&R Block	HSBC	\$3,845	\$396	\$71.20	69%					\$20 check fee	\$487.20
GW2	Tax Centers of America	Chase	\$4,946	\$235	\$81.46	61%		\$30	\$15	\$15	\$25 Service Bureau Fee	\$401.46
VS	Independent	Chase	\$6,883	\$145	\$100.83	54%			\$2	12.95		\$260.78
New York												
JK	Independent	Republic	\$1,608	\$125	\$42.49 (not taken)	99%						\$125 (\$167.49 if RAL taken)
RMH	Jackson Hewitt	Meta Bank	\$3,517	\$443		na	\$32			\$11.95	\$10 - unknown. difference between Meta and JH docs	\$496.95
JA	Independent	Chase	\$3,413 (s/b \$702)	\$200 (negotiated from \$350)	\$60 (not taken)	65%						\$200 (\$260 if RAL taken)
GC	Liberty Tax Service	Republic	\$4,861	\$218 (after 50% discount)		na	\$29.95 (not taken)				\$10 unspecified fee for RAC (not taken)	\$218 (\$257.95 if RAC taken)
NC	H&R Block	HSBC	\$2,655	\$437		na	\$29.95 (not taken)					\$437 (\$466.95 if RAC taken)
ZK	Jackson Hewitt	Meta Bank	\$920	\$84 (after \$203 discount)		na					\$16 Data and Document Storage Fee	\$100
KK	Independent	na	\$599	\$40	na	na						\$40
North Carolina												
KB	Mo' Money Taxes	Chase	\$3,467	\$195	\$66.67	72%			\$27	\$15	\$39 Service Bureau Fee	\$342.67
RH	Mo' Money Taxes	Chase	na (\$1201 state refund)	\$275	na	na	\$32		\$27	\$15	\$39 Service Bureau Fee	\$388
JJ	Mo' Money Taxes	Chase	\$815	\$275	\$40.15	189%			\$27	\$15	\$29 Service Bureau Fee	\$357.15

APPENDIX C

Tester	Preparer	RAL Bank	Written Disclosures	Wall Postings	Oral Disclosures	Provided Copy of Tax Return	Provided Copy of Privacy Consent	Charged Possible Illegal Add-on Fee	Other Issues
	Arkansas								
CM	Independent (CPA)	Chase	No	No	Partial compli	Yes	No	Yes	Failed to ensure that niece properly claimed as dependent
GW	Jackson Hewitt	Republic	Yes (not on color paper)	Partial col	Partial compli	Yes	No	No	Felt rushed; did not provide data sheet tester requested
JS	H&R Block	HSBC	Yes (not on color paper)	Yes	Yes	Yes	Yes	No	Frustration not being explained what happens if loan not approved; (also appears to be wrong explanation- tester was military)
KW	Small Chain	Republic	Yes (not on color paper)	No	No	Yes	Yes	Yes	Over-estimated refund by \$822. Disclosure by Post It
MR	Small Chain	Chase	No	Yes	No	Not until check issued	No	Yes	Initially declined to provide fee estimate forms
KS	Mo' Money Taxes	Chase	No	No	Partial compli	Yes	No	Yes	Recommended against reporting 1099 income; hesitant to provide fee disclosure
SB	H&R Block	HSBC	Yes	Partial col	Partial compli	Yes	Yes	No	Preparer told tester that fees would be high
GW2	Tax Centers of America	Chase	No	No	No	Yes	No	Yes	Privacy problems; unclear disclosure of fees in response to question
VS	Independent	Chase	No	No	Partial compli	Yes	No	Yes	Failure to properly with with First Time Homebuyer Credit; reluctant to give sheet with RAL fee info
	New York								
JK	Independent	Republic	No	No	Partial compli	Yes	na	No	Travel agency; Did not push RAL, said rates exorbitant
RMH	Jackson Hewitt	Meta Bank	Yes	No	No	Yes	Yes	possible	No longer offered RALs; failed to explain to tester she was getting RAC; unexplained mystery fee; gave her estimate of \$70 over phone but ended up being more than \$440.
JA	Independent Liberty Tax Service	Chase	Partial Compliance	not noted	No	Yes	na	Unclear	Tax Fraud - Included bogus \$2,000 church donation and \$400 for 2008 tax prep; pushed RALs
GC	Service	Republic	Partial Compliance	No	na	Yes	an	Unclear	Advertised 1/2 off but tester has to ask; tester had to push to pay in cash not RAC
NC	H&R Block	HSBC	Yes	No	Partial compliance	Yes	Yes	No	Encouraged to take out RAC to pay tax prep fee; explained filing well but said she couldn't estimate fees because "computer did it" and only at the end did they give her price tag.
ZK	Jackson Hewitt	Meta Bank	na	Yes	na	Yes	Yes	no	Advised to leave out \$300 in income; felt rushed; advised against RAL; \$16 fee charged even wo RAL or RAC
KK	Independent	na	na	na	na	Yes	na	na	did not offer RALs or RACs

Tester	Preparer	RAL Bank	Written Disclosures	Wall Postings	Oral Disclosures	Provided Copy of Tax Return	Provided Copy of Privacy Consent	Charged Possible Illegal Add-on Fee	Other Issues
	North Carolina								
KB	Mo' Money Taxes	Chase	No	No	na	Not until check issued	No	na	Did not give TIL disclosures until asked; would not permit direct deposit of RAL
RH	Mo' Money Taxes	Chase	na	No	na	Yes	No	na	Did not give RAC fee disclosures until asked
JJ	Mo' Money Taxes	Chase	No	No	na	Not until check issued	No	na	Did not give TIL disclosures until asked; no explanation of RAL given