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Tax–Time Products 2018: New Generation of Tax–Time Loans Surges in Popularity

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EXECUTIVE SUMMARY

Tax-time is a critical moment for millions of Americans, providing much-needed funds in the form of billions in refunds. In particular, the Earned Income Tax Credit (EITC) helps 27 million families and is the largest anti-poverty program in the country. This year, these EITC recipients and many other taxpayers face new and old challenges in accessing these critical funds.

- **New generation of RALs grow in volume**

There has been a dramatic growth in volume of a new generation of refund anticipation loans (RALs), with 1.7 million of these RALs made in 2017. These RALs are different from the high-cost loans that were driven off the market in the early 2000s, in that they are promoted as advances that do not charge the taxpayer a fee. However, some tax preparers are actually imposing other fees to make up for the lack of a direct cost for the RAL, in effect charging a disguised fee.

Part of the reason for the popularity of these second-generation RALs is that refunds for recipients of the EITC and Additional Child Tax Credit (ACTC) were delayed until late February, a result of the 2015 Protecting Americans from Tax Hikes Act. This delay likely drove demand for RALs by EITC and ACTC recipients.

A related product is the refund anticipation check (RAC). About 20.5 million consumers obtained a RAC in 2017, at a cost of at least half a billion dollars.

- **One more state adopts competency standards for paid preparers.**

The vast majority of paid tax preparers are not required to meet any minimum educational, competency, or training standards. The lack of competency standards for paid preparers exposes consumers to potential error or fraud. Previously, only four states (California, Maryland, New York and Oregon) regulated paid tax preparers. In 2017, Connecticut joined this group of states.

- **Private debt collectors squeeze financially-constrained taxpayers**

The IRS private debt collection program began operating in 2017. The program has disproportionately targeted economically vulnerable families. Nearly half of taxpayers who made payments to the IRS after being contacted by private debt collectors had incomes below 250% of the poverty level (\$24,200 for a family of four), and 28% made less than \$20,000 per year. Meanwhile, the program has resulted in a \$13.3 million loss to the federal government.

- **Immigrant taxpayers and ITIN renewals**

Millions of immigrant taxpayers who hold Individual Taxpayer Identification Numbers (ITINs) were required to have the numbers renewed, also potentially delaying the processing of tax refunds. An estimated 440,000 taxpayers were required to renew their ITINs last year, yet only 176,000 did so, while 152,000 taxpayers had their returns flagged for using an expired ITIN. This year, three times as many taxpayers will be required to renew their ITINs, about 1.2 million.

INTRODUCTION

For most Americans, tax time is a “golden moment” in their financial lives. About 73% of Americans receive a refund when they file their tax returns, putting over \$324 billion in their pockets.¹ Of these taxpayers, about 27 million are hard-working families that receive the Earned Income Tax Credit (EITC), a refundable credit intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, providing more than \$65 billion to these 27 million families last year.² Since 2017, EITC taxpayers have faced a statutorily mandated delay in the issuance of their refunds, a new burden that may drive these working families to use tax-time financial products.

Historically, EITC recipients and other taxpayers receiving substantial refunds presented lucrative targets for a variety of businesses. Refund anticipation loans (RALs) and related financial products evolved to profit off taxpayers and EITC recipients. In the past several years, a new generation of RALs has developed which are marketed as not imposing interest or fees on taxpayers. These second generation RALs proved popular with taxpayers in 2017 and this year, no doubt due in part to the refund delays faced by EITC recipients. They do, however, present the risk that unscrupulous tax preparers will charge unrelated fees to make up for the cost of the loan.

Since 2002, the National Consumer Law Center (NCLC) and the Consumer Federation of America (CFA) have jointly issued annual reports on tax-time consumer issues, particularly focused on the financial products industry and the drain caused by these products from tax refunds and EITC benefits.³ In addition to our yearly reports, we have issued a number of special reports, including studies using mystery shopper testing of paid preparers.⁴

I. TAX-TIME FINANCIAL PRODUCTS UPDATE

A. Refund Anticipation Loans

For decades, refund anticipation loans (RALs) were the main tax-time financial product, and provided hefty profits to tax preparers and lenders. These were loans made by banks, secured

¹ IRS, Filing Season Statistics for Week Ending Dec. 29, 2017, Jan. 17, 2018, www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-29-2017.

² IRS, Statistics for Tax Returns with EITC, Jan. 18, 2017, www.eitc.irs.gov/eitc-central/statistics-for-tax-returns-with-eitc/statistics-for-tax-returns-with-eitc.

³ These reports are all available at <https://www.nclc.org/issues/refund-anticipation-loans.html>.

⁴ See, e.g., Chi Chi Wu, Alice Vickers, Amelia O'Rourke-Owens, Peter Skillern, and Cara Williams, National Consumer Law Center, Florida Alliance for Consumer Protection, Reinvestment Partners, *Prepared in Error: Mystery Shoppers in Florida and North Carolina Uncover Serious Tax Preparer Problems* (Apr. 2015)[hereinafter “*Prepared in Error*”]. Additional reports can be found at <http://www.nclc.org/issues/refund-anticipation-loans.html>.

by and repaid directly from the proceeds of a consumer's tax refund. In the past, the fees for these loans could translate into triple digit annual percentage rates (APRs). Between 2009 and 2012, all of the banks that made these high cost loans either stopped voluntarily or were forced out by federal regulators.⁵

In 2016, lenders began offering a new type of RAL -- "advances" that are promoted as not charging interest or fees to the consumer for the loan. There is danger, however, that unscrupulous tax preparers may impose other charges to make up for the cost of the loan. These second generation RALs boomed in popularity in 2017, with approximately 1.7 million consumers applying for them.⁶

This year, many of the RAL providers have increased the maximum amount they will loan for these second generation RALs, to about \$3,000. Preliminary reports are that one provider alone -- H&R Block -- has made nearly 1 million loans this year.⁷

Much of the popularity of these second generation RALs could be due to the delay in federal refunds for recipients of the Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC), which is mandated by the Protecting Americans from Tax Hikes (PATH) Act.⁸ The PATH Act requires the IRS to delay refunds to EITC and ACTC recipients until at least February 15,⁹ and the IRS estimated that refunds would not arrive in bank accounts or prepaid cards until February 27 because financial institutions needed time to process deposits.¹⁰ About 15 million taxpayers faced a PATH Act delay in their refunds in 2017.¹¹

The PATH Act delay likely caused problems for many EITC/ACTC taxpayers, who are often low-income working taxpayers with children. These taxpayers depend on their refunds to help pay for groceries, holiday bills, overdue utility debt, or other pressing expenses. A sign of how the PATH Act delay drove demand for RALs is that in 2016, before the delay became effective, only 465,600 taxpayers applied for a RAL.¹²

⁵ For a history of these high-cost RALs, see Chi Chi Wu, Tom Feltner, and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, *Something Old, Something New in Tax-Time Financial Products: Refund Anticipation Checks and Quickie Tax Loans* 2-3 (Feb. 2013) [hereinafter "NCLC/CFA 2013 Tax-Time Products Report"].

⁶ Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) for Tax Year 2016 (2017 Filing Season).

⁷ See Section III.A below.

⁸ Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV (2015) [hereinafter "PATH Act"].

⁹ PATH Act, § 201.

¹⁰ IRS, Refund Timing for Earned Income Tax Credit and Additional Child Tax Credit Filers, www.irs.gov/individuals/refund-timing, Jan. 30, 2018.

¹¹ H&R Block, *PATH Act*, www.hrblock.com/tax-center/media-kit/path-act-tax-impact/ (visited March 26, 2018).

¹² IRS, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2015.

In addition to supposedly not charging a fee, these second generation RALs are supposedly “non-recourse,” *i.e.*, the consumer is not required to repay the loan if the refund is not received.¹³ Previously, one risk of taking out a RAL was that, if the refund was miscalculated or seized by the government to repay a student loan or another debt, the consumer could be liable for repaying the loan. Lenders claim that this risk does not exist with second generation RALs, although there are reports by some taxpayers that they are being required to repay RALs when there is a student loan intercept.¹⁴

Also, a Jackson Hewitt press release claims that its RAL “does not impact applicants’ credit scores,”¹⁵ but a document that Hewitt presents to clients states: “Failure to return to Jackson Hewitt to complete my tax return constitutes fraud and can be reported to the Credit Bureau...”¹⁶

Lenders offering second generation RALs include:

- **MetaBank** makes RALs available to independent preparers through its EPS Unit, Refund Advantage and Specialty Consumer Services LP units.¹⁷ MetaBank also makes RALs through Jackson Hewitt of up to \$3,200.¹⁸
- **Bank of the Internet, Inc. (BoFI)** is the new RAL lender for H&R Block.¹⁹ Block offers RALs of \$500, \$750, \$1,250 or \$3,000.²⁰

¹³ See, e.g., MetaBank, 2017 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 10 [hereinafter “MetaBank 2017 10-K”]; Republic Bancorp, 2017 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 10-11 [hereinafter “Republic Bank 2017 10-K”].

¹⁴ Persis Yu, National Consumer Law Center, *Voices Of Despair: Student Borrowers Trapped in Poverty When the Government Seizes Their Earned Income Tax Credit*, March 2018, at 20, available at www.nclc.org/images/pdf/student_loans/voices-of-despair.pdf (student loan borrower whose federal and state tax refund was intercepted writes “Topping it off is the money we now owe to H& R Block for the filing fees and the refund advance of \$500, both to be taken out of the returns!”).

¹⁵ Press Release, Jackson Hewitt® Clients Could Get up to \$3,200 at 0% APR with No Fee Refund Advance Loan, Nov. 20, 2017, available at [www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-\\$3200-at-0-apr-with--no-fee-refund-advance-loan/](http://www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-$3200-at-0-apr-with--no-fee-refund-advance-loan/).

¹⁶ Jackson Hewitt forms, on file with the authors.

¹⁷ MetaBank 2017 10-K at 3.

¹⁸ Press Release, Jackson Hewitt® Clients Could Get up to \$3,200 at 0% APR with No Fee Refund Advance Loan, Nov. 20, 2017, available at [www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-\\$3200-at-0-apr-with--no-fee-refund-advance-loan/](http://www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-$3200-at-0-apr-with--no-fee-refund-advance-loan/).

¹⁹ BoFI Holding, Inc., 2017 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 10 [hereinafter “BoFI 2017 10-K”].

- **Santa Barbara Tax Products Group** (SBTPG) offers RALs of up to \$1,500.²¹ MetaBank is the official lender for this product.²² In addition to a “no-fee” RAL, SBTPG and MetaBank offer a second \$1,000 loan that is secured by the tax refund, and does charge interest. The interest rate is 29.9%, which at least is below the traditional 36% usury cap for small loans in many states.²³
- **Republic Bank & Trust** is offering RALs of \$1,000, \$1,500 or \$2,500 called an ‘Easy Advance’.²⁴ These RALs are offered through independent preparers. Republic is the lender for Liberty Tax’s RAL offering, which provides loans up to \$3,250.²⁵
- **River City Bank** offers a RAL of up to \$1,750. This year, River City Bank appears not to require the purchase of a refund anticipation check (RAC) in order to obtain a RAL.²⁶

Even though these second generation RALs supposedly do not impose a fee directly on the consumer, they do present potential costs and risks for consumers. The lenders charge the tax preparers a fee of \$35 to \$45 for these RALs. Preparers might pass along these fees, or charge even more, by increasing their tax preparation fees or by charging separate “add-on” junk fees. While several of the lenders for second generation RALs state that they prohibit preparers from charging higher tax preparation fees to RAL customers,²⁷ hidden fees can be hard to avoid given that tax preparation fees are so opaque and few consumers can get firm price estimates before their returns are prepared.

For example, Liberty Tax Service appears to be allowing its franchisees to impose a cost on customers for RALs by charging add-on fees to make up for the cost imposed on the franchisee. The *Virginian Pilot* uncovered a memo in which the corporate offices of Liberty Tax urged franchisees to charge other unrelated fees to cover the costs of offering Easy Advances.²⁸ The article notes “In a memo containing information confirmed by three franchisees, the company

²⁰ H&R Block, Refund Advance, <http://www.hrblock.com/lp/fy17/refundadvance.html> - /en/(visited Mar. 20, 2018).

²¹ Santa Barbara Tax Products Group, FastCash ADVANCE, www.sbtpg.com/fastcash-advance (visited Mar. 20, 2018).

²² *Id.*

²³ Santa Barbara Tax Products Group, AdvancePLUS, www.sbtpg.com/advance-plus (visited Mar. 20, 2018).

²⁴ Republic Bank & Trust, Grow your business with Republic Bank’s Easy Advance, www.republicrefund.com/Products/EasyAdvance.aspx (visited Mar. 20, 2018).

²⁵ Liberty Tax Service, Easy Advance, www.libertytax.com/easy-advance/(visited Mar. 20, 2018).

²⁶ River City Bank, 2018 Freedom to Choose Pricing Tiers, www.rcbtaxdivision.com/pricing.aspx?mnu=3 (visited Mar. 20, 2018).

²⁷ *See, e.g.*, Republic Bank 2017 10-K at 11.

²⁸ *See* Kimberly Pierceall, “No fees for that \$3,250 refund advance loan from Liberty Tax? Think again,” *The Virginian Pilot*, March 3, 2018, available at pilotonline.com/business/consumer/article_4accf2f9-b76a-5ce0-9404-2138eca89d5d.html.

notes ‘options and revenue to help offset the cost of the advance,’ including up to \$49.95 for a ‘federal E-file fee.’”²⁹

Another RAL lender, River City Bank, arguably imposes a \$15 finance charge for its supposedly “no-fee” RAL. A tax preparer who does not offer RALs has the option of enrolling in the “Low Cost Fee Collection” program, which charges \$29.95 for a related product, a refund anticipation check (RAC).³⁰ But if the preparer wishes to offer RALs, the RAC price is higher at \$44.95.³¹ This \$15 price difference could constitute a hidden finance charge for the RALs. This year, River City Bank no longer requires the purchase of a RAC in order to obtain a RAL.³² However, we would assume many RAL borrowers still will end up also getting a RAC, and this \$15 upcharge would serve the same function as a finance charge.

The greatest expense for a supposedly “no-fee” RAL could actually be the tax preparation fee. In order to access a RAL, the taxpayer is required to use the services of a paid preparer. If the taxpayer was originally intending to use a paid preparer, then there is no additional expense. But obtaining a RAL means the taxpayers cannot use a free Volunteer Income Tax Assistance site or prepare the return themselves. Since tax preparation fees can be very high -- up to \$500 or more -- that can be a considerable additional expense.

B. Refund Anticipation Checks

The refund anticipation check (RAC) or “refund transfer” is a product related to RALs. With RACs, the bank opens a temporary bank account into which the IRS direct-deposits the refund monies. After the refund is deposited, the bank issues the consumer a check or prepaid card, or makes a direct deposit into the consumer’s own bank account, and closes the temporary account. A RAC is no faster than the direct deposit of a refund to the taxpayer’s own bank account, but it allows the consumer to have the tax preparation fees deducted out of the refund.

RACs are the dominant tax-time financial product currently on the market. According to the latest IRS data, about 21.4 million taxpayers obtained RACs in 2016,³³ and 20.5 million did so in 2017.³⁴ Since the fee for a RAC is at least \$25, these taxpayers paid a minimum of \$500 million

²⁹ *Id.*

³⁰ River City Bank, 2018 Freedom to Choose Pricing Tiers, www.rcbtaxdivision.com/pricing.aspx?mnu=3 (visited Mar. 20, 2018). For a discussion of RACs, see Section I.C, below.

³¹ River City Bank, 2018 Freedom to Choose Pricing Tiers, www.rcbtaxdivision.com/pricing.aspx?mnu=3 (visited Mar. 20, 2018).

³² *Id.*

³³ IRS, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2015 (2016 Filing Season).

³⁴ Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) for Tax Year 2016 (2017 Filing Season).

for these financial products, and probably paid more. The vast majority of RAC consumers – nearly 80% in 2016 – have adjusted gross incomes under \$50,000.³⁵

RACs present a number of issues for consumers. This year, RACs generally cost \$29 to \$65 for the federal refund, plus in some cases another \$10 for a RAC of the state tax refund. This is very pricey for what is essentially a one-time use bank account.

For 2018, sample RAC fees include:

- **H&R Block** charges \$39.95 for a RAC of the federal refund delivered on an Emerald Card (H&R Block’s prepaid card product) or via direct deposit, or \$64.95 for a RAC delivered via paper check. Block does not impose a charge for a RAC of the state refund.³⁶
- **Santa Barbara Tax Products Group** charges \$29.95 for a RAC of the federal refund if delivered on a Wal-Mart Money prepaid card or \$39.95 otherwise, plus \$10 for a RAC of the state refund.³⁷
- **Jackson Hewitt** charges \$38.95 for a federal refund RAC and \$49.95 for a state refund RAC, plus a \$20 “data and document storage fee.”³⁸
- **Republic Bank & Trust** charges either \$29 or \$39 for a RAC of the federal refund. The price depends on whether the preparer wants to charge the lower price and receive nothing, or charge a higher price and receive an \$8 kickback. There is an additional fee of either \$3 or \$10 for a subsequent deposit, i.e. a state refund RAC.³⁹
- **River City Bank** offers two programs. The first program charges \$44.95 for both a federal and state refund RAC and allows the preparer to offer a RAL of \$1,750 at no additional cost. This program also pays a \$12 “rebate” or kickback to the preparer. The second option charges only \$29.95 for a RAC, but the preparer cannot provide RALs, there is no kickback, and there is a \$9.95 charge for a RAC of the state refund. Both programs also provide a kickback for selling a prepaid card.⁴⁰

³⁵ IRS, Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2015 (2016 Filing Season).

³⁶ H&R Block, Refund Transfer: Pay Nothing Out-of-Pocket, www.hrblock.com/financial-services/tax-refund-payment/ (visited Mar. 21, 2018).

³⁷ Santa Barbara Bank & Trust, Refund Transfer, www.sbtbg.com/refund-transfer (visited Nov. 20, 2017).

³⁸ Jackson Hewitt, Chicago Tax Preparation Disclosure, 2018.

³⁹ Republic Bank & Trust, Pricing Plans, www.republicrefund.com/Products/Pricing-Plans.aspx (visited Mar. 21, 2018).

⁴⁰ River City Bank, 2018 Freedom to Choose Pricing Tiers, www.rcbtaxdivision.com/pricing.aspx?mnu=3 (visited Mar. 21, 2018).

- **EPS Financial**, now owned by MetaBank, offers two RAC options. The “e-Collect” program offers a free RAC if the refund is deposited on the E1 Visa Prepaid Card; otherwise it charges \$15 for direct deposit or \$20 for a check.⁴¹ The program does not pay the preparer a kickback. The “e-Bonus” program charges \$35 for a RAC and provides a kickback of \$12 or \$25 to the tax preparer.⁴² Both programs permit the preparer to offer a RAL.⁴³

In addition to the RAC fee itself, many tax preparers charge add-on fees, such as “document processing” or e-filing fees, discussed in earlier reports on tax-time products.⁴⁴ This can significantly add to the expense of a RAC.

RACs do not have a speed advantage over a refund that is direct deposited by the IRS into the consumer’s own bank account or onto a prepaid card. Thus, RACs essentially represent nothing more than a disguised loan of the tax preparation fee. This is because, when taxpayers obtain a RAC simply because they cannot afford the price of tax preparation upfront, they are essentially paying to defer payment of the tax preparation fee—which is a loan. If a taxpayer pays \$35 to defer payment of a \$350 tax preparation fee for three weeks, the APR would be equivalent to 174%. At least two court decisions have held that a RAC constitutes a loan of the tax preparation fee, and thus RAC fees are finance charges under the Truth in Lending Act.⁴⁵

Furthermore, by permitting the taxpayer to have the price of tax preparation deducted from the refund, RACs make taxpayers less sensitive to the price of tax preparation. The problems with lack of transparency in tax preparation fees are discussed in earlier reports on tax-time products.⁴⁶

⁴¹ EPS, e-Collect, www.epstax.net/e-collect.html (visited Mar. 21, 2018).

⁴² EPS, e-Bonus, www.epstax.net/e-bonus.html (visited Mar. 21, 2018).

⁴³ EPS, Refund Transfer Programs Built for Your Tax Office, www.epstax.net/ (visited Mar. 21, 2017).

⁴⁴ See, e.g., Chi Chi Wu and Tom Feltner, National Consumer Law Center and Consumer Federation of America, *It’s a Wild World: Consumers at Risk from Tax-Time Financial Products and Unregulated Preparers*, at 11-12 (Feb. 2014) [hereinafter “NCLC/CFA 2014 Tax-Time Products Report”].

⁴⁵ *United States v. ITS Fin., LLC*, 2013 WL 5947222 (S.D. Ohio Nov. 6, 2013); *People v. JTH Tax, Inc.*, 212 Cal. App. 4th 1219, 151 Cal. Rptr. 3d 728 (2013).

⁴⁶ See, e.g., NCLC/CFA 2014 Tax-Time Products Report at 16-19; Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, *The Party’s Over for Quickie Tax Loans: But Traps Remain for Unwary Taxpayers*, at 14-17 (Feb. 2012).

II. TAX-TIME CONSUMER PROTECTION ISSUES

A. Minimum Competency Standards Needed for Paid Preparers

The lack of minimum competency standards for paid preparers in most states continues to be one of the most problematic aspects of paying taxes in the United States. Except in a handful of states, the only tax preparers, apart from attorneys, certified public accountants and enrolled agents, who are required to pass a test are the unpaid volunteers at Volunteer Income Tax Assistance (VITA) and AARP Tax-Aide sites. The history of this gaping hole in taxpayer consumer protections is discussed in previous tax-time products reports⁴⁷ and other reports documenting the results of tax preparer mystery shopper testing.⁴⁸

Previously, only California, Maryland, New York, and Oregon had laws or regulations requiring minimum competency standards for paid tax preparers. Connecticut has joined these four states by passing a law in 2017 requiring preparers to obtain a permit from the state Department of Revenue Services.⁴⁹ Starting in 2020, Connecticut will require as part of this permit that preparers to obtain a certification from the IRS, which is otherwise voluntary for preparers in other states.⁵⁰

The lack of regulation for paid preparers in the other 45 states has created a culture that allows incompetence and abuses to flourish. This is documented by the results of mystery shopper testing detailed in reports by consumer groups.⁵¹ The percentages of problematic returns in these mystery testing programs ranged from 25 percent to 90 percent.⁵²

⁴⁷ See, e.g., Chi Chi Wu, Chantal Hernandez, Michael Best, National Consumer Law Center and Consumer Federation of America, *Minefield of Risks: Taxpayers Face Perils from Unregulated Preparers, Lack of Fee Disclosure, and Tax-Time Financial Products*, Mar. 2016, at 10-14, available at www.nclc.org/images/pdf/pr-reports/TaxTimeReport2016.pdf [hereinafter “NCLC/CFA 2016 Tax-Time Products Report”]; Chi Chi Wu and Michael Best, National Consumer Law Center and Consumer Federation of America, *Taxpayer Beware: Unregulated Tax Preparers and Tax-Time Financial Products Put Taxpayers at Risk*, March 6, 2015, at 12-13, available at www.nclc.org/images/pdf/pr-reports/report-tax-time-products-2015.pdf.

⁴⁸ *Prepared in Error*; Chi Chi Wu, National Consumer Law Center, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (November 2013), available at <http://www.nclc.org/issues/riddled-returns.html> [hereinafter “*Riddled Returns*”].

⁴⁹ Conn. Public Act 17-147.

⁵⁰ *Id.*

⁵¹ *Prepared in Error* at 1-2; *Riddled Returns* at 6-13. See also Elise Blasingame, Georgia Watch Financial Protection Program, *Errors, Fraud & Arbitrary Fees: A Secret Shopper Study of Paid Tax Preparation Services in Southwest Atlanta*, 2016, available at www.georgiawatch.org/wp-content/uploads/2016/06/Errors-Fraud-Arbitrary-Fees-Final-Formatted-Report.pdf (mystery shopper testing in Southwest Atlanta found inaccuracies in 18 out of the 20 tax returns prepared by paid tax preparers).

⁵² *Id.*

NCLC has drafted a Model Individual Tax Preparer Regulation Act to assist states and encourage them to consider establishing competency standards for paid preparers.⁵³ The Model Act is based on the existing laws in three of the five states that do regulate tax preparers (California, Maryland and Oregon), as well as IRS regulations for paid tax preparers that were later invalidated by the courts due to lack of authority.⁵⁴ In summary, the Model Act requires tax preparers to:

- Obtain a registration unless they fit into one of the exceptions for the limited number of tax preparers already regulated, such as certified public accountants, enrolled agents, and lawyers.
- Pass a basic competency exam.
- Have 60 hours of initial education and 15 hours per year of continuing education.
- Provide a standardized disclosure of their fees.

B. Private Debt Collectors Begin Collecting IRS Tax Debts in 2017

The IRS is required by a 2015 federal law to outsource collection of certain overdue tax debt.⁵⁵ It began placing these debts with four private collection agencies starting in 2017.⁵⁶ Private collection of tax debts is problematic for many reasons, discussed in our earlier reports.⁵⁷

The IRS tried using private collectors twice before and both attempts were big money-losers. The first attempt in the mid-1990s was scrapped a year after the program was launched, after losing \$17 million.⁵⁸ The second experiment began in 2006 and ended three years later after a net loss of almost \$4.5 million to the government.⁵⁹ This third attempt has resulted in the

⁵³ *Id.* at 19-45.

⁵⁴ The fourth and fifth states to regulate tax preparers were New York and Connecticut. Both of these states adopted measures to regulate preparers after NCLC had developed its Model Act.

⁵⁵ 26 U.S.C. § 6306(c)(A) (requiring the IRS to outsource tax debts if: (a) more than one year has passed without any interaction between the taxpayer and IRS; (b) 1/3 of the statute of limitations has lapsed and there is no IRS collector assigned; or (c) the IRS is otherwise not working the debt due to lack of resources).

⁵⁶ IRS, Private Debt Collection, Aug. 7, 2017, www.irs.gov/businesses/small-businesses-self-employed/private-debt-collection.

⁵⁷ Chi Chi Wu and Michael Best, National Consumer Law Center and Consumer Federation of America, Big Changes Burden Taxpayers: New Law Delays Refunds, Drives Demand for Loans; Immigrant Taxpayers Face Challenges, March 2017, at 13-14 *available at* www.nclc.org/images/pdf/pr-reports/report-tax-time-products-2015.pdf [hereinafter “NCLC/CFA 2017 Tax-Time Products Report”]

⁵⁸ Government Accountability Office, *Internal Revenue Service: Issues Affecting IRS’ Private Debt Collection Pilot*, GAO/GGD-97-129R, at 1 (July 1997), *available at* www.gao.gov/assets/90/86658.pdf.

⁵⁹ Letter from Nina Olson, National Taxpayer Advocate, to Senate Committee on Finance and House Ways & Means Committee, regarding the use of private collection agencies (PCAs) to collect delinquent federal tax debts, May 13, 2014, at 15, *available at* taxpayeradvocate.irs.gov/userfiles/file/nta_pdc_letter.pdf

collection of \$6.7 million at a cost of \$20 million, which is a \$13.3 million loss.⁶⁰ Private collectors have only managed to collect less than 1% of the \$920 million in tax debts assigned to them.⁶¹

Furthermore, this latest version of the private debt collection program has disproportionately targeted the most economically vulnerable families. A study by the National Taxpayer Advocate found that 44% of taxpayers who made payments to the IRS after being subjected to a private debt collector had incomes below 250% of the poverty level (\$24,200 for a family of four), and 28% made less than \$20,000 per year.⁶²

In her annual report to Congress, the National Taxpayer Advocate conducted an analysis of 4,141 taxpayers who made payments to the IRS after being subjected to private debt collection. The analysis revealed that:

- 19 percent of these taxpayers had incomes below the federal poverty level, with a median income of \$6,386;
- 25 percent had incomes above the federal poverty level but below 250 percent of that threshold, with a median income of \$23,096; and
- 28 percent had annual income of less than \$20,000.⁶³

The data also shows that private collectors are pressuring families into making payments they cannot afford. The National Taxpayer Advocate reported that 45% of taxpayers who agreed to payment plans with private collectors had incomes that were less than their “allowable living expenses.”⁶⁴ This is a measure used by the IRS to estimate the amount of income needed to pay for essential living expenses, such as housing, utilities, transportation, food, and out-of-pocket healthcare costs.⁶⁵ IRS payment plans are usually calculated to leave the taxpayer enough funds to pay for these living expenses; if a taxpayer’s income is below this amount, collection attempts are suspended. But it appears that private debt collectors may have squeezed taxpayers into agreeing to payment plans despite being too poor to pay. This means that financially strapped families could be left with insufficient funds to pay for necessities, putting their health, shelter, or well-being at risk.

Moreover, one of the four private debt collectors hired by the IRS has been accused of using illegal and abusive tactics. Call scripts for Pioneer Credit Recovery show that its collectors were instructed to ask taxpayers to use 401(k) funds, home loans and credit cards to pay off IRS tax

⁶⁰ National Taxpayer Advocate 2017 Report to Congress at 10-11.

⁶¹ *Id.* at 12.

⁶² *Id.* at 11.

⁶³ *Id.* at 13-14.

⁶⁴ *Id.* at 11.

⁶⁵ IRS, Collection Financial Standards, March 26, 2018, www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards.

debts.⁶⁶ Four Democratic senators, who obtained the call scripts, sent a letter to Pioneer Credit Recovery and its parent, Navient, accusing the collection agency of violating federal law, its IRS contract, and IRS policy.⁶⁷

Private debt collectors collecting IRS debts are subject to the federal Fair Debt Collection Practices Act (FDCPA).⁶⁸ The FDCPA protects consumers against harassment and deception, gives consumers the right to send a collector a written request to stop contacting them, and provides consumers with the right to take legal action.⁶⁹

C. Immigrant Taxpayers Hampered by ITIN Renewals

An Individual Taxpayer Identification Number (ITIN) is used by anyone who is required to file a tax return under U.S. law but is not eligible for a Social Security number, including but not limited to undocumented immigrants.⁷⁰ In addition to the refund delay for EITC and ACTC recipients discussed earlier in this report, another change mandated by Congress in the PATH Act is a requirement that all ITINs issued before 2013 must be renewed.⁷¹ The PATH Act mandates that those ITINs expire on a rolling basis.

An estimated 440,000 taxpayers were required to renew their ITINs last year, yet only 176,000 did so.⁷² This year, three times as many taxpayers will be required to renew their ITINs, because 1.2 million ITINs that were recently used on a tax return expired on January 1, 2018.⁷³

⁶⁶ Stacy Cowley and Jessica Silver-Greenberg, *Outside Collectors for I.R.S. Are Accused of Illegal Practices*, N.Y. Times, June 23, 2017, *available at* www.nytimes.com/2017/06/23/business/dealbook/irs-private-collectors.html.

⁶⁷ Letter from Senators Elizabeth Warren, Jeff Merkley, Sherrod Brown and Ben Cardin to CEOs of Pioneer Credit Recovery and Navient, June 23, 2017, *available at* https://static01.nyt.com/packages/pdf/business/20170623_IRS/LettertoPioneerCredit.pdf.

⁶⁸ 26 U.S.C. § 6306(g).

⁶⁹ See generally National Consumer Law Center, *Fair Debt Collection* (8th ed. 2014), *updated at* www.nclc.org/library.

⁷⁰ National Taxpayer Advocate, 2017 Annual Report to Congress – Volume One, Jan. 10, 2018, at 181, *available at* <https://taxpayeradvocate.irs.gov/reports/2017-annual-report-to-congress/full-report> [hereinafter “National Taxpayer Advocate 2017 Report to Congress”].

⁷¹ PATH Act, § 203.

⁷² See National Taxpayer Advocate 2017 Report to Congress at 181 (IRS received only 176,000 renewal applications at the close of the 2017 filing season); National Taxpayer Advocate, 2016 Annual Report to Congress, Jan. 10, 2017, at 244, *available at* <https://taxpayeradvocate.irs.gov/reports/2016-annual-report-to-congress> (IRS sent renewal letters to 440,000 taxpayers whose ITINs expired in 2017 and used the numbers to file tax returns in the past three years).

⁷³ National Taxpayer Advocate 2017 Report to Congress at 183.

These include:

- Any ITIN with middle digits of either 70, 71, 72, or 80 (e.g., 9NN-71-NNNN)
- Any ITIN not used on a tax return at least once in the past three years⁷⁴

Additional ITINs will expire next year and will need to be renewed.

These taxpayers must renew their ITINs by submitting a completed Form W-7 to the IRS. If they file a tax return without renewing their ITIN, they will be ineligible for certain tax credits and exemptions and no refund will be paid until the ITIN is renewed.⁷⁵ Last year, 152,000 taxpayers had their returns flagged by the IRS for using an expired ITIN.⁷⁶

⁷⁴ IRS, ITIN Expiration Frequently Asked Questions, Q1, Dec. 8, 2017, www.irs.gov/individuals/itin-expiration-faqs.

⁷⁵ *Id.* at Q15-16.

⁷⁶ See National Taxpayer Advocate 2017 Report to Congress at 181.

III. INDUSTRY PLAYERS

This section provides basic information on the tax-time financial activity of key industry players, an overview that we provide annually.

A. H&R Block

H&R Block is the nation's largest tax preparation chain, accounting for 14% of all individual tax returns in 2017, or 19.5 million.⁷⁷ The company earned about \$148 million from refund anticipation checks (RACs) in 2017,⁷⁸ which translates into about 4.2 million RACs.

H&R Block began offering second generation RALs in 2017, with MetaBank as the lender. During the 2017 filing season, Block had received 1.1 million applications for RALs, of which 78% were approved – or about 858,000 loans.⁷⁹ In 2018, applications for RALs totaled 1.2 million, a 14% increase over last year.⁸⁰ Assuming the same approval rate, that would be 936,000 loans. H&R Block changed lenders in 2018 to BofI Bank.⁸¹

H&R Block also offers the Emerald Card, a prepaid debit card, to its tax preparation customers. H&R Block earned \$95.2 million in Emerald Card revenues in 2017.⁸² The Emerald Card also allows customers to access the Emerald Advance Line of Credit, which is a pre-season or “pay stub” product. H&R Block earned about \$57 million in interest from the Emerald Advance product in 2017.⁸³

B. Jackson Hewitt

Jackson Hewitt is the second largest tax preparation chain in the U.S. It has about 6,000 company-owned and franchise offices, including 3,000 in Wal-Mart stores.⁸⁴

⁷⁷ H&R Block Inc., *2017 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 2. [hereinafter “H&R Block 2017 Form 10-K”].

⁷⁸ *Id.* at 13.

⁷⁹ H&R Block, Inc., H&R Block (HRB) William C. Cobb on Q3 2017 Results - Earnings Call Transcript, Mar. 8, 2017, available at seekingalpha.com/.

⁸⁰ H&R Block, Inc., H&R Block (HRB) CEO Jeffrey Jones on Q3 2018 Results - Earnings Call Transcript, Mar. 6, 2018, available at seekingalpha.com/.

⁸¹ Press Release, H&R Block Announces Refund Advance of Up to \$3,000, Dec. 7, 2017, available at investors.hrblock.com/news-releases/news-release-details/hr-block-announces-refund-advance-3000 (visited Mar. 27, 2018).

⁸² H&R Block 2017 Form 10-K at 62.

⁸³ *Id.*

⁸⁴ Jackson Hewitt, Our Story, www.jacksonhewitt.com/about-jh/ (visited Mar. 21, 2018).

This year, Hewitt is offering its clients a RAL of up to \$3,200, with MetaBank as the lender.⁸⁵ Hewitt processed 485,000 of these loans in 2017.⁸⁶ One-quarter of Hewitt customers took out a RAL that year,⁸⁷ which means that Hewitt had about 1.9 million customers. Hewitt also offered paystub RALs of up to \$400. Paystub RALs pose a risk to borrowers, because they are made based on estimated tax returns before taxpayers receive their final tax information from a W-2.⁸⁸

C. Liberty Tax Service

Liberty Tax is the third significant commercial tax preparation chain in the country, with about 3,800 locations.⁸⁹ Liberty Tax prepared about 1.7 million returns in 2017 through its U.S. retail offices.⁹⁰ The company has been in considerable turmoil after founder John Hewitt was fired due to allegations of sexual misconduct.⁹¹

Liberty earned about \$52 million in RAC and loan fees in 2017, constituting 30% of revenue.⁹² It sold RACs to 48% of its customers or about 800,000.⁹³

Both this year and last year, Liberty offered the “Easy Advance” RAL, made by Republic Bank & Trust Company.⁹⁴ It sold about 175,000 of these loans in 2017.⁹⁵

⁸⁵ Press Release, Jackson Hewitt® Clients Could Get up to \$3,200 at 0% APR with No Fee Refund Advance Loan, Nov. 20, 2017, available at [www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-\\$3200-at-0-apr-with--no-fee-refund-advance-loan/](http://www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-$3200-at-0-apr-with--no-fee-refund-advance-loan/).

⁸⁶ Bowdeya Tweh, *Why More Than a Million Taxpayers Are Reaching for Refund Loans*, Wall St. J., Mar. 11, 2017, available at www.wsj.com/articles/why-more-than-a-million-taxpayers-are-reaching-for-refund-loans-1489237201 (visited Mar. 27, 2018).

⁸⁷ Press Release, Jackson Hewitt® Clients Could Get up to \$3,200 at 0% APR with No Fee Refund Advance Loan, Nov. 20, 2017, available at [www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-\\$3200-at-0-apr-with--no-fee-refund-advance-loan/](http://www.jacksonhewitt.com/newsroom/media-releases/jackson-hewitt-clients-could-get-up-to-$3200-at-0-apr-with--no-fee-refund-advance-loan/) (visited Mar. 27, 2018).

⁸⁸ Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom* (Nov. 2008), available at www.nclc.org/images/pdf/high_cost_small_loans/ral/paystub_ral_report.pdf.

⁸⁹ Liberty Tax Service, 2017 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 36 [hereinafter “Liberty Tax Service 2017 10-K”].

⁹⁰ *Id.* at 6.

⁹¹ Liberty Tax Founder John Hewitt Faces Ouster Amid Sex Scandal Allegations, Bloomberg News, Dec. 13, 2017, available at fortune.com/2017/12/13/liberty-tax-sex-scandal/ (visited Mar. 27, 2018).

⁹² Liberty Tax Service 2017 10-K at 37 (total revenues of \$174 million).

⁹³ *Id.* at 9.

⁹⁴ Liberty Tax Service, Refund and Product Options, www.libertytax.com/services/refund-options/ (visited March 23, 2017).

⁹⁵ Bowdeya Tweh, *Why More Than a Million Taxpayers Are Reaching for Refund Loans*, Wall St. J., Mar. 11, 2017, available at www.wsj.com/articles/why-more-than-a-million-taxpayers-are-reaching-for-refund-loans-1489237201 (visited Mar. 27, 2018).

D. MetaBank

MetaBank is the RAL lender for Jackson Hewitt and independent preparers. It was formerly the lender for H&R Block, but Block dropped it for Boffl. MetaBank also offers RALs through its EPS unit, which it purchased from Drake Software in November 2016.⁹⁶ MetaBank made \$1.26 billion worth of second generation RALs in both 2017 and 2018.⁹⁷

MetaBank had previously purchased Refund Advantage, the tax-time products unit of Fort Knox Financial Services/Ohio Valley Bank, in September 2015. MetaBank made about 2.4 million RACs in 2017 through Refund Advantage and EPS Financial, and made 2.5 million in 2018.⁹⁸

E. Republic Bank & Trust

Republic Bank & Trust was the last bank to stop making high-cost RALs in 2012.⁹⁹ It continued to make RACs after 2012, and began making second generation RALs in 2016.¹⁰⁰ Republic originated \$329 million in RALs in 2017, compared to \$123 million in 2016.¹⁰¹ Since the RALs were generally for \$1,250 in 2017, that translates into about 260,000 RALs. Republic also earned \$18.8 million in RAC fees in 2017.¹⁰²

F. Santa Barbara Tax Products Group

Another provider of tax-time financial products is Santa Barbara Tax Products Group (SBTPG). SBTPG is the former Pacific Capital Bancorp RAL unit that was spun off after that bank was ordered to cease making RALs by its federal regulator, the Office of the Comptroller of the Currency.¹⁰³ SBTPG was purchased in October 2014 by GreenDot, one of the largest providers of prepaid cards.¹⁰⁴

⁹⁶ MetaBank 2017 10-K at 3.

⁹⁷ Press Release, MetaBank Provides 2018 Tax Season Update, Mar. 5, 2018, *available at* www.metafinancialgroup.com/news-releases/news-release-details/metabank-provides-2018-tax-season-update.

⁹⁸ *Id.*

⁹⁹ NCLC/CFA 2013 Tax-Time Products Report at 3.

¹⁰⁰ NCLC/CFA 2016 Tax-Time Products Report at 6.

¹⁰¹ Republic Bancorp, *2017 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934* at 62.

¹⁰² *Id.* at 59.

¹⁰³ See Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, *Major Changes in the Quick Tax Refund Loan Industry* 14-15 (Feb. 2010).

¹⁰⁴ Press Release, Green Dot Completes Acquisition of Santa Barbara Tax Products Group, Oct 23, 2014, *available at* www.businesswire.com/news/home/20141023006379/en/Green-Dot-Completes-Acquisition-Santa-Barbara-Tax.

SBTPG is the largest processor of tax refund disbursements in the U.S. and processed about 11.17 million refund transactions in 2017,¹⁰⁵ which appears to be more than half the RAC volume for that year.¹⁰⁶ SBTPG also offers a “no-fee” RAL called a “FastCash Advance” of up to \$1,500¹⁰⁷ and a second RAL called an “AdvancePlus” of up to \$1,000 at 29.9% APR.¹⁰⁸ Both loans are made by MetaBank.

CONCLUSION

The tax-time financial products market continues to develop. Lenders and tax preparers are offering a new generation of RALs that are promoted as not imposing interest or fees on taxpayers. However, they present the risk that unscrupulous tax preparers will charge unrelated fees to make up for the cost of the loan. These second-generation RALs proved popular with taxpayers in 2017 and this year, no doubt due in part to the refund delays faced by EITC recipients. Tens of millions of taxpayers continue to be sold RACs, which can be subject to significant add-on fees and may represent a high-cost loan of the tax preparation fee.

Consumers face other problems in addition to tax-time financial products. The most significant problem is the lack of regulation for tax preparers, leading to incompetence and fraud. In addition, nearly half a million immigrant taxpayers were required to renew their ITINs for the 2017 filing season, but less than half did so. Private debt collectors hired to collect IRS tax debts disproportionately targeted economically vulnerable families, potentially leaving them with insufficient funds to pay for basic life necessities.

¹⁰⁵ Green Dot Corporation., 2017 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 34.

¹⁰⁶ See Section I.B above (20.5 million RACs).

¹⁰⁷ Santa Barbara Tax Products Group, FastCash ADVANCE – The Advance that Helps You Attract More Clients, www.sbtpg.com/fastcash-advance (visited Nov. 20, 2017).

¹⁰⁸ Santa Barbara Tax Products Group, Advance PLUS- Attract clients with an extra \$1,000 advance, www.sbtpg.com/advance-plus (visited Nov. 20, 2017).