Consumer Federation of America

TAX PREPARERS PEDDLE HIGH PRICED TAX REFUND LOANS:

MILLIONS SKIMMED FROM THE WORKING POOR AND THE U.S. TREASURY

Consumer Federation of America (CFA)

and the

National Consumer Law Center (NCLC)

January 31, 2002

REFUND ANTICIPATION LOAN REPORT

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By Chi Chi Wu, Staff Attorney, National Consumer Law Center
Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America and
Elizabeth Renuart, Staff Attorney, National Consumer Law Center

The Center for Law & Human Services and Michael O'Connor provided guidance and technical assistance in the preparation of this report. Carolyn Carter, of counsel to NCLC, provided editorial assistance.

Consumer Federation of America is a non-profit association of over 285 groups, with a combined membership of over 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

The National Consumer Law Center is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations, who represent low-income and elderly individuals on consumer issues.

Consumer Federation of America
1424 16th St NW Suite 604
Washington, DC 20036
Phone: 202-387-6121
(http://www.consumerfed.org

National Consumer Law Center
77 Summer St. 10th Floor
Boston, MA 02110
Phone: 617-542-8010
(http://www.nclc.org

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Findings/Executive Summary

- Refund anticipation loans (RALs) are usurious short-term loans secured by the taxpayer's tax refund, which often includes the Earned Income Tax Credit. Loans cost from 67% to 774% APR. RALs share many characteristics of fringe financial products such as rent-to-own, payday loans, and car title pawns, which target vulnerable low-to moderate- income consumers who can least afford their triple-digit interest rates.

- The refund anticipation loan industry primarily consists of commercial tax preparers and the banks that provide the loans. Banks are used to evade state usury and small loan rate caps. In 2000, consumers paid an estimated **$810 million in RAL fees**.

- Tax refund loan costs siphon off **an estimated $324 million in loan fees and cost an *additional* $670 million in tax preparation, electronic filing fees, and check cashing fees** every year from the Earned Income Tax Credit (ETIC), the largest federal anti-poverty program. Forty percent of taxpayers who get a RAL are EITC recipients. EITC recipients often get a RAL because they do not have the cash in hand to pay the fees for commercial tax preparation services needed to file the complex forms and to avoid IRS audits of EITC filings.

- Many consumers who get a refund anticipation loan do not even know they have taken out a loan against their tax refund. For many years, some commercial tax preparers have been accused of misleading consumers about the loan transactions and of receiving kickbacks from banks.

- There is very little federal governmental regulation of RALs. Although the IRS has issued rules requiring tax preparers to advertise RALs as loans, enforcement has been left to class action lawsuits and state enforcement agencies. The IRS does not regulate the loan fees. The states' ability to do so is hampered by federal law.

- The IRS is under a mandate from Congress to expand electronic tax filing to 80% of filed returns by 2007. Electronic filing is a driving force behind refund anticipation loans. The IRS reinstated a controversial Debt Indicator service that lowers the risk of RALs for the commercial tax preparers and partner banks, yet the costs of RALs have not decreased proportionately.

Refund Anticipation Loans Are Usurious Small Loans

Refund anticipation loans (RALs) are part of the fringe financial industry which includes pawns, car title pawns, payday loans, and rent-to-own transactions. RALs provide quick credit to vulnerable consumers at a steep price, including the potential risk of ruined credit ratings and debt collection harassment. RALs target low- to moderate-income consumers with few resources and great financial needs. Consumers often are mislead into thinking of RALs as "quick refunds," not understanding that they are loans.

Instead of waiting to receive tax refunds, RAL customers borrow against part or all of their expected tax refund. The tax refund may include the Earned Income Tax Credit, a federally provided benefit for poor working families that is generally distributed in a lump sum through the tax system.

The Price of RALS

Consumers pay three fees to get a refund anticipation loan: a fee to a commercial tax preparer for filling out the federal and state tax forms, typically $60 to $300;[1] a fee for the electronic filing, with the average fee being $40;[2] and a loan fee to the lender, typically set on a sliding scale based on the amount of the expected refund. Typical loan fees range from $29 to $89,[3] but can be as high as half the refund.[4] What the consumer receives in hand is the refund minus the loan fee, the tax preparation fee, and the electronic filing fee. The total amount of the three fees can range from $129 to $429.

RALs speed up receipt of cash from tax refunds, but not by much. The refund anticipation loan puts cash into the consumer's hand in one or two days, accounting for its appeal as a quick and "painless" way to get cash.[5] What consumers who want their refunds quickly don't realize is that electronic filing alone cuts the waiting to about ten days, if the consumer has a bank account

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[1] Chris Serres, *Speedy Refunds, Hefty Fees*, Raleigh News and Observer, February 25, 2001, at E1. The average tax preparation fee is about $85. National Taxpayer Advocate, FY 2001 Annual Report to Congress, December 31, 2001, at 63 [hereinafter "National Taxpayer Advocate 2001 Report"].

[2] National Taxpayer Advocate 2001 Report, at 63.

[3] Reed, Robert, *Slamming the Brakes on Speedy Tax Refunds*, Crain's Chicago Business, March 12, 2001, at 8. The authors also have on file several advertisements by RAL lenders which indicate a general fee range of $29 to $90. The latest advertisement is flyer mailed by Household Bank for the 2002 tax season advertising to tax preparers its "ExpressRefund Lending" products [hereinafter "Household 2002 ExpressRefund flyer."]

[4] For example, one consumer in Colorado paid $574 in loan fees for a loan of $1,099. Brief of amicus curiae filed in *State ex rel. Salazer v. The Cash Now Store*, 31 P.3d 161 (Colo. 2001), reprinted in National Consumer Law Center, Cost of Credit (2d. ed 2000), App. F.4.

[5] The 1 or 2 day figure is H&R Block's estimate from prior years. *See Taxpayers Using Filing Services to Get Refunds Quicker*, Morning Edition, National Public Radio (transcript) (statement by H&R Block spokeswoman Linda McDougall). Advertisements by RAL lenders on file with the authors also claim 1 or 2 day turnaround times, and these figures are cited in the case *JTH Tax v. H&R Block Eastern Tax Services*, 128 F. Supp.2d 926, 930-931 (E.D. Va. 2001), *aff'd in part, vacated in part, and remanded in part*, 2002 U.S. App. LEXIS 477 (4th Cir. January 10, 2002) (the appellate court substantially affirmed the District Court's decision, but vacated and remanded the calculation of damages and scope of the injunction; findings of bad faith and malice upheld.) This year, however, H&R Block has begun offering a same-day RAL product, called the Instant Money refund loan. (Direct mail advertisement for H&R Block, received in January 2002, on file with the authors)

into which the refund can be direct deposited by Treasury.[6] Often, the lender does not explain this reduced wait or includes the information only in small print in a long loan document.

How RALs Are Structured

When the loan is made, the bank prepares to collect on the loan by opening a temporary bank account for the borrower to receive electronic deposit of the refund. The documents signed by the borrower instruct the IRS to direct deposit the refund into that account. The contract usually contains a right of setoff, so the lender is repaid when the refund appears in the bank's account. The consumer is liable for the full amount of the loan if the refund is disallowed in whole or in part. The refund amount would be affected if, for example, IRS disallows a deduction or if there is an intercept of the refund for child support or a student loan debt.

Triple Digit Interest Rates for RALs

If the annual percentage rate for these loans is based upon the actual amount of time that the money is lent, about 10 days,[7] the typical RAL loan fees translate into APRs of 67% to 774% for a 10-day loan.[8] However, the lenders usually structure RALs as demand notes to take advantage of a disclosure loophole. Under Federal Reserve Board rules, in some states, the lender is permitted to calculate the APR for demand notes on the assumption that the loan will be paid in one year.[9] The longer term reduces the APR. As a result, RAL lenders typically disclose APRs in the range of 1.8% to 21%.

Further, neither the tax preparation fee nor the electronic filing fee is required to be included in the APR, because it is also charged to consumers who file electronically but do not receive a loan.[10]

Consumers can expect to pay somewhere in the neighborhood of $810 million in RAL fees in 2002.[11] In 2000, about 40% of RAL consumers, or 4.32 million, were working poor families

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[6] Timothy Boone, *Tax Refund Loans Carry High Cost*, The Sun Herald (Biloxi, MS), March 21, 2001 (quoting IRS spokesperson in New Orleans); Colleen Heild, *Interest Charged For Service*, Albuquerque Journal, February 5, 2001, at A.1 (quoting IRS spokesperson in Phoenix). To receive a refund with a paper return and mailed check takes 4 to 6 weeks. Nina Olson, *Olson Testimony at Ways and Means Oversight Hearing on 2001 Filing Season*, Tax Notes Today, April 4, 2001 (Nina Olson is the IRS Taxpayer Advocate).

[7] The 10-day figure is the amount of time that the IRS has stated it takes to process a refund if the return is electronically filed, and the refund is direct deposited. See text containing footnote 6, *supra.*

[8] This figure was calculated based upon 2002 fees, as advertised by Household Bank, one of the largest RAL lenders. Household 2002 ExpressRefund flyer. It includes *only* the loan fees, not the fee for filling out the tax forms or the fee for electronic filing.

[9] Official Staff Commentary 12 C.F.R. § 226.17(c)(1)-17. *See Cades v. H&R Block*, 42 F.3d 869 (4th Cir. 1994). For an explanation of how this happens, see National Consumer Law Center, Truth In Lending § 4.4.5.2 (4th ed. 1999).

[10] Official Staff Commentary 12 C.F.R. § 226.17(c)(1)-17 (requiring electronic filing fees to be included in the finance charge to the extent that they are *higher* than the fee for non-RAL customers).

[11] This estimate is based on the average RAL fee of $75 (according to the Household 2002 ExpressRefund flyer) for a $1,900 refund (which was the average refund in 2000 according to Timothy Boone, *Tax Refund Loans Carry High Cost*, The Sun Herald, March 21, 2001), and an estimate that 10.8 million consumers obtained RALs in 2000. This latter number (10.8 million) was calculated as follows: As a proxy for the number of RALs, the IRS has provided information on the number of requests for the Debt Indicator (the Debt Indicator is discussed later

who received the Earned Income Tax Credit (EITC).[12] Charging triple-digit interest for loans paid out of the Earned Income Tax Credit diverts federal benefits from working poor families into the pockets of companies that prepare tax returns and make loans. Last year, Crain's Chicago Business editorialized that:

> [T]his is an odious business, one that systematically exploits those who have the least and stand to lose the most. The free enterprise system won't suffer if lawmakers and regulators crack down on 'refund anticipation loans,' or even ban them outright. And it wouldn't hurt if the Internal Revenue Service, which must officially approve the tax filings before quickie refunds are made, decides to review its part in this process, too."[13]

Millions in Earned Income Tax Credit Benefits Siphoned Off by RALs

For low income working families, refunds are usually not a result of over-withheld wages, but a result of the Earned Income Tax Credit. The Earned Income Tax Credit, created in 1975, is the nation's largest anti-poverty program and is delivered as a refundable credit distributed through the federal tax system.[14] Working families with children earning up to roughly 200% of the federal poverty level receive the largest share.[15] The EITC is also available to childless individuals or couples who make less than about $10,000. In 1998, half of all national EITC dollars went to working families earning less than $12,000.[16]

In 2001, the federal EITC provided over $30 billion to 18.4 million low-income taxpayers across the U.S.[17] During the same year, the maximum federal EITC refund was $4,008 and the average EITC refund was $1,600. Recipients can choose to get the EITC refund in installments or in a lump sum. Most recipients choose the lump sum option. The EITC lifts approximately 4.7 million people, over half of them children, from poverty, more than any other federal program.[18] Moreover, the EITC has been found responsible for 60% of the increase in employment among

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below). The number of Debt Indicator requests was 12 million (statistic provided by the Internal Revenue Service, on file with the authors). We assumed that each of these requests for the Debt Indicator was for purposes of a RAL application. About 90% of RAL applications result in an approved loan (George Guttman, *IRS Reinstates Debt Indicator to Increase Electronic Filings*, 85 Tax Notes 1125, Nov. 29, 1999 [hereinafter "Guttman, IRS Reinstates Debt Indicator"]). Thus, 90% of 12 million is 10.8 million. Note that even when a RAL application is denied, the consumer is usually flipped into another bank product, sometimes called a "refund anticipation check." In these cases, the consumer still must pay a substantial fee, essentially for the privilege of a temporary bank account into which the refund can be direct deposited. In 2002, this refund check fee will be approximately $28 for Household Bank. Household 2002 ExpressRefund flyer.

[12] Statistic provided by the Internal Revenue Service, on file with the authors.

[13] Robert Reed, *Slamming the Brakes on Speedy Tax Refunds*, Crain's Chicago Business, March 12, 2001, at 8.

[14] Ten states and the District of Columbia also have an EITC for state taxes. Alan Berube and Benjamin Foreman, *A Local Ladder for the Working Poor: The Impact of the Earned Income Tax Credit in U.S. Metropolitan Areas,* Brookings Institution (September 2001), at 10. [hereinafter "Local Ladder"]

[15] Alan Berube and Benjamin Foreman, *Rewarding Work: The Impact of the Earned Income Tax Credit in Greater Chicago,* Brookings Institution (November 2001), at 2-3 [hereinafter "Rewarding Work"].

[16] *Id.* at 3.

[17] Local Ladder at 1.

[18] Council of Economic Advisors, "Good News for Low Income Families: Expansions in the Earned Income Tax Credit and the Minimum Wage, at 1 (December, 1998).

single mothers during the period 1984-1996.[19] It reduces poverty and income inequality, promotes work, and helps low-income families build assets.[20]

Why EITC Recipients Use Commercial Tax Preparers

EITC recipients are a ripe market for commercial tax preparers. Many must pay high tax preparation fees just to obtain their refunds. These taxpayers, facing barriers of education, literacy and language as well as fear of IRS audits, are more likely than the general population to rely on commercial tax services. In 1994, 60% of EITC recipients used a paid preparer, compared to 52% of all filers.[21] Filing the multiple forms for EITC is more challenging than filing Form 1040 with Schedule A. An estimated 46 to 51% of the general population and 76% of food stamp recipients do not have adequate literacy skills to complete the multiple tax forms necessary to claim the EITC. The IRS also closely checks EITC filings, providing further incentive for recipients to use paid preparers. [22]

In 2002, many low-income families with children will be eligible for a new refundable federal child credit, which will increase refunds for most families that receive the EITC. Extra forms must be filed to claim the child credit and the definition of "child" for purposes of the child credit is different than the EITC definition.[23]

A Brookings Institution study of the impact of the EITC in Chicago confirms that EITC recipients disproportionately use paid preparers. The study also highlights that paid preparers deliberately seek out EITC recipients.[24] Neighborhoods with the highest percentage of working poor families have the highest percentage of commercial tax preparation services. Chicago ZIP codes where 25 percent of the population earned the tax credit in 1999 have an average of 17 tax preparation services compared to 11 in other ZIP codes.[25] The author of the report observed in the Chicago Tribune: "A lot of these services charge $100 and up for the tax services, plus more money to advance a quick electronic refund. The good that the government program does gets eroded by these high charges."[26]

Even though EITC recipients use a commercial preparer because of fear of making mistakes, the error rates for self-prepared and commercially-prepared returns are about the same. One study found that error rates were respectively, 26% and 23.1%.[27] Consequently, the IRS

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[19] Meyer, Bruce D. and Dan T. Rosenbaum, "Making Single Mothers Work," 1026, at 1028, National Tax Journal, Vol. 53, No 4, Part 2 (December, 2000).
[20] Rewarding Work at 2, Local Ladder at 2.
[21] Michael O'Connor, *Tax Preparation Services for Low Income Filers*, 90 Tax Notes 231, January 8, 2001. In 1999, 54.2% of EITC recipients used paid preparers. Janet McCubbin, *EITC Noncompliance: The Determinants of the Misreporting of Children*, National Tax Journal, Dec. 1, 2000, at 1135.
[22] Michael O'Connor, *Tax Preparation Services for Low Income Filers*, 90 Tax Notes 231, January 8, 2001.
[23] Rewarding Work at 8.
[24] Rewarding Work at 6.
[25] *Id*.
[26] Janet Kidd Stewart, *Tax Credit Pumps Millions Into Area*, Chicago Tribune, Nov. 27, 2001.
[27] Michael O'Connor, *Tax Preparation Services for Low Income Filers*, 90 Tax Notes 231, January 8, 2001. Another study by an IRS researcher found that error rate for self-prepared returns was 26.1% and the error rate for preparer returns was 25.7%. *See* Janet McCubbin, *EITC Noncompliance: The Determinants of the Misreporting of Children*, National Tax Journal, Dec. 1, 2000, at 1135.

National Taxpayer Advocate has urged Congress to issue a directive stating that low-income taxpayers who claim the earned income tax credit need to be protected in the tax preparation market.[28]

The RAL Bite Out of EITC Benefits

Hundreds of millions of public dollars in EITC benefits are siphoned off by RALs. An estimated 4.32 million EITC recipients received a RAL in 2000.[29] Since there were about 10.8 million RAL borrowers in all in 2000,[30] four out of ten RAL borrowers were EITC recipients.

If the average EITC refund is $1,600, the average RAL fee for an EITC recipient will be about $75 in 2002.[31] If the number of EITC recipients who receive RALs remains the same in 2002, as in 2000, **about $324 million will be drained from the EITC program to pay RAL lenders.**[32] The $75 fee for a 10-day loan of $1,600 generates a whopping APR of 179%.

The Total Drain on EITC Benefits

On top of the loan fee, RAL customers must pay fees for tax preparation and electronic filing, which averaged respectively $85 and $40 in 1999.[33] This adds $540 million to the amount paid by EITC recipients for RALs.[34]

In addition, a significant percentage of these EITC RAL borrowers will end up paying a check casher to cash their RAL check, as discussed later in this report. The check cashing fee is likely to be 4% of the check amount plus $3 or about $67.[35] The check cashing fee is especially outrageous since part of the RAL loan fee is supposedly attributed to opening a temporary bank account into which a refund is deposited. If we assume 45% of these consumers use a check casher,[36] that means an additional drain on the EITC program of $130 million.[37]

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[28] National Taxpayer Advocate 2001 Report, at 64

[29] Statistic provided by the Internal Revenue Service, on file with the authors. As discussed in footnote 11, *infra*, the IRS essentially provided statistics on the number of RAL applicants who received the EITC, which was 4.8 million. Since about 90% of RAL applications are approved (Guttman, IRS Reinstates Debt Indicator, at 1125), this translates to about 4.32 million EITC RAL borrowers.

[30] *See* footnote 11, *infra*.

[31] Household 2002 ExpressRefund flyer. See table after footnote 64.

[32] 4.32 million times $75.

[33] National Taxpayer Advocate 2001 Report at 63. Some paid preparers, such as Jackson Hewitt, have begun offering free electronic filing with paid tax preparation.

[34] This figure is calculated as follows: 4.32 million times $85 = $367.2 million in tax preparation fees; 4.32 million times $40 = $172.8 million in electronic filing fees. $367.2 million + $172.8 million = $ 540 million.

[35] These figures are based on the fees charged by ACE Cash Express. See text containing footnote 93.

[36] This 45% figure is taken from a study of EITC recipients who used *free* tax preparation services. Timothy M. Smeeding, Katherine Ross Phillips, and Michael O'Connor, *The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility*, Center for Policy Research, Working Paper Series No. 13 (2000), at Table 5, available at www-cpr.maxwell.syr.edu/cprwps/pdf/wp13.pdf. Given the relationship between *commercial* tax preparers and check cashers, see section on check cashers, *supra*, we believe this figure actually underestimates the number of EITC recipients who use check cashers.

[37] The calculation is: 4.32 million times 45% = 1.944 million EITC recipients who will cash their RAL checks through a check casher. 1.944 million times $67 = $130,248,000.

Not only do these fees add up on a nationwide basis, they add up for the average EITC RAL borrower. This low-income worker will end up paying out of her $1,600 refund:[38]

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL loan fee	$75	$324 million
Electronic filing fee	$40	$172.8 million
Check cashing fee	$67	$130 million
Tax preparation fee	$85	$367.2 million
Total	**$267**	**$994 million**

Why EITC Recipients Get RALs

One reason for the disproportionate percentage of EITC recipients who get RALs is the need to pay for commercial tax preparation services. Many EITC recipients do not have the cash up front to pay the tax preparation fee. Taxpayers who get a refund anticipation loan do not have to pay fees up front but can deduct the tax preparation fee, electronic filing fee, and loan fee from the combined tax refund/EITC benefit.[39]

Another driving force is the lack of a bank account into which refunds can be electronically deposited. Over 10 million U.S. households lack a bank account,[40] and one study showed that only about 40% of EITC recipients have a checking account.[41] Part of the solution would be to create opportunities for EITC recipients to open bank accounts. The IRS and the Treasury's Financial Management Service have the ability to establish deposit accounts for unbanked consumers into which tax refunds could be directly deposited.[42] One useful strategy is to link EITC recipients with the First Accounts program being developed by Treasury's Financial Management Service.

Free Tax Preparation Programs and Partner Banks Help EITC Recipients

A clear alternative for EITC recipients is for them to seek out free tax assistance through organizations authorized under the IRS VITA program. The VITA (Volunteer Income Tax Assistance) program seeks to provide volunteer-driven tax preparation services to low-income taxpayers. There are a number of large and very successful free tax preparation programs, in cities such as Chicago, Tulsa, Detroit and Minneapolis, but as a whole there are too few in other

[38] The tax preparation fee and the electronic filing fee in this example are average fees taken from the National Taxpayer Advocate 2001 Report at 63.

[39] Both advocates for low-income taxpayers and RAL lenders agree with this theory. See Michael O'Connor, *Tax Preparation Services for Low Income Filers*, 90 Tax Notes 231, January 8, 2001, and Roger Russell, *Products That E-Preparers Can Take To The Bank*, Accounting Today, June 4, 2001, at 10 (quoting Republic Bank Vice President Bill Nelson).

[40] John P. Caskey, *Bringing Unbanked Households into the Banking System*, Brookings Institution (January 2002), at 2.

[41] Timothy M. Smeeding, Katherine Ross Phillips, and Michael O'Connor, *The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility*, Center for Policy Research, Working Paper Series No. 13, at Table 5.

[42] Nina Olson, *Olson Testimony at Ways and Means Oversight Hearing on 2001 Filing Season*, Tax Notes Today, April 4, 2001 (Nina Olson is the IRS Taxpayer Advocate).

areas of the country to meet the needs of low-income taxpayers. In 1998, there were 17 million return filers with incomes below the poverty threshold, yet there was only enough volunteer or free help to prepare 113,000 returns.[43] About 23,000 of those returns were completed by volunteers from two organizations: the Community Action Project of Tulsa County and the Tax Counseling Project of the Center for Law & Human Services in Chicago. In Chicago, the Mayor's Office has teamed up with the Center for Law & Human Services to conduct outreach and educate taxpayers about the refund loans, encouraging filers to submit their returns electronically but avoiding the fees associated with RALs.

These two organizations have also launched innovative programs that seek to confront the factors that lead to a heavy reliance on RALs in low-income communities. Specifically, they seek to provide bank accounts and other savings vehicles to taxpayers who utilize their services, since many of them lack bank accounts. In Chicago, the Tax Counseling Project of the Center for Law & Human Services has teamed up with ShoreBank, preparing tax returns for 717 customers at two bank branches and opening up 202 savings accounts in the two years of the program.[44] Initial deposits in those accounts totaled $204,000 and many customers kept their accounts open a year later, leading Jennifer Tescher, an Assistant Vice-President at ShoreBank, to conclude that offering these types of accounts "makes sense for the bank, the customers and the community. We've even opened twenty additional accounts for related products for the people who had their tax returns done by the Tax Counseling Project," said Tescher.

The Community Action Project of Tulsa County has encouraged many of their tax clients to open Individual Development Accounts (IDA's) using their tax refunds that allow them to leverage their contributions with matched funds. The funds in the accounts can be used towards homeownership, education or opening a business. Legacy Bank of Milwaukee offers a tax preparation center in conjunction with the Social Development Commission. Local banks in Chicago that offer accounts to taxpayers who receive refunds include Cole Taylor Bank, Park Federal Savings Bank, and First Bank of the Americas. The FDIC plans to expand the tax program to Chicago, Atlanta, and Kansas City, MO.

The Refund Anticipation Loan Industry and Bank Partners

Refund anticipation loans are a high volume business. In 1994, 9.5 million consumers took out RALs, paying about $300 million.[45] By 2000, this number had risen to about 12 million consumers.[46] In 2001, one company alone (H & R Block) made 4.5 million RALs.[47]

The refund anticipation loan industry is made up of two large tax preparation companies and their partner banks, as well as a large network of smaller tax preparers who make loans through a handful of banks. Check cashers, automated check cashing machine companies, retailers and car dealers also cash in on the availability of large lump sums of tax refunds/EITC benefits.

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[43] National Taxpayer Report, at 51.
[44] Ben Jackson, *ShoreBank Courts Unbanked via Tax Service*, American Banker, Dec. 12, 2001.
[45] Ryan Donmoyer, *IRS Takes Aim at RAL Fraud, Hits Preparer Profits*, 66 Tax Notes 1750, February 20, 1995
[46] Statistic provided by the Internal Revenue Service, on file with the authors.
[47] H&R Block Inc., 2001 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 4. [hereinafter "H&R Block, 2001 Form 10-K"].

H & R Block

H & R Block is the single largest tax preparer in the nation. Fourteen percent, or almost one in every seven individual tax returns, is prepared by Block.[48] Half of all commercially prepared returns filed electronically are from Block.[49] In 2001, Block filed 16.4 million tax returns, 14.5 million of which were filed electronically.[50]

In 2001, Block alone processed 4.5 million RALs. Block's RAL business has grown in the past few years, from 2.8 million in 1999, to 4.8 million in 2000, and 4.5 million last year. In 2001, Block made $133.7 million in gross revenue and $68 million in net profits on RALs[51] -- a rate of return of over 50%. Clearly, RALs are very profitable for H&R Block, and they accounted for 8% of the company's revenues from its U.S. tax preparation services. [52]

H & R Block benefits financially from the RAL program in two major ways: 1) through a "license" or "participation" fee paid by the lender for each RAL, which is now $9; and 2) through purchasing about half of the loans made by its RAL partner, Household Bank.[53] In 2001, the participation fee generated fees for Block in excess of $44 million,[54] while loan fees from the purchased RALs added $89.7 million in revenues.[55]

H & R Block also is marketing an Electronic Refund Advance, a RAL targeted toward on-line filers who already have a bank account. The loan costs $29.95, with Block netting $7.21 per transaction from the bank loan fee.[56]

Block even makes money when customers cash their tax refund and RAL checks. A number of H & R Block offices are located at Sears stores.[57] When Block's customers use Sears to cash their tax refund or RAL checks, Sears passes through 15% of its fee to Block.[58]

There have been reports that H&R Block may reduce its emphasis on RALs in the 2002 tax season.[59] H&R Block, which has cultivated an image of a trusted advisor, may be concerned about damage to its reputation because of RALs.[60]

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[48] H & R Block, 2001 Form 10-K, at 5.
[49] *H & R Block Reports Record Tax Season Results*, Press Release, May 3, 2001.
[50] *Id.*
[51] H & R Block, 2001 Form 10-K, at 10.
[52] H&R Block, *One to One: 2001 Annual Report*, at 23.
[53] H & R Block, 2001 Form 10-K, at 3-4, 10.
[54] The math is $9 times 4.5 million RALs. *See* H & R Block, 2001 Form 10-K, at 4.
[55] H&R Block, *One to One: 2001 Annual Report*, at 23. There the company reports total income from RAL fees as $133,710,000. The math is $133,710,000 minus $44,000,000 in participation fees = $89,710,000.
[56] H & R Block, 2001 Form 10-K, at 9-10.
[57] H & R Block, 2001 Form 10-K, at 6.
[58] David Lupi-Sher, *H & R Block's Refund Loan Program Under Attack in State Courts*, 85 Tax Notes 282, October 15, 1999.
[59] Gene Meyer, *H & R Block to Reduce Emphasis on Refund Loans*, Kansas City Star, September 13, 2001, at C4.
[60] David Cay Johnston, *New Questions about Block's Lucrative Tax Loans*, New York Times, July 2, 2000, Section 1, at 3. Block has been accused of other questionable tactics recently. Last year in Ohio, Block charged an extra $22 fee for its supposedly optional "Peace of Mind," often without the customers' permission or knowledge. Amy Higgins, *Peace of Mind*, H&R Block Accused of Trickery, Cincinnati Enquirer, March 24, 2001.

Household Bank

H&R Block partners with Household Bank[61] to make RALs. Household's take from these transactions in 2000 is in the tens of millions and is included in the $108.5 million it reported as miscellaneous income.[62] Household has about an 80% share in the electronic tax refund business.[63] Household also makes RAL loans through other tax preparers in addition to H & R Block.[64] For 2002, Household's finance charges for RALs, which are similar to the other major RAL lenders, are[65]:

H&R Block 2002 RAL Fee Schedule

Amount of Loan	Loan Fee
$200-$500	$34.95
$501-1,000	$44.95
$1,001-$1,500	$64.95
$1,501-$2,000	$74.95
$2,001-$5,000	$89.95

Tax preparers who use Household Bank's program get rebates of $5 for every approved loan application, plus an end of season rebate based on the delinquency rate for loans, up to another $4 per loan.[66]

Household is one of the larger subprime lenders in the nation, and has been accused of illegal practices on a number of occasions.[67] Most recently, the California Department of Corporations sued Household and its subsidiary, Beneficial California, Inc., for allegedly charging its consumer loan and mortgage borrowers certain fees in excess of the amounts allowed by California law.[68] Household settled this matter just a few weeks ago by agreeing to pay nearly

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[61] Household Bank is part of Household Finance Corporation. *See* the Household website at www.household.com/corp/hioc_businesses.jsp. Household also owns Beneficial Finance Corporation. Beneficial Bank continues to originate some RALS made through H&R Block. *See* H & R Block, 2001 Form 10-K, at 10.

[62] Household Finance Corp., 2000 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 14.

[63] Katie Kuehner-Hebert, *California Bank Finds Gold in E-Returns*, American Banker, August 12, 2001, at 1.

[64] As evidenced by a solicitation recently sent by Household to tax preparers to enroll in the Household RAL Program. Household 2002 ExpressRefund flyer.

[65] From Household 2002 ExpressRefund flyer.

[66] *Id.*

[67] For example, the AARP has filed a lawsuit against Household and Beneficial for abusive practices in home-secured financing. *See AARP Foundation Litigation Attorneys Represent Victims of Predatory Mortgage Loans in New York Class Action Lawsuit*, Press Release, September 25, 2001, available at www.aarp.org. Household has come under fire from both community groups and government officials for these practices *See, e.g.*, Anitha Reddy, *ACORN Says Lender Exploits DC Clients*, Washington Post, June 21, 2001, at E03 *and* National Association of Attorneys General, *Arizona Files Suit Against Finance Companies*, NAAG Consumer Protection Report, July 2000, at 16.

[68] *See California ex rel. California Corp. Comm'r v. Household Fin. Corp. of Calif.*, Case No. BC261513 (Los Angeles Cty. Super. Ct. filed Nov. 9, 2001)(citing thousands of violations reported by both companies), available at www.corp.ca.gov.

$12 million in penalties and refunds for over 60,000 violations of state lending laws.[69]

Jackson Hewitt

Jackson Hewitt, part of the Cendant Corporation, is the second largest commercial tax preparation service with 3,300 locations in 48 states and the District of Columbia. It has both free-standing offices and offices located inside retail locations, including Wal-Mart and Kmart.[70] The company prepared 1.8 million returns in 2000 and 2.2 million during the 2001 tax season.[71] Ninety-five percent of returns prepared by Jackson Hewitt are e-filed.[72]

Jackson Hewitt processes tax refund loans by partnering with Santa Barbara Bank & Trust, a subsidiary of Pacific Central Bancorp.[73] Santa Barbara Bank & Trust earned $25.2 million from tax refund loans processed by both that company and other tax preparers.[74] It has about a 10% share of the RAL market.[75]

Other RAL Providers

Bank One Corp. of Chicago is the third bank leader in refund anticipation lending. Bank One Corp. also has about a 10% share of the RAL market.[76] The other smaller players in the RAL industry are Republic Bank & Trust, Republic First Bancorp, and River City Bank.

Republic Bank & Trust, based in Kentucky, offers RALs through its web site www.refundsnow.com and a nationwide network of tax preparers. The bank earned $4.8 million in the first quarter 2001 from RALs.[77]

Republic First Bancorp, the holding company of the Philadelphia-based First Republic Bank, partners with Liberty Tax Service to make RALs.[78] Liberty is a much smaller tax preparer that prepared about 243,000 tax returns in 2000.[79] Republic First Bancorp was formerly Jackson Hewitt's RAL partner, prior to the latter's purchase by Cendant Corporation.[80]

River City Bank has partnered with a number of smaller providers. Its website,

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[69] James A. Sweeney, *Subprime Lender to Settle Suit Over Fees*, San Diego Union-Tribune, January 2, 2002, at C1.
[70] *Jackson Hewitt Reports Record Growth for Tax Season 2001*, Press Release, April 27, 2001.
[71] *Id.*
[72] *Id.*
[73] Katie Kuehner-Hebert, *California Bank Finds Gold in E-Returns*, American Banker, August 12, 2001, at 1; *Jackson Hewitt Reports Record Growth for Tax Season 2001*, Press Release, April 27, 2001, available at www.jacksonhewitt.com. Click on media center.
[74] Katie Kuehner-Hebert, *California Bank Finds Gold in E-Returns*, American Banker, August 12, 2001, at 1.
[75] *Id.*
[76] *Id.*
[77] *Republic Bancorp Reports 33 Percent Increase in First Quarter Earnings Per Share*, Business Wire, April 17, 2001.
[78] *Republic First Bancorp Join Forces with Liberty Tax Service to Provide Tax Refund Products*, Business Wire, July 26, 2000.
[79] *Id.*
[80] Republic First Bancorp, 2000 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 4-5

www.rcbral.com, describes its RAL program.

Variations on Refund Anticipation Loans

In addition to the more "conventional" RALs discussed above, there are a number of variations on tax refund loans. Retailers are sometimes involved in making these loans. Some car dealers advertise during tax season, suggesting that consumers use their tax refunds as down payments on cars. The dealer prepares the tax return and consumers agree to have the refund applied to the purchase of the car. Consumers whose tax refunds are disallowed must then repay the loan or face repossession, which also results in the loss of any monthly payments they have already made.[81] By combining tax preparation and auto shopping in one transaction, consumers run the risk of not getting the best deal for either.

Native American trading posts are another group of merchants who sometimes make RALs.[82] Even jewelry stores[83] and the dot.com businesses are getting a piece of the action. In Minnesota, there is a company that promises a "free" computer and an on-line tutorial for children in return for the parents' assignment of the state education tax credit. In reality, the company is providing a tax refund loan secured by the anticipated refund of the state tax credit.[84]

Refund anticipation loans are even being marketed to consumers who file their own taxes electronically, using tax preparation software. Intuit's TurboTax software includes an offer for up to $5,000 in a Quick Cash loan, provided by Santa Barbara Bank & Trust.[85] "Why wait for your federal refund," the ad states. "Just electronically file your return with TurboTax – and take advantage of our Quick Cash option to get a loan against your expected federal refund amount."[86] Although the ad discloses that a fee will be charged for the service, no cost information is included in the ad.[87]

Check Cashers Profit from Tax Refunds and Loans

Check cashing outlets also take a slice out of tax refunds, by charging fees to cash both the refund and the anticipation loan checks. Many RAL consumers, especially EITC recipients, do not have bank accounts. In one study, 45 percent of EITC recipients planned to use a check casher to cash a refund check.[88] Although some states cap check cashing fees for government checks, they may apply that fee cap only to recurring government checks. In Pennsylvania, some

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[81] This example was cited in Nina Olson, *Olson Testimony at Ways and Means Oversight Hearing on 2001 Filing Season*, Tax Notes Today, April 4, 2001.
[82] Colleen Heild, *Interest Charged For Service*, Albuquerque Journal, February 5, 2001, at A.1.
[83] As reported by Jennifer Stoller, Legal Aid Society of Cleveland, Ohio.
[84] This company is called Cyberstudy 101. See www.cyberstudy101.com.
[85] Advertisement from Quicken TurboTax, on file with the authors.
[86] *Id.*
[87] *Id.*
[88] Timothy M. Smeeding, Katherine Ross Phillips, and Michael O'Connor, *The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility*, Center for Policy Research, Working Paper Series No. 13 (2000).

check cashers charge up to 10% of the refund to cash tax refund or RAL checks.[89] Additionally, check cashers are filing returns electronically and collecting fees for this service.[90]

One of the nation's largest check cashing chains, ACE Cash Express, reported cashing 414,000 tax refund and refund anticipation loan checks in fiscal 2001, resulting in tax check fees of $15.1 million.[91] The number of tax checks is expected to reach between 425,000 and 450,000 in fiscal 2002, generating tax check fees of $16 to $17 million.[92] ACE adds a surcharge for cashing tax refund checks. While it usually charges 2.2% of a check's face value,[93] it charges up to 4% plus a $3 first-time "membership" fee for tax refund and RAL checks. [94]

ACE has also teamed up with H & R Block in a cross-marketing deal. ACE is providing its check cashing customers $10 discounts on tax preparation at H & R Block, while H & R Block is giving its tax preparation clients discounts on check cashing at some ACE locations.[95] ACE has also placed 100 automated self service check cashing machines at Block offices in 21 states for the 2002 tax season. [96] Last year ACE received $1 million in fees from fifty check cashing machines at Block offices[97] and has entered into an agreement to place up to 500 of its machines at other H & R Block locations.[98] Jackson Hewitt also installed check cashing machines at some of its offices in North Carolina, charging three percent of the loan value to cash the checks.[99]

New Technologies and RALs

New technologies have been making an appearance in the refund anticipation loan business. Some RALs are provided through a debit card instead of a check to the consumer. In 2001, Jackson Hewitt offered refund anticipation loan customers a PIN-based Western Union Cash Card that can be used to make purchases at merchant locations that accept MAC or Star, or to withdraw cash at Plus ATMs or at Western Union locations.[100] H & R Block issues PIN-only debit cards that can be used at Cirrus ATMs for withdrawals.[101] Both companies charge a processing fee to send checks to customers with unspent funds after cards expire.[102] The H&R Block/Household product also costs $2 per transaction.[103]

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[89] Reported in correspondence from Irv Ackelsberg, Community Legal Services, Philadelphia, PA, on file with the authors.

[90] ACE Cash Express, 2001 Annual Report. at 53, Dollar Financial Group, 2001 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 6.

[91] *ACE Cash Express Announces Fiscal 2001 Results*, PR Newswire, August 16, 2001.

[92] *Id.*

[93] Ace Cash Express, 2001 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 4. [hereinafter "ACE 2001 Form 10-K"]

[94] Information provided to one author by employees of several ACE Cash Express stores in Virginia.

[95] *ACE Cash Express Partners with H&R Block, PR Newswire*, January 17, 2002.

[96] *Id.*

[97] ACE Cash Express, 2001 Annual Report, at 20.

[98] ACE 2001 Form 10-K, at 6

[99] Chris Serres, *Speedy Refunds, Hefty Fees*, Raleigh News and Observer, Feb. 25, 2001, at E1.

[100] *Tax Preparers Add A Stored-Value Option for Refunds*, ATM & Debit News, Feb. 1, 2001, at 1.

[101] *Id.*

[102] *Id.*

[103] Anthony Burke Boylan, *Household's Controversial Tax Refund Pays Off; Low-Risk Pact with H&R Block*, Crain's Chicago Business, March 5, 2000, at 4.

These new technologies are not without risks to consumers. A Cleveland-based job training and placement program reports a client who was charged $100 to activate the card and $29 every time he used it.[104] Since the consumer could only transfer $400 out of the tax refund account at a time, he had to pay $29 repeatedly to gain access to his tax refund.

Regulation of RALs

There is little federal governmental regulation of RALs. The IRS has issued a handful of rules, which are described below. However, the IRS does not regulate the fees charged for refund anticipation loans (or electronic filing in general). Nor does it appear to penalize preparers for high error rates[105] or publicly sanction tax preparers for violating the rules on RALs.

Most states have usury caps of 36% annual interest (or lower) that would severely restrict the amount of fees and interest that RAL lenders could collect. Because the large tax preparers partner with banks, the usury caps may not apply, as discussed below. There is little state legislation specifically addressing refund anticipation lending.[106]

IRS Rules Concerning Refund Anticipation Loans

The IRS rules are set forth in IRS Publication 1345, an IRS document that governs providers of electronic tax return filing or "e-file providers".[107] E-file providers include tax preparers who engage in the electronic filing of returns. The vast majority of tax preparers who facilitate RALS are e-file providers.

Most of the rules regarding RALs are set forth in Chapter 3 of Publication 1345, in a subsection entitled "Refund Anticipation Loans." There are also several rules concerning RALs in Chapter 6 of Publication 1345, in a subsection entitled "Advertising Standards."

The IRS's formal position concerning RALs is stated quite succinctly in the first paragraph of the subsection on RALs in Chapter 3: "The IRS is in no way involved in or responsible for RALs." The IRS also makes clear in the same subsection that "[t]he Department of Treasury is not liable for any loss suffered by taxpayers, [e-file providers], or financial institutions …" over a RAL.

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[104] As reported in correspondence from Kathryn Harlow, Cleveland Words, Cleveland, Ohio, on file with the authors.

[105] Discussed in Section on Risks to RAL Borrowers.

[106] Only two states have addressed tax refund loans in any significant way. North Carolina focused on regulating the facilitator of RALS, rather than on the lender. N.C. Gen. Stat. §§ 53-245 to 53-254. Wisconsin, on the other hand, imposes only disclosure requirements on the lender. Wis. Stat. §§ 421.301 and 422.310. The North Carolina law has withstood industry challenge on the grounds that federal law preempted state law. *See North Carolina Ass'n of Electronic Tax Filers, Inc. v. Graham*, 429 S.E.2d 544 (N.C. 1993).

[107] IRS Revenue Procedure 2000-31 is the official set of rules that governs the IRS e-file program. Section 5(.01) of Revenue Procedure 2000-31 requires e-file providers to abide by all IRS publications and notices governing the e-file Program, including specifically IRS Publication 1345.

For consumers, the most significant IRS rule concerning RALs is the one requiring an e-file provider to disclose that:

- The RAL is an interest bearing loan;[108]
- The RAL is not a substitute for or faster way to receive a refund; and
- If the refund is not received by the RAL lender within the expected time frame, the taxpayer may be liable for additional interest on the RAL.

The IRS also has developed rules in Publication 1345 concerning the fee an e-file provider may charge to facilitate a RAL. The IRS allows the provider to charge a fee, but requires that it be a flat fee and identical for all customers. The provider's fee cannot be related to the amount of the RAL. The IRS forbids an e-file provider from accepting a fee from a lender for facilitating a RAL, *if that fee is contingent on the amount of the RAL*. Thus, the IRS implicitly permits the provider to accept a fee from the lender, so long as it is a flat fee.

In Chapter 3 of Publication 1345, the IRS has included several rules concerning the relationships between the consumer, e-file provider/tax preparer, and the lender. The IRS forbids an e-file provider who is also a tax preparer from acting as the lender who makes the tax refund loan. It requires the e-file provider to obtain the consumer's written consent before disclosing tax information to a lender in connection with a RAL application. The IRS notes that under § 6695(f) of the IRS Code, a tax preparer is forbidden from cashing a taxpayer's refund check.[109]

Chapter 6 of Publication 1345, which regulates e-file advertising in general, includes several rules concerning the advertisement of RALs. It prohibits improper or misleading advertising, including misleading statements concerning the time frames for refunds and RALs. It requires e-file providers and financial institutions to make a disclosure in RAL advertisements that clearly describe the funds being advanced as a loan. Furthermore, this disclosure must be easy to identify and in readable print. It must make clear that the taxpayer is borrowing against the anticipated refund and not obtaining the refund itself from the financial institution.

The IRS can sanction a violation of Publication 1345 by issuing a written reprimand, or by suspending or expelling the provider from the e-file program.[110]

Attempts by Lenders to Circumvent State Usury Caps

The early version of RALs was constructed as a sale or "assignment" of the tax refund, designed in this fashion to avoid usury laws. However, the assignment pretext has largely vanished, except for the small lenders. Most refund lending is now facilitated through tax preparers and conducted by major depository institutions, including bank subsidiaries of major finance companies. Like the payday loan/bank partnerships, the advantage of this partnership is

[108] Publication 1345 also requires that the e-file provider to disclose the existence of a RAL to the IRS, by requiring providers to include "RAL indicators" in the electronic return.
[109] According to Publication 1345, this prohibition is limited to refund checks for which the preparer prepared the tax return. Also, a preparer that is also a lender but who has not made a RAL to the consumer may cash the consumer's refund check or accept it for deposit. The preparer-lender may also endorse or negotiate a refund check as part of the check-clearing process.
[110] Rev. Proc. 2000-31, § 7(.02).

the ability of the bank to charge the rate allowed by its home state due to the doctrine of rate exportation.[111] This principle allows a bank chartered in a deregulated state to ignore usury laws in the borrower's home state, undermining that state's ability to protect its citizens from out-of-state exploiters.[112] The bank is invariably chartered in a state with no usury caps, like Delaware or South Dakota.

The banks rely upon the court decision in *Cades v. H&R Block*[113] to justify making these loans at any effective interest rate they chose, without regard to the law of the borrower's home state. The court held that agents of a national bank located in the *borrower's* home state may solicit loan customers. The bank may charge any rate allowed by the *bank's* home state. In addition, Beneficial did not create a "branch" at the H&R Block office. If it had, it may have subjected itself to the borrower's state law.[114] The *Cades* decision, however, predates the Reigel-Neal Act. This Act, in part, attempts to restrain banking agency overreaching by establishing a public notice and comment period for any request for advisory opinions preempting state law.[115] In debate surrounding this Act, Congress noted that states have a legitimate interest in protecting the rights of their consumers.[116]

If the lender is a finance company rather than a depository institution, it cannot take advantage of federal preemption of state usury laws. These lenders may still attempt to avoid the usury caps of state small loan laws by disguising the loan as an assignment of the right to receive the tax refund. Recently, however, the Colorado Supreme Court found that tax "assignments" constituted disguised loans, paving the way for the state credit code administrator to obtain an injunction shutting down a finance company.[117]

RALs, Electronic Tax Filing, and the Debt Indicator

RALs were created to take advantage of rapid refunds available through electronic filing. An IRS study shows that for people who do not need money immediately, the electronic filing fee imposed by the tax preparers is a deterrent.[118] The IRS reports that in 1997, 81% of all e-filed returns were completed by paid preparers, making these consumers a captive audience for

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[111] *See* Jean Ann Fox & Edmund Mierzwinski, *Rent-a-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections*, Consumer Federation of America and U.S. PIRG, November 2001, available at www.consumerfed.org.

[112] For a full discussion of this doctrine and its ramifications, *see* National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges Ch. 3 (2d ed. 2000 & Supp).

[113] 43 F.3d 869 (4th Cir. 1994).

[114] At the time *Cades* was decided, H&R Block had no ownership interest in the loans. Since, 1996, however, H&R Block buys back a 49.9% interest in each loan it processes with Beneficial Bank. "Rent-a-charter" issues may raise their head in the RAL context as they have in the payday loan market. *See* Jean Ann Fox & Edmund Mierzwinski, *Rent-a-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections*, Consumer Federation of America and U.S. PIRG, November 2001.

[115] 12 U.S.C. § 36.

[116] H.R. Cong. Rep. No. 651, 103rd Cong., 2d Sess. 53-54 (1994), *reprinted in* 1994 U.S.C.C.A.N. 2068, 2074-76.

[117] *State ex rel. Salazar v. The Cash Now Store.*, 31 P.3d 161 (Colo. 2001)

[118] George Guttman, *Electronic Filing: Who Pays, Who Benefits*, 66 Tax Notes 1750, March 20, 1995.

RALs.[119] In fact, during the early 1990s, most electronic filers were RAL consumers. And while the percentage of electronic filers who receive RALs has decreased, the actual number of RAL consumers has remained steady.

The number of RALs may increase because of a Congressional mandate requiring IRS to meet a goal of having 80% of tax returns to be filed electronically by 2007.[120] Currently, less than 30% of returns are processed electronically.[121] The IRS is not likely to interfere with commercial tax preparers who process RALs for their customers. As a representative of RAL lenders stated a few years ago, his industry is "almost wholly responsible for boosting interest in electronic filing in the first place … without them, the Service's push for tax systems modernization would be in serious jeopardy."[122] According to this lender representative, "We're carrying a critical program for the IRS."[123]

In fact, the IRS has actually made loans less risky for lenders by reinstating the Debt Indicator Service. The Debt Indicator service screens RAL filings to see if there are any claims against consumers' refunds.[124] The Debt Indicator service is controversial, having been dropped in 1995 due to massive fraud in e-filed returns that involved RALs.[125] The Debt Indicator was quietly reinstated in 1999 after virulent complaints by the RAL industry.[126] One of the larger RAL lenders reported a sharp increase in loans versus electronic transfers of refunds following reinstitution of the Debt Indicator.[127]

The IRS claimed that a reinstated Debt Indicator was good for consumers because it would lower RAL fees.[128] That turned out not to be the case for at least one major tax preparer and its lender partner. The fees of H&R Block and Household Bank did drop for one year, but then shot back to pre-Debt Indicator levels. In 1999, prior to the reinstatement of the Debt Indicator, Block/Household charged $40 to $90 for RALs.[129] After the IRS reinstated the Debt Indicator, fees did go down, to between $19.95 to $59.95 for the 2000 tax season.[130] However, fees rose significantly in 2001, with Block/Household charging $29.95 to $86.95 -- close to the fees charged prior to reinstatement of the Debt Indicator.[131] Those higher fees resulted in H&R Block's RAL revenues increasing by 49% from 2000 to 2001.[132] Most of the revenue increase

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[119] Internal Revenue Service, Electronic Tax Administration – A Strategy for Growth, December 1998, at App. D, available at www.irs.gov/prod/elec_svs/appndx-d.html.
[120] Guttman, IRS Reinstates Debt Indicator at 1127.
[121] Internal Revenue Service, Electronic Tax Administration – A Strategy for Growth (December 2000), at 56.
[122] Ryan Donmoyer, *IRS Takes Aim at RAL Fraud, Hits Preparer Profits*, 66 Tax Notes at 1087 (paraphrasing Gary Perkinson of the Electronic Filing Coalition, a lobbying group for RAL lenders).
[123] *Id.* (direct quote).
[124] Guttman, IRS Reinstates Debt Indicator at 1125.
[125] Ryan Donmoyer, *IRS Takes Aim at RAL Fraud, Hits Preparer Profits*, 66 Tax Notes at 1087-1088.
[126] Amy Hamilton, *Taxwriters Zeroing in on 'Rapid Refund Loans,'* 91 Tax Notes 189, 192 (April 9, 2001).
[127] Pacific Capital Bancorp, 2000 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 23. [hereinafter "PCB 2000 Form 10-K"]
[128] Amy Hamilton, *Taxwriters Zeroing in on 'Rapid Refund Loans,'* 91 Tax Notes at 192-193; PCB 2000 Form 10-K, at 23.
[129] Guttman, IRS Reinstates Debt Indicator at 1127.
[130] *Refund Anticipation Loans May Include Several Fees*, St. Louis Dispatch, Feb 22, 2000, at C6.
[131] Chris Serres, *Speedy Refunds, Hefty Fees*, Raleigh News and Observer, February 25, 2001, at E1.
[132] H&R Block, *One to One: 2001 Annual Report*, at 23.

appears to be the result of the higher finance charges, because per-RAL-revenue rose by 43.9%, while sales volume only increased by 2.7%.[133]

While electronic filing is part of the RAL problem, it is also a possible part of the solution. In a few years, the IRS plans to have the ability to process refunds for e-filed returns within 48 to 72 hours, thus reducing the perceived need for RALs.[134] However, the IRS has not made an institutional commitment to do so because of concerns over fraud.[135]

Refund Anticipation Loan Customers

Consumers who pay triple digit interest to borrow against tax refunds are financially vulnerable. According to company focus group studies cited in a Pennsylvania court decision, H & R Block "Rapid Refund" customers tend to have $10,000 to $15,000 annual incomes, are unemployed or employed in service occupations, and possess less than a high school education.[136] Another marketing survey found that customers who used the "Rapid Refund" service were frequently in dire economic straits and used Block's services to obtain cash to meet pressing personal needs.[137]

Beneficial Bank has reported that the median income of its RAL customer is $25,000 per year.[138] In 1995, a former official at Beneficial Bank wrote a memo describing refund anticipation loan customers as "one step away from financial disaster. The entire concept of this RAL program is appealing to the poor, the destitute and the desperate. Even the most desperate customers I have interviewed have expressed dismay at the prices charged for the loans, but they have resignedly acquiesced because of their financial plight."[139]

Military personnel are also targeted by refund anticipation loan advertising. A federal lawsuit in Norfolk, Virginia brought by a competitor against H & R Block included several examples of RAL ads placed in the newspapers that cater to branches of the military.[140]

RAL Customers Misled and Confused About Loans

There is widespread confusion about refund anticipation loan products marketed by commercial tax preparation companies. Many RAL consumers simply do not know they are

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[133] *Id.*

[134] Amy Hamilton, *Taxwriters Zeroing in on 'Rapid Refund Loans,'* 91 Tax Notes at 192; Nina Olson, *Olson Testimony at Ways and Means Oversight Hearing on 2001 Filing Season*, Tax Notes Today, April 4, 2001.

[135] *Id.* at 192.

[136] H&R Block marketing study, on file with the authors and described in *Basile v. H&R Block*, 777 A.2d 95 (Pa. Super. Ct. 2001).

[137] *Id.*

[138] Ryan Donmoyer, *IRS Takes Aim at RAL Fraud, Hits Preparer Profits*, 66 Tax Notes 1750, March 20, 1995.

[139] David Cay Johnston, *New Questions about Block's Lucrative Tax Loans*, New York Times, July 2, 2000, Section 1, at 3.

[140] *JTH Tax v. H&R Block Eastern Tax Services*, 128 F. Supp. 2d 926, 932-934 (E.D. Va. 2001), *aff'd in part, vacated in part, and remanded in part*, 2002 U.S. App. LEXIS 477 (4th Cir. January 10, 2002) (the appellate court substantially affirmed the District Court's decision, but vacated and remanded the calculation of damages and scope of the injunction; findings of bad faith and malice upheld.).

getting a loan. A 1996 study revealed that almost 50% of taxpayers who had received a RAL did not understand this basic fact.[141] This confusion exists despite the fact that IRS rules require clear disclosure that RALs are loans and not refunds.[142] For example:

> *S.B. is a single mother of a disabled daughter. She works as a waitress in a local diner and did not finish high school. S.B. went to H&R Block to have her taxes done. She did not seek or even ask questions about a tax refund loan or "Rapid Refund." When S.B. got to the H&R Block office, an employee presented S.B. with a stack of papers, which included an application for a refund anticipation loan. According to S.B., the H&R Block employee flipped the stack of papers and directed S.B. where to sign without giving her a chance to read the papers. S.B. did not know she had taken out a loan until she went to see an attorney about filing a divorce.* [143]

One tax preparation company's own internal research documents that many clients were not aware that they had received a loan. An H&R Block study found that many consumers would decline to participate in the "Rapid Refund" service if they knew it was a loan.[144] Company training manuals instruct staff not to provide full information, but to limit affirmative disclosures to items "most important to the client," such as when the check would be available, the amount of the fees, and whether the fees would be withheld from the check.[145] A Pennsylvania judge concluded that many of Block's customers had no significant understanding of the "Rapid Refund" service.[146]

This case is not an isolated occurrence. Historically, H&R Block has avoided providing clear advertising about this loan product. In *JTH Tax v. H&R Block Eastern Tax Services*,[147] a federal judge found that H&R Block not only misled consumers by advertising a RAL product as a "refund" but had engaged in bad faith in so doing. The court noted the many prior legal actions against H&R Block over similar misleading advertising and the fact that the company "made no effort to comply with [the] IRS e-filing advertisement regulation."[148]

H&R Block's advertisements even for this year's tax season are not entirely clear. A direct mail piece for the company announces boldly:

> "After 12 months of paying taxes, you shouldn't have to wait to get a check. In a world of instant coffee, instant replay and instant gratification, H&R Block is pleased to offer Instant Money – the H&R Block Instant Money refund loan. Come to H&R Block to have your taxes done, and we'll show you how to take advantage of the world's way to

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[141] Joan Koonce Lewis, et al., *Refund Anticipation Loan and the Consumer Interest: A Preliminary Investigation*, Consumer Interests Annual, Vol. 42 (1996), at 167.
[142] IRS Publication 1345, at 50-51 and 74-75. See section on IRS rules concerning RALs, *infra*.
[143] These were the facts alleged by the lead plaintiff in *Basile v. H&R Block*, 777 A.2d at 105.
[144] H&R Block focus group study, on file with the authors and described in *Basile v. H&R Block*, 777 A.2d at 105.
[145] *Basile v. H&R Block*, 777 A.2d at 105-106.
[146] *Id.* at 106.
[147] 128 F. Supp. 2d 926, 938 (E.D. Va. 2001), *aff'd in part, vacated in part, and remanded in part*, 2002 U.S. App. LEXIS 477 (4th Cir. January 10, 2002) (the appellate court substantially affirmed the District Court's decision, but vacated and remanded the calculation of damages and scope of the injunction; findings of bad faith and malice upheld.)
[148] *Id.*

get money instantly. Walk in with your taxes – walk out with a check. It's as simple as

that. No more waiting days – or even weeks – for your tax refund. Now you can get money in minutes."[149]

While this advertisement does use the word "loan," it also confuses readers by stating that they don't need to wait for their *tax refunds*. Furthermore, the fact that there is an "[a]dditional fee charged by Household Bank, …" and that "Loan subject to approval" is only disclosed in very fine print.[150]

Consumers Do Not Get Clear Price Signals

Under the federal Truth in Lending Act,[151] borrowers entering into a loan must receive certain disclosures about the cost of the loan, including the annual percent rate, so that they can make informed decisions when seeking credit. If borrowers are not provided the important cost disclosures early in the transaction, this information cannot be used to serve its intended purpose to protect consumers.

RAL customers may receive cost disclosures too late in the loan process to help make informed decisions. Often, the RAL application does not include Truth in Lending disclosures, or includes only illustrative examples.[152] Further, the Truth in Lending information, including the annual percentage rate, may be printed on a stub attached to the actual loan check.[153] It is highly unlikely that a needy borrower with a RAL check in hand would refuse the loan at that point. Once the consumer endorses the check, she is held to have agreed to the terms of the loan contract. Even if the consumer were given the Truth in Lending disclosures at an appropriate time, in many instances because they use a one-year repayment period, they understate the Annual Percentage Rate so grossly that they would be of little use.

Some courts have upheld the practice of providing the Truth in Lending disclosures on the stub with the RAL check, while others have suggested it should be earlier in the process, when the consumer fills out the RAL application.[154] As part of a global class action settlement, Block has agreed to make the Truth in Lending disclosures on the RAL application.[155] It remains to be seen whether the rest of the industry will follow suit.

Risks to RAL Borrowers

Refund anticipation loans cause borrowers problems beyond the high cost of the loans. Commercially prepared tax returns contain errors that can cause the EITC claims to be refused. Of the EITC returns that contained a math error in 1999, an estimated 44% of them (or about

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[149] Direct mail advertisement for H&R Block, received in January 2002, on file with the authors.
[150] *Id.*
[151] 15 U.S.C. §§ 1601 *et seq.*
[152] *See, e.g., Beckett v. H&R Block*, 714 N.E.2d 1033, 1036-1037 (Ill. App. 1999) (Beckett II); *Affafato v. Beneficial*, 1998 U.S. Dist. LEXIS 12447 (E.D.N.Y. 1998).
[153] *Beckett II* at 1037; *Affafato v. Beneficial*, 1998 U.S. Dist. LEXIS at *5-6. The authors also have a sample check stub on file.
[154] *Compare Beckett v. H&R Block*, 1996 U.S. Dist. LEXIS 17,714 (N.D. Ill. 1994) *with Affafato v. Beneficial*, 1998 U.S. Dist. LEXIS at *7-8.
[155] *Zawikowski v. Beneficial National Bank*, 2000 U.S. Dist. LEXIS 11,535, *13 (N.D. Ill. 2000).

254,000) were commercially prepared.[156] Commercially prepared returns accounted for 55% of the math error adjustments in which the EITC was partially or fully disallowed.[157] The National Taxpayer Advocate concluded that taxpayers whose income is so low as to be eligible for the Earned Income Credit are a captive market for return preparers who are not very accurate or who are not making the proper inquiries of their clients in order to accurately complete the returns.[158]

If a refund is denied because of a preparer's error or for any other reasons, the consumer ends up on the hook for the loan. This imposes a substantial hardship, because the consumer usually has not budgeted to repay this loan from regular, periodic income. It subjects the consumer to expensive late fees, debt collection harassment, and a damaged credit rating. Banks involved in RAL lending use aggressive debt collection tactics. They have entered into cooperative agreements with each other to collect back debts from RAL customers. If a taxpayer owes money to one bank from a prior year and applies for a loan from a participating bank, the second bank repays the delinquent amount to the first bank before remitting the refund to the taxpayer.[159] Bank SEC filings show that these cooperative agreements provide a relatively high recovery on losses from prior years. For example, Santa Barbara Bank & Trust expected to collect a significant portion of 2000 net charge-offs in 2001 through the cooperative program.[160]

> *J.D. is a Native American woman who is the mother of three children. She is paraplegic and lives in a remote area of Arizona. In 2000, J.D. went to an H&R Block office to have her 1999 tax return done. J.D. thought she was getting a "Rapid Refund," but she actually was sold a refund anticipation loan. Subsequently, the IRS disallowed J.D.'s earned income tax credit. As a result, J.D. ended up owing Household Finance close to $5,000. Household tried to collect this money in several ways, including calling J.D. on a daily basis and charging her late fees of $75 per month. A legal services program is helping J.D. appeal the IRS decision to disallow the EITC, but H&R Block has not cooperated with J.D. in the appeal.*[161]

> *M.X. is an immigrant who does not speak or read English. He went to a tax preparer and showed the preparer his children's social security cards. The social security cards clearly state "not valid for employment," indicating that his family is not eligible for the EITC. The preparer not only claimed an EITC for M.X., but had him apply for a RAL with an APR of 176.89%. The preparer, who was working on commission, did not tell M.X. that he was applying for a loan. M.X. spent the loan, and now must pay back the*

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[156] Nina Olson, *Olson Testimony at Ways and Means Oversight Hearing on 2001 Filing Season*, Tax Notes Today, April 4, 2001.
[157] *Id.*
[158] *Id.*
[159] For example, a Household Bank/H&R Block application for a refund anticipation loan authorizes Household Bank and Mellon Bank, Greenwood Trust, Bank One, Chemical Bank Delaware, County Bank, River City Bank, First Security Bank, Republic Bank and Bank of Santa Barbara to disclose to each other information about their respective credit experience concerning present and prior RALs and Refund Rewards. If the borrower has delinquent debt from prior years with any of these banks that have not been discharged in bankruptcy, the borrower authorizes Household Bank to deduct from the proceeds for funds in the account to pay off these past debts. Application, Authorization and Certification for Refund Anticipation Loan, Form BTM-0221D (01/00), on file with the authors.
[160] PCB 2000 Form 10-K, at 23.
[161] As reported by Leslie McLean, DNA-People's Legal Services, Chinle, AZ.

bank. The bank is adding late fees to the loan payments.[162]

RAL Litigation and Enforcement Cases

During the last decade, a number of consumer class action lawsuits were filed against H&R Block and its RAL partner, Beneficial/Household, over alleged RAL abuses. These class actions alleged that the companies violated a range of laws, including the federal Truth in Lending Act, the federal Racketeering Influenced and Corrupt Organizations Act, and state unfair and deceptive acts and practices laws.[163] Some of the class actions focused specifically on whether H&R Block breached a fiduciary relationship to its customers when it failed to disclose the kickback it received from Beneficial for each RAL.[164] These class actions met with some limited success until February 2000, when they were abruptly snuffed out by a controversial $25 million global settlement.[165] Objections to this settlement included allegations that it would only pay pennies on the dollar and that it was a product of collusion between Block and Beneficial and some "friendly" plaintiffs' attorneys.[166] An appeal has been filed and is pending in the federal Court of Appeals for the Seventh Circuit.

Government consumer protection agencies have also made attempts to curb RAL abuses. As early as the mid-1970s, the Federal Trade Commission issued an order forbidding Beneficial from advertising its RAL product as an "instant tax refund."[167] During the 1990s, several state consumer protection agencies and attorneys general instituted proceedings against H&R Block for failing to clearly distinguish between its RAL and "Rapid Refund" products.[168] For example, in 1993, Texas Attorney General Dan Morales settled such a case, forcing the company to advertise that its "Rapid Refund" program is actually a loan that costs borrowers up to 150% interest. In the Texas case, H&R Block agreed to disclose the true nature of the loan transactions, not to use the phrase "Rapid Refund" unless an actual refund was delivered, and to stop false advertising that federal income tax filers can be convicted and given a jail sentence for unintentionally making errors on returns.[169]

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[162] As reported by Christine Cook, Legal Aid Society of Minneapolis.

[163] *See Peterson v. H&R Block Tax Services*, 22 F. Supp 2d 795 (1998); *Basile v. H&R Block*, 777 A.2d 95 (Pa. Super. Ct. 2001); *H&R Block v. Haese*, 976 S.W.2d 237 (Tex. Ct. App 1998); *Green v. H&R Block*, 735 A.2d 1039 (Md. 1999); *Cades v. H&R Block*, 42 F.3d 869 (4th Cir. 1994); *Affafato v. Beneficial*, 1998 U.S. Dist. LEXIS 12447 (E.D.N.Y. 1998);

[164] *See Basile v. H&R Block*, 777 A.2d 95 (Pa. Super. Ct. 2001); *Mitchell v. H&R Block*, 783 So.2d 812 (Ala. 2000); *H&R Block v. Haese*, 976 S.W.2d 237 (Tex. Ct. App. 1998); *Green v. H&R Block*, 735 A.2d 1039 (Md. 1999).

[165] *Zawikowski v. Beneficial National Bank*, 2000 U.S. Dist. LEXIS 11,535 (N.D. Ill. 2000).

[166] David Cay Johnston, *New Questions about Block's Lucrative Tax Loans*, New York Times, July 2, 2000, Section 1, at 3.

[167] *Beneficial Corporation v. Federal Trade Commission*, 542 F.2d 611 (3rd Cir. 1976) (upholding part of FTC order, but overturning in part).

[168] *See, e.g.*, National Association of Attorneys General, *Texas – H&R Block, Inc., H&R Block of South Texas, Inc., 150 Percent Interest Charges*, NAAG Consumer Protection Report, September 1993, at 28. Several of the state enforcement actions are discussed in *JTH Tax v. H&R Block*, 128 F. Supp. 2d at 938 (citing *In re: H&R Block Eastern Tax Services*, No. 93-410039 (Fla. Office Attorney Gen. Jan. 6, 1994) (assurance of voluntary compliance); *Cerullo v. H&R Block*, No. 95-409497 (N.Y. Gen. Term) (consent order); *In re H&R Block*, No. 93-198 (Conn. Comm'r Consumer Prot. July 27, 1993)).

[169] *Consumer Protection Report*, National Association of Attorneys General, September 1993, at 28.

The New York City Department of Consumer Affairs (DCA) cited H&R Block for 2,230 violations of the city's consumer protection law for misrepresenting its Rapid Refunds in April 2001. The New York agency investigated more than 100 Block offices in the city and said 86% of them failed to differentiate between refunds and loans costing up to 500% annual interest. The April 2001 action was the sixth one against H&R Block by the city for similar behavior. The DCA Commissioner stated "Effectively, H&R Block is using its Rapid Refund program as an enticement to lure consumers into signing up for a very expensive loan where consumers borrow against their own money at very high rates. When used this way, the Rapid Refund claim is a rapid rip-off."[170]

In *JTH Tax v. H&R Block Eastern Tax Services*,[171] the federal judge issued a nationwide injunction restraining H & R Block from using certain advertisements. The case was brought by a local competitor regarding the advertising of a new tax refund loan product unveiled in the 2000 tax season. H & R Block offered a RAL with no interest charges or fees, instead charging customers one price for its tax preparation service regardless of whether the customer accepted or declined the RAL. Several strings were attached, however. The taxpayer had to sign certifications including one about past bankruptcies, agree to pay collection costs and attorneys' fees if the tax refund was less than anticipated, agree to pay the lending bank the difference between the loan amount and the refund, and agree to allow banks to assist one another in collecting delinquent debts.

Although IRS rules require that RALs be advertised as "loans," H & R Block used the word "advance" in its Norfolk ads, since company research indicated that most consumers would not associate an "advance" with a loan.[172] The court rejected Block's argument that these transactions were not loans, stating that "[t]his characterization, however, neglects the other significant liabilities of a loan. Plaintiffs established that the no interest, no additional cost loan still carries obligations and conditions which refunds do not."[173] The court noted that H & R Block engaged in a pattern of consenting to one state's court order, then taking its advertisements to a new jurisdiction and continuing to run offending ads, including running offending ads a week after signing a February 17, 2000 consent order. The court's injunction forbids H & R Block from advertising any loan as a "refund," "advance, "refund amount, "a check in the amount of your refund" unless the advertisement prominently and clearly states it is a "loan" whether or not fees are charged. The order requires Block to comply with IRS rules to disclose whether any product is a loan and prohibits use of the term or mark "rapid refund" in connection with loan products, whether or not fees or interest are charged.[174]

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[170] *Investigators Find That H&R Block Violates Agreement with Department by Misrepresenting Its Rapid Refund Program—Consumer Affairs Issues More than 2,200 Violations and Over One Million Dollars in Potential Fines*, Press Release, New York City Consumer Affairs, April 5, 2001.

[171] 128 F. Supp. 2d at 938, *aff'd in part, vacated in part, and remanded in part*, 2002 U.S. App. LEXIS 477 (4th Cir. January 10, 2002) (the appellate court substantially affirmed the District Court's decision, but vacated and remanded the calculation of damages and scope of the injunction; findings of bad faith and malice upheld.)

[172] *Id.* at 935.

[173] *Id.*

[174] *Id.* at 952. The Court of Appeals later vacated that part of the injunction prohibiting Block from using the phrase "rapid refund." *JTH Tax v. H&R Block Eastern Tax Services*, 2002 U.S. App. LEXIS 477 (4th Cir. January 10, 2002).

Arbitration Clauses in Loan Documents Undermine Consumer Rights and Remedies

In the past few years, the major tax preparers and RAL lenders have added arbitration clauses to RAL loan documents.[175] These arbitration clauses prohibit consumers who have been harmed by RALs from seeking a remedy in court. They effectively prevent RAL consumers from getting any relief, especially in an organized effort such as a class action that might make a significant impact.[176]

Major policy issues with RALs and EITC

Refund anticipation loans are extremely expensive, and their interest rates would violate most state small loan or usury laws. Tax preparers partner with federally insured banks in order to claim the banks' exportation and preemption privileges to evade these consumer protections. RALs should be banned outright or the fees capped at a fair cost. The finance charge and Annual Percentage Rate for RALs should be disclosed in ads, on the walls of tax preparation centers, and on loan applications. Banks should not be permitted to charge rates that violate the law of the state where the consumer receives the proceeds of the loan.

Low income consumers should not have to pay a high price in order to receive a public benefit, such as the Earned Income Tax Credit. American taxpayers should not subsidize commercial tax preparers and their partner banks for usurious loans to pay for the assistance consumers need in order to file for the Earned Income Tax Credit. Millions of dollars in public funds are being diverted from asset development and anti-poverty benefits into the pockets of major tax preparation companies and national banks. Congress should ensure that a taxpayer who is eligible for EITC in order to maintain a baseline standard of living should not see the EITC reduced by large return processing or preparation fees.

Three separate problems need to be overcome to provide a replacement for refund anticipation loans. First, low income taxpayers need access to free help to file taxes or a ready mechanism to pay for the tax preparation when cash is not available to pay it upfront. Second, taxpayers want a fairly quick refund, in days rather than weeks. Third, in order to get the faster refund provided electronically, taxpayers need bank accounts. Unbanked taxpayers do not have accounts into which Treasury can electronically deposit tax refunds/EITC benefits. While Treasury can set up Electronic Transaction Accounts (ETAs) for consumers who receive federal payments such as Social Security, SSI, and pension checks, the ETAs are not available solely to deliver tax refunds electronically. Also, the success of the ETA has been limited, with only 11,000 consumer nationwide taking advantage of them.[177]

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[175] *Household Bank v. Allen*, 2001 U.S. Dist. LEXIS (S.D. Miss. May 25, 2001). The authors also have a copy of a RAL application with an extensive arbitration agreement. Application, Authorization and Certification for Refund Anticipation Loan, Form BTM-0221D (01/00), on file with the authors.

[176] For more information on the hazards of arbitration clauses to consumers, see National Consumer Law Center, Consumer Arbitration Agreements (2001).

[177] Margot Saunders, Testimony Before the Committee on Financial Services, Subcommittee on Oversight and Investigations, Regarding The EFT Requirements of the Debt Collection Improvements Act of 1996 and the Use of ETA, June 20, 2001, available at www.consumer.org, click on "Electronic Benefits."

Complex and changing regulations, forms, and eligibility standards for EITC guarantee that recipients need help in order to file correctly for the tax credits without running into trouble with tax audits and the IRS. While rules are necessary so that benefits go to the intended recipients and to deter fraud, the federal government should provide the assistance needed to file for the benefits. Free tax preparation programs and IRS offices are not necessarily located where low-income consumers can conveniently get help.

Reform Recommendations

- ✓ Refund anticipation loans should be banned outright or made subject to state usury and small loan interest rate laws. Tax preparation services should not be permitted to evade state consumer protections by partnering with national banks to make triple digit interest loans.

- ✓ The IRS should enforce its advertising rules for refund anticipation loans by revoking the electronic filing privileges of commercial tax preparation companies that violate them. The IRS should refer bank partners of offending tax preparers to the Office of the Comptroller of Currency or other appropriate agency for enforcement.

- ✓ All refund anticipation lenders should disclose the full cost of loans at the time consumers apply for them instead of providing Truth In Lending Act disclosures only with the check stub. The cost of electronic filing should be included in the total cost computations for RALs, and the Annual Percentage Rate should be based on a loan of 10 days.

- ✓ Many, including leaders in Congress and the IRS, have called for streamlining the application process for Earned Income Tax Credit, so that more consumers can apply without hiring commercial preparers. Unfortunately, each step toward simplification seems accompanied by more complexity. Until the goal of simplification is reached, the federal government should support and/or provide free direct assistance to help eligible consumers apply for EITC.

- ✓ Electronic Transaction Accounts should include the deposit of tax refunds and EITC benefits in account services. The First Accounts pilot projects funded by Congress to provide ETA-type electronic bank accounts to unbanked consumers who do not receive ongoing federal benefits should be targeted at working low-income consumers eligible for the EITC. Giving EITC recipients priority for First Accounts benefits both programs by preserving EITC benefits for asset development and by providing a large enough initial deposit to make savings attractive to consumers and the accounts profitable for banks.

- ✓ Congress should rethink the 2007 deadline for 80 percent electronic tax filing if the hidden cost of achieving that government efficiency goal is to saddle the lowest income citizens with high fees for commercial tax preparation and usurious loan rates.