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### **CONSUMER ADVISORY: AVOID TAX-TIME REFUND PRODUCTS**

*No More Bank Refund Anticipation Loans, But Other Financial Traps Can Drain Refunds*

**BOSTON** — The good news? For the first time in decades, millions of taxpayers will avoid having their refunds drained by refund anticipation loans (RALs), which are no longer available from banks on a large scale, nationwide basis. The bad news? Taxpayers are still at risk of needless fees from tax-time refund products, such as:

- RALs from fringe, non-bank lenders – Some payday and other high-cost lenders are offering RALs. These loans could be more expensive and riskier than bank RALs.
- Shady tax preparers offering phantom RALs – In 2012, some preparers promoted RALs, but apparently did not have the financial capacity to make them to a large number of customers. These RAL offers were allegedly bait-and-switch schemes to get customers into their offices.
- Refund anticipation checks (RACs) – RACs do not deliver refunds any faster than the IRS can, yet cost \$30 to \$35. Some preparers charge add-on fees which can range from \$25 to several hundred dollars.

“While we are glad to see the disappearance of bank RALs, consumers should avoid the other traps still out there on the market,” said Chi Chi Wu, staff attorney at the National Consumer Law Center (NCLC). “They should especially steer clear of RALs made by payday lenders, which are likely to be more expensive and riskier.”

Consumer advocates suggest that taxpayers looking for quick refund cash should consider lower-cost or free alternatives. Taxpayers with a bank account can get their tax refunds in 21 or less days with e-filing and direct deposit.<sup>1</sup> Taxpayers without a bank account can get the same three week or less refund by e-filing and having their refund deposited to a prepaid card, including any existing payroll or prepaid card that the taxpayer already has.

#### **Non-Bank RALs and Phantom RALs**

With the end of RALs made by banks, high cost non-bank lenders have stepped into the fray. Liberty Tax Service is partnering with an unnamed non-bank lender to make RALs in 30 states. Last year, Liberty partnered with SGS Credit Services, Inc., which appeared to be affiliated with payday lenders. The president of SGS Credit Services served as the treasurer for the Texas Consumer Lenders PAC at one point.

RALs made by nonbank lenders will most likely not be as widespread as bank RALs. Unlike banks, nonbank lenders do not have the legal ability to flout state laws that cap interest rates, *i.e.*, usury laws. Tax-time loans from payday lenders and other storefront outlets that offer to prepare taxes and make loans may be subject to state loan laws, usury caps, or loan broker requirements in states that have them. Seventeen states (and the District of Columbia) do not permit payday lending at all (for a complete listing of state payday lending laws, see [www.paydayloaninfo.org/state-information](http://www.paydayloaninfo.org/state-information)).

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<sup>1</sup> In previous years, taxpayers could get refunds in as little as 8 to 15 days; however, refunds will take longer this year in part due to new IRS anti-fraud measures.

Nonbank lenders may also lack the funding necessary to make RALs on a broad scale. One problem last year was “phantom” RAL lending, where less-than-scrupulous tax preparers claimed to have RALs but did not. For example, the Department of Justice’s lawsuit against one such preparer – Instant Tax Service – alleged that the chain promoted RALs to entice customers, but was so severely undercapitalized that its overall denial rate was often over 90%. Note that in order to make 100,000 RALs, a lender would need \$150 million in capital (assuming loans of \$1,500). Preparers allegedly used phantom RAL offers to lure customers into their offices, where some of them ended up paying \$400 to \$500 or more for tax preparation, RACs, and add-on fees.

### **Refund Anticipation Checks**

With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund check. After the refund is deposited, the bank issues the consumer a check or prepaid card and closes the temporary account. A RAC allows the consumer to pay for tax preparation fees out of the refund and provides the speed of direct deposit of tax refunds for unbanked taxpayers, but generally at an additional cost.

Banks generally charge about \$30 - \$35 for a RAC. While this is much less than the price of a RAL, some tax preparers also charge their own add-on fees, which can range from \$25 to several hundred dollars. Consumer advocates recommend taxpayers avoid a RAC, or at least go to a preparer that does not charge add-on fees.

Since one of their purposes is to defer payment of the tax preparation fee until the refund arrives, RACs may represent a high-cost loan of that fee. If a taxpayer pays \$30 to defer payment of a \$200 tax preparation fee for 3 weeks, the APR would be equivalent to 260%.

Prepaid cards are one alternative to allow taxpayers without a bank account to receive a faster refund. Taxpayers, however, should be cautious when selecting a prepaid card.

“As with any financial product, taxpayers should compare prepaid card costs and consumer protections,” recommends Tom Feltner, director of financial services for Consumer Federation of America. Taxpayers without a bank account should also consider opening a bank account to receive their refund. “Getting a big refund is the perfect time to open a savings account and start a nest egg,” advised Feltner.

Low-income taxpayers have a number of options for free tax preparation, including Volunteer Income Tax Assistance (VITA) (1-800-906-9887 or [www.irs.gov](http://www.irs.gov)) and AARP Tax-Aide sites ([https://locator.aarp.org/vmis/sites/tax\\_aide\\_locator.jsp](https://locator.aarp.org/vmis/sites/tax_aide_locator.jsp)). Choosing a VITA or AARP Tax-Aide site saves taxpayers the cost of the tax preparation fee. Many VITA sites also offer services to help open a bank account or get a low-cost prepaid card, which enables taxpayers to get faster refunds without paying a fee. Free tax preparation may be available on military bases, and since servicemembers are required to have bank accounts, they are able to benefit from the speed of electronic delivery of their tax refunds

There are also a number of websites that allow many taxpayers to prepare and file their taxes online for free, such as the IRS Free File program ([www.irs.gov](http://www.irs.gov)).

### **RAL History and Data for Prior Years**

RALs were bank loans secured by the taxpayer’s expected refund — loans that lasted about 7 to 14 days until the actual IRS refund repaid the loan. RALs were expensive. In 2012, the last of the RAL banks (Republic Bank) charged \$61.22 for a RAL of \$1,500, which translated into an APR of 149%.

RAL lending had dropped significantly during the last two years of their existence. In 2011, about 1 million taxpayers applied for a RAL, and National Consumer Law Center and the Consumer Federation of America estimate that 550,000 people obtained a RAL at a cost of \$33.7 million in loan fees. This contrasts with 2010, in which 6.85 million taxpayers applied for a RAL, and an estimated 5 million received them at a cost of \$338 million. At their height in 2002, about 12.7 million taxpayers obtained a RAL at a total cost of \$1.1 billion.

The dramatic drop in 2011 was because the three largest RAL lending banks were forced out or exited the market, leaving only three small state-chartered banks making RALs. This development also left industry giant H&R Block without a RAL lender.

Many RAL borrowers have now shifted to RACs. In 2011, the number of taxpayers receiving a RAC increased to an estimated 18.4 million, up from 14.6 million taxpayers in 2010 and 12.9 million in 2009.

**Upcoming Report Available in February 2013**

NCLC and CFA will publish their annual comprehensive report on tax-time financial products, regulation, and litigation in February 2013. The report will be available on NCLC's website at [www.nclc.org](http://www.nclc.org) and on CFA's website at [www.consumerfed.org](http://www.consumerfed.org).

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Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training.

The Consumer Federation of America is an association of nearly 300 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education.