



# **Picking Taxpayers' Pockets, Draining Tax Relief Dollars: Refund Anticipation Loans Still Slicing Into Low-Income Americans' Hard-Earned Tax Refunds**

## **The NCLC/CFA 2005 Refund Anticipation Loan Report**

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### **Executive Summary**

- Refund anticipation loans (RALs) are usurious short-term loans secured by the taxpayer's expected tax refund. This is the annual update from the National Consumer Law Center and Consumer Federation of America on how much RALs are costing taxpayers.
- A nationwide survey of consumers commissioned by NCLC found that 18% of them had taken out a RAL at some point. Of these consumers, a startling two-thirds did not realize a RAL is a loan. This lack of awareness persists despite consumer advocacy and some improved disclosures by tax preparers.
- Consumers paid an estimated \$1 billion in RAL fees, plus an additional \$389 million in "administrative" or "application" fees in 2003 to get quick cash for their refunds – essentially borrowing their own money at extremely high interest rates. From 2002 to 2003 RAL volume leveled off, declining slightly for the first time in several years. Consumers took out approximately 12.15 million RALs during the 2002 tax-filing season compared to 12.7 million in 2001.

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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 is a non-profit association of about 300 groups, with a combined membership of over 50 million people. CFA was founded in 1968 to advance consumers' interest through advocacy and education.

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- The effective annualized interest rate for RALs based on a 10 day loan period ranges from about 40% (for a loan of \$9,999) to over 700% (for a loan of \$200), or 70% to over 1,700% if administrative or “application” fees are included.
- Low-income consumers are mostly footing the bill for high cost RALs: According to the IRS, 79% of RAL recipients in 2003 had incomes of \$35,000 or less. HBSC/Household reported that the majority of their RAL customers have an average household income of \$17,800. Jackson Hewitt reported 73% of the company’s customers make less than \$30,000 annually. The nationwide survey found about a quarter of respondents with incomes under \$50,000 had taken out RALs, as compared to only 10% of those who made over \$75,000.
- Over half of RAL consumers are recipients of the Earned Income Tax Credit (EITC), even though EITC recipients constitute just 17% of all taxpayers. RALs siphoned off an estimated \$740 million in loan fees and administrative or application fees from low-wage workers who receive the EITC in the latest year measured. If tax preparation fees are included, the total estimate rises to \$1.57 billion paid by EITC recipients. Check cashing fees for 45% of these EITC recipients add another \$158 million, for a total estimate of \$1.73 billion spent by the working poor to get access to this government benefit distributed through the tax system.
- The nationwide survey also found racial and educational disparities in RAL usage. Twenty-eight percent (28%) of African-American and 21% of Latino taxpayers responded that they’d received RALs, compared with 17% of white consumers. RALs were used more often by consumers with a high school education (23%) or less (30%) than by college graduates (12%).
- Stored value cards are emerging as a method to deliver RALs or refunds. Some stored value cards are expensive, and are added on top of a RAL or refund anticipation check as an additional cost. Other cards may be a less expensive alternative to RALs or Refund anticipation checks, and can help unbanked consumers move toward the financial mainstream. NCLC has produced a guide entitled “Selecting a Stored Value Card: Issues for VITA Sites,” attached as Appendix A.
- One additional state (Connecticut) and one city (Seattle) enacted RAL legislation in 2004. In addition, the California Legislature passed a RAL law, but it was vetoed by Governor Schwarzenegger. In Congress, a bill banning RALS secured by the EITC was introduced in 2004. RAL bills based in part on the NCLC Model RAL Act were introduced in Arizona, Maryland, New York, Ohio, and Texas.
- This report also contains an update on consumer advocacy around RALs, RAL litigation, and government enforcement.

## I. Introduction

Refund anticipation loans (RALs) are high cost loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs usually run for a duration of about 7-14 days (the difference between when the RAL is made and when it is repaid by deposit of the taxpayer's refund), fees for these loans translate into triple digit annualized interest rates. RALs drain billions from the pockets of consumers and the U.S. Treasury. They are targeted at the working poor, especially those who receive the Earned Income Tax Credit (EITC), a refundable credit provided through the tax system and intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, with over \$38 billion provided to 21.7 million families in the last reported year.<sup>1</sup>

This report updates the NCLC/CFA annual reports on the refund anticipation loan (RAL) industry and the drain caused by RALs from EITC benefits. Those interested in background information on the industry and regulation should refer to the first NCLC/CFA RAL Report published in January 2002.<sup>2</sup>

Progress continues in the effort to combat RALs and inform consumers of their true nature and costs. One additional state and one city recently enacted legislation requiring better RAL disclosure. A bill to regulate RALs passed the legislature in California but was vetoed by the Governor. Federal legislation to ban RALs secured by the EITC has been introduced.

The grassroots advocacy group Association of Community Organizations for Reform Now (ACORN) reached an agreement with the largest tax preparation chain, H&R Block. The agreement provides for improved disclosures, a joint EITC outreach effort, and most importantly, Block will stop charging its "system administration" fee, averaging \$32, for RALs and refund anticipation checks.<sup>3</sup> This will bring down the cost of RALs and refund anticipation checks significantly for consumers. ACORN also reached an initial understanding with Jackson Hewitt, which has promised better disclosures and dropping its "application" fee in 50 markets.

The volume of RALs in 2003, the most recent year for which the IRS has data, shows a leveling off of RAL usage. In addition, Block reported that the number of RALs they brokered declined 8% in 2004, as compared to 2003.

A national survey of RAL consumers by a professional polling company indicates that many consumers remain unaware of the most basic fact about RALs: that they are loans. In the

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<sup>1</sup> IRS, *Tax Stats at a Glance*, available at [www.irs.gov/taxstats/article/0,,id=102886,00.html](http://www.irs.gov/taxstats/article/0,,id=102886,00.html).

<sup>2</sup> Chi Chi Wu, Jean Ann Fox, and Elizabeth Renuart, "Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed from the Working Poor and the U. S. Treasury," National Consumer Law Center and Consumer Federation of America, January 31, 2002, [hereinafter "NCLC/CFA 2002 RAL Report"], available at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation).

<sup>3</sup> Refund anticipation checks are the non-loan bank product that many RAL lenders and tax preparers offer in addition to RALs. With refund anticipation checks, the bank opens a temporary or "dummy" bank account into which the IRS direct deposits the refund check. After the direct deposit of the consumer's refund, the bank issues the consumer a paper check and closes the dummy account. The consumer then picks up the check from the tax preparer's office.

meantime, RALs continue to drain over a billion dollars from the pockets of American taxpayers including EITC recipients.

## II. RAL Volume Stays Flat

The latest available IRS data indicates leveling off in RAL volume. During the 2003 tax filing season, consumers took out approximately 12.15 million RALs.<sup>4</sup> In our last RAL report, we estimated approximately 12.7 million RALs were taken out in 2002, so there was a decrease of 4.3% from 2002 to 2003.<sup>5</sup> However, the percentage of taxpayers who took out RALs remained the same, about 1 in 10 taxpayers.<sup>6</sup>

In 2003, taxpayers received an average refund of \$2,057.<sup>7</sup> Based on prices stated by the leading RAL lender for that year, the average taxpayer paid about \$90 in RAL fees.<sup>8</sup> Thus, taxpayers paid somewhere in the neighborhood of \$1.09 billion in RAL fees in 2003. This compares to an estimated \$1.14 billion in RAL loan fees in 2002.<sup>9</sup>

The following chart documents the trends in RALs since the 2000 filing season:<sup>10</sup>

Filing Year	No. of RALs	Increase/decrease from prior year	RAL loan fees
2003	12.15 million	(-4)%	\$1,090,000,000
2002	12.7 million	5%	\$1,140,000,000
2001	12.1 million	12%	\$907,000,000
2000	10.8 million	--	\$810,000,000

This \$1.09 billion for 2003 would be even higher if we could include the additional fees paid for additional loan products called “Instant Money Loans” (H&R Block) or “Money Now

<sup>4</sup> The 12.15 million figure was calculated as follows: 1) IRS statistics state that there were 13.5 million tax returns which were associated with a RAL. Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2002, July 2004; 2) we assume that since IRS would not know whether a RAL was approved or denied, these statistics represent the number of RALs applied for. About 90% of RAL applications result in an approved loan. Household International, *Exploring the Refund Anticipation Loan (RAL): Questions and Answers*, on file with the authors; George Guttman, *IRS Reinstates Debt Indicator to Increase Electronic Filings*, 85 Tax Notes 1125, Nov. 29, 1999. Thus, 90% of 13.5 million is 12.15 million.

Industry sources have claimed that the IRS data includes some non-loan products, such as refund anticipation checks. However, until we have more information, we can only rely on the IRS SPEC database which is labeled “estimated RALs.” Furthermore, according to the IRS SPEC database, these numbers represent requests for the debt indicator, which would not be necessary for a non-loan product such as a refund anticipation check because there would be no need for underwriting for such products.

<sup>5</sup> Chi Chi Wu and Jean Ann Fox, *All Drain, No Gain: Refund Anticipation Loans Continue to Sap the Hard-Earned Tax Dollars of Low-Income Americans*, January 2004, at 4 [hereinafter referred to as “NCLC/CFA 2004 RAL Report.”].

<sup>6</sup> Data from IRS SPEC, Return Information Database for Tax Year 2002, July 2004.

<sup>7</sup> IRS, *Tax Stats at a Glance*, available at [www.irs.gov/taxstats/article/0,,id=102886,00.html](http://www.irs.gov/taxstats/article/0,,id=102886,00.html).

<sup>8</sup> This was the loan fee in 2003 for a RAL from \$2,001 to \$5,000 from Household. See Household’s website at [www.household.com/corp/hirl\\_express\\_refund\\_loan.jsp](http://www.household.com/corp/hirl_express_refund_loan.jsp), printout dated January 13, 2003, on file with authors.

<sup>9</sup> NCLC/CFA 2004 RAL Report at 4.

<sup>10</sup> NCLC/CFA 2004 RAL Report at 4, NCLC/CFA 2003 RAL Report at 1, NCLC/CFA 2002 RAL Report at 4.

Loans” (Jackson Hewitt). These products are same-day loans, by which consumers can receive all or part of their RALs immediately when they file their taxes. Lenders charge an additional \$20 to \$39 for same-day RALs, a fee which the consumer pays on top of regular RAL fees.<sup>11</sup> We do not have data on the number of same-day RALs taken out by consumers.

In addition to the RAL loan fee, major tax preparation firms charge additional fees for RALs, often termed “system administration,” “document preparation” or “application” fees. H&R Block will eliminate this fee as part of its agreement with ACORN.<sup>12</sup> Jackson Hewitt has agreed to drop this fee for some of its offices but has not yet stated that it will eliminate the fee<sup>13</sup>

Given that the system administration fee was not entirely dropped until this year, we will include the system administration fee for the calculations for the amounts paid in 2003 for RALS. According to Block, its system administration fee ranges from \$28 to \$59, with an average of \$32.<sup>14</sup> Using the average figure, these additional fees add about \$389 million to the amount paid in RAL fees in 2003.

### III. Price of a RAL for 2005

Based upon the prices for RALs in 2005, a consumer can expect to pay about \$100 in order to get a \$2,050 RAL from a commercial tax preparation chain this year. This loan fee includes the fee supposedly for the “dummy” bank account used to receive the consumer’s tax refund from IRS to repay the RAL. The effective APR on this RAL would be 187%.<sup>15</sup>

The fee for the RAL plus the fee for tax preparation, which average about \$120,<sup>16</sup> would total about \$220. If the consumer chooses a tax preparer that charges a “system administration” or “application” fee, in the neighborhood of \$30 per loan, the total would rise to \$250.

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<sup>11</sup> [www.hsbctaxpayerfinancialservices.com/htax/ERO/Ind?cmd\\_static=eroRefundLoan](http://www.hsbctaxpayerfinancialservices.com/htax/ERO/Ind?cmd_static=eroRefundLoan); Santa Barbara Bank & Trust, *2004 Program Newsletter for Tax Professionals*, available at the Taxwise website at [www.taxwise.com/inc/content-managed/pdf/05Update.pdf](http://www.taxwise.com/inc/content-managed/pdf/05Update.pdf).

<sup>12</sup> Association of Community Organizations for Reform Now, *ACORN Annual Report 2004*, January 5, 2005. This agreement is further discussed in Section VIII below.

<sup>13</sup> ACORN Press Release, *ACORN Suspends Jackson Hewitt Protests*, January 11, 2005 (Jackson Hewitt committing to eliminate the application/administrative fee in 50 of its markets). Note that Jackson Hewitt has about 2,700 “territories” in which it operates. Jackson Hewitt, *Final Prospectus*, June 22, 2004, at 47. We do not know whether a “market” is the equivalent of a “territory.”

<sup>14</sup> H & R Block, *America’s Tax and Financial Partner*, January 2004.

<sup>15</sup> Most tax preparers and RAL lenders have been reporting APRs lower than our estimates because they do not include the charge supposedly for the “dummy” bank account, claiming that it is comparable to the charge for the non-loan refund anticipation check product. However, this unbundling is questionable. For an analysis of why the fee for the dummy bank account should be included in the APR, see NCLC/CFA 2004 RAL Report at 5. We continue to include the charges for the dummy account fee in our estimates for the APR to present a truer picture of the real “cost of credit” for a RAL.

<sup>16</sup> According to industry leader H & R Block, its average tax preparation fee is \$121. H&R Block, *Q4 2002 H & R Block Earnings Release Conference Call*, June 12, 2002, available at 2002 WL 26337229. One media report noted that Jackson Hewitt charged a \$179 tax preparation fee in 2003. Tony Pugh, *Short-Term Tax Loan Eats Chunk of Refund*, *Charlotte Observer*, March 15, 2003. The client in *Hood v. Santa Barbara Bank & Trust* (in which NCLC is co-counsel) was charged \$155 by Jackson Hewitt for tax preparation. Documents on file with the authors.

For the 2005 filing season, we estimate that the APRs on RALs range from about 40% (for a loan of \$9,999) to over 700% (for a loan of \$200).<sup>17</sup> We also continue to report a version of the APR that includes administration or application fees, if they are charged, because those fees when charged also represent a cost of the credit for a RAL.<sup>18</sup> For loans with administrative or application fees, the fees can translate into APRs of about 70% (for a loan of \$7,000)<sup>19</sup> to over 1,700% (for a loan of \$200).

#### **IV. Impact on Low-Income Taxpayers and EITC recipients**

RALs are mostly marketed to low-income taxpayers. According to IRS data, 79% of RAL recipients in 2003 had adjusted gross incomes of \$35,000 or less. This is consistent with statistics from both Jackson Hewitt, which reports in its SEC filings that 73% of its customers make less than \$30,000 adjusted gross income,<sup>20</sup> and HBSC/Household, which reports that the majority of their RAL customers have an average household income of \$17,800.<sup>21</sup>

RALs continue to drain hundreds of millions from the Earned Income Tax Credit. IRS data shows that in 2003 nearly 57% of RAL consumers are EITC recipients, or 6.92 million families.<sup>22</sup> Yet EITC recipients made up only 17 % of individual taxpayers in 2003.<sup>23</sup> Thus, EITC recipients are vastly overrepresented among the ranks of RAL consumers. In addition, IRS data shows that 1 in 3 EITC recipients took out a RAL in 2003.<sup>24</sup>

Based on this IRS data, we estimate that about \$519 million was drained out of the EITC program in 2003 by RAL loan fees.<sup>25</sup> Tax preparation fees and administrative/application fees added another \$1.06 billion to the drain. Adding check cashing costs, the total drain was \$1.74 billion. Each of these fees undermines the effectiveness of the EITC in supporting low-wage workers. These fees transfer billions in wealth, paid out of the U.S. Treasury, from poor families to multi-million dollar corporations.

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<sup>17</sup> These APRs are based upon a 10 day loan period. The estimated time provided by the federal government to receive a refund with e-filing and direct deposit is 8 to 15 days. IRS, *IRS e-file 2005 Refund Cycle Chart*, Publication 2043, October 2004. The median time would be 11.5 days, and the loan itself takes one or two days to process. Moreover, some free tax preparation sites report that during the height of tax season in early February, refunds arrive as quickly as a few days.

<sup>18</sup> The U.S. General Accounting Office reported even higher estimates for RAL APRs of 400% and 900%. U.S. General Accounting Office, *Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS is a Challenge*, GAO-04-70, October 31, 2003, at 10, available at [www.gao.gov/cgi-bin/getrpt?GAO-04-70](http://www.gao.gov/cgi-bin/getrpt?GAO-04-70)

<sup>19</sup> We did not calculate an APR with an administrative fee for a loan of \$9,999, because Block makes those loans and it no longer charges the administrative fee.

<sup>20</sup> Jackson Hewitt, Final Prospectus, June 22, 2004, at 46.

<sup>21</sup> Household International, *2003 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 7 [hereinafter "Household 2003 Form 10-K"].

<sup>22</sup> IRS data reports that 7.83 million EITC returns were associated with a RAL in 2002. Data from IRS SPEC, Tax Year 2001 Return Information (Returns Filed in 2002), October 2003. Using the 90% approval rate, *see note 3 supra*, the number of approved RALs is 7 million.

<sup>23</sup> There were 21.7 million EITC returns in 2003. IRS, *Tax Stats at a Glance*, available at [www.irs.gov/taxstats/article/0,,id=102886,00.html](http://www.irs.gov/taxstats/article/0,,id=102886,00.html). There were 130.7 million individual tax returns in 2003. *Id.*

<sup>24</sup> Data from IRS SPEC Return Information Database for Tax Year 2002, July 2004

<sup>25</sup> Based on an average EITC refund of \$1,802. IRS SPEC, EITC Statistics at-a-Glance, available at [www.irs-eitc.info/SPEC/](http://www.irs-eitc.info/SPEC/).

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL loan fee (inc. dummy account fee)	\$75	\$519 million
Application/Admin. Fee	\$32	\$221 million
Tax preparation fee	\$120	\$830 million
<b>Total</b>	<b>\$227</b>	<b>\$1.57 billion</b>
Check cashing fee (for 45% of EITC recipients) <sup>26</sup>	\$54 <sup>27</sup>	\$168 million
<b>Total with check cashing</b>	<b>\$ 281</b>	<b>\$1.74 billion</b>

## V. Survey Results

In previous RAL reports, we discussed the fact that many taxpayers receiving RALS did not understand the product was a loan. A 1996 study from the University of Georgia revealed that almost 50% of taxpayers who had received a RAL didn't realize they were getting a loan.<sup>28</sup> A small sampling of RAL consumers in the Fall/Winter 2003 in Virginia and Arizona found that over 80% did not know the product involved a loan.<sup>29</sup>

These disturbing findings indicated that further research was necessary to determine whether consumers now have a better understanding of RALs. In December 2004, NCLC commissioned a public opinion polling firm to conduct a telephone poll of over 2,000 consumers about their experiences with RALs. The results of the survey suggest that many RAL consumers may still be unaware that RALs are loans.

Survey participants were asked whether they had ever gotten a "rapid or speedy refund," which was described as "services that allow you to get your federal income tax refund in one to three days." These services are invariably RALs since only a RAL delivers funds to consumers in one to three days.

The survey found that 18% of consumers, or over 1 in 6, have gotten a RAL at some point in their lives. Over a quarter (26%) of consumers with children get RALs, while only 13% of childless taxpayers get the loans, making families twice as likely to get RALs.

The survey also found racial disparities in RAL usage. Analyzed by race, 28% of African-American and 21% of Latino taxpayers got RALs, compared to 17% of white

<sup>26</sup> 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. Given the relationship between *commercial* tax preparers and check cashers, see NCLC/CFA 2003 RAL Report at 9, we believe this figure actually underestimates the number of EITC recipients who use check cashers. Since there were 7 million RAL consumers who received the EITC in 2002, 45% would be 3.15 million.

<sup>27</sup> The average check cashing fee for a RAL check is about 3%, or \$54 for the average EITC refund of \$1,802. See NCLC/CFA 2003 RAL Report at 12.

<sup>28</sup> Joan Koonce Lewis, et al., *Refund Anticipation Loan and the Consumer Interest: A Preliminary Investigation*, Consumer Interests Annual, Vol. 42 (1996), at 167.

<sup>29</sup> NCLC/CFA 2004 RAL Report at 12-13.

consumers. This is consistent with Brookings Institution data showing that usage of RALs is higher in African American communities than other communities. The Brookings Institution found that, even controlling for these economic and regional differences, each additional 10 percent of a ZIP code's population that is African American is associated with a 1.6 percentage-point increase in the share of EITC claimants who apply for a RAL.<sup>30</sup>

Consistent with the findings discussed in Section IV, RALs were used more frequently by lower and moderate income consumers. About one quarter of respondents with incomes under \$50,000 had taken out RALs, as compared to only 10% of those who made over \$75,000. RALs were also used more often by consumers with a high school education (23%) or less (30%) than by college graduates (12%).

Participants who answered that they had received a RAL were then asked a number of follow-up questions. The question about whether they understood the nature of RALs was "Was your rapid or speedy refund the kind that involved a loan?"<sup>31</sup> The question was phrased in this manner to avoid biasing answers, and is similar to the question used in the 1996 University of Georgia study discussed above.

Of consumers who had received a RAL, a startling 70% did not realize they had received a loan. The results indicate that despite educational efforts and supposedly better-written disclosures, consumers continue to be confused about RALs. Younger consumers (ages 18 to 24) were the least likely to know a RAL was a loan -- only 14% as compared to slightly older consumers (ages 25 to 24), 40% of whom knew a RAL was a loan.

The survey also showed that consumers are interested in saving money while getting tax refunds quickly. When survey participants who had previously gotten RALs were informed about the ability to receive their tax refund in 7 to 14 days if they filed electronically and used direct deposit, 79% of prior RAL users stated they would rather use this free method instead of getting a RAL.

The survey was conducted by Opinion Research Corporation International from December 9-13, 2004 and involved a representative sample of 2,044 adult Americans. The survey's overall margin of error is plus or minus 2 percentage points. The margin of error for questions asked only of the sample of consumers who had gotten RALs is plus or minus 6 percentage points. All of the differences cited are statistically significant at the 0.05 level.

## **VI. Tax Preparers and RAL Lenders**

Tax preparers in general play a tremendous role in the growth of RALs. The overwhelming majority of RAL recipients use commercial tax preparers. IRS data shows that nearly 20% of consumers who go to a paid preparer end up with a RAL.<sup>32</sup> Half of all EITC recipients who go to a paid preparer end up with a RAL.<sup>33</sup> As discussed below, over one-quarter

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<sup>30</sup> Unpublished data from Alan Berube, Brookings Institution.

<sup>31</sup> This is very similar to the question used in the 1996 University of Georgia study cited in note 28.

<sup>32</sup> Data from IRS SPEC Return Information Database for Tax Year 2002, July 2004

<sup>33</sup> *Id.*

of H&R Block customers, and over one-third of Jackson Hewitt customers get a RAL. Nearly 50% of Block customers and a stunning 90% of Jackson Hewitt customers get some sort of bank product.

RALs are made by banks, which allow them to charge interest rates that would otherwise exceed state usury caps. Tax preparers act as loan brokers, soliciting customers and getting them to accept RALs. Three banks dominate the RAL industry: HSBC/Household, Santa Barbara Bank & Trust, and Bank One.

We focus on the two largest commercial preparation chains, H&R Block and Jackson Hewitt. These companies had mixed results in terms of RAL growth. H&R Block did not experience any growth in its RAL business in 2003, and its RAL business declined in 2004. Jackson Hewitt's RAL business grew both in 2002 and 2003. Because 2004 corporate filings are available for some of these companies, this section also includes selected 2004 data.

### H&R Block

H&R Block is the nation's largest tax preparation chain, accounting for 12.5% of all tax returns by individuals in 2003.<sup>34</sup> For 2003, the number of RALs brokered by H&R Block appears to have stayed flat. Block reported that it facilitated 4.65 million RALs that were funded,<sup>35</sup> compared to 4.67 million in 2002.<sup>36</sup> In 2003, 28.5% of Block customers got a RAL.

For 2004, H&R Block actually experienced an 8% decline in the number of RALs they facilitated that were funded, to 4.27 million.<sup>37</sup> The company attributed this decline to having fewer customers plus less aggressive promotion of the product.<sup>38</sup> Nevertheless, a Block spokesperson stated that the company had "anticipated the refund anticipation business would decline but we didn't anticipate it would decline so much."<sup>39</sup> Block processed 16 million tax returns in 2004;<sup>40</sup> thus, 26.6% of its customers got RALs in 2004. H&R Block also facilitated 2.95 million refund anticipation checks in 2004,<sup>41</sup> thus 45% of its customers get a refund financial product.

Block earns fees from RALs several ways: 1) a per RAL "license fee";<sup>42</sup> 2) loan fees received by Block Financial Corporation, which had an arrangement to buy a 49.9%

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<sup>34</sup> Block prepared 16.3 million returns in 2003. H&R Block Inc., *2003 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, 2003 Form 10-K"]. According to the IRS, there were 130.7 million individual tax returns in 2003. IRS, *Tax Stats at a Glance*, available at [www.irs.gov/taxstats/article/0,,id=102886,00.html](http://www.irs.gov/taxstats/article/0,,id=102886,00.html).

<sup>35</sup> H&R Block, 2003 Form 10-K at 5. Block also facilitated 1.64 million refund anticipation checks in 2003. *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> H&R Block Inc., *2004 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 17. [hereinafter "H&R Block, 2004 Form 10-K"].

<sup>38</sup> See H&R Block, Year-End Conference call, June 9, 2004 (comments of Jeff Yabuki).

<sup>39</sup> Associated Press, *H&R Block Gives Tax Season Update*, Kansas City Star, April 1, 2004.

<sup>40</sup> H&R Block, 2004 Form 10-K at 17.

<sup>41</sup> H&R Block, *Answering Your Questions About Refund Anticipation Loans*, January 30, 2005.

<sup>42</sup> This fee had been \$9. H&R Block Inc., *2002 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 4. It has been changed to an undisclosed amount. H&R Block and Household

interest in RALs arranged by the tax preparation arm; and 3) an “administrative” fee, ranging from \$28 to \$59 and averaging \$32.<sup>43</sup> As a result of an agreement with ACORN, Block has agreed to eliminate this third fee.

In 2003, Block waived its right to buy this 49.9% interest in RALs, as well as its “license fee” in exchange for a flat fee per RAL.<sup>44</sup> Block received \$133 million from Household in payment for its waivers.<sup>45</sup> With the waiver no longer in effect for 2004, Block earned \$174.2 million in revenues from RALs, representing 4.1% of the company’s revenues.<sup>46</sup>

In addition to its participation interest in RALs, Block’s incentives to promote RALs include payments by Household to reimburse Block for the cost of advertising.<sup>47</sup> Block’s agreement with its bank partner, HSBC/Household, expires in 2006, which the company has sometimes cited as a reason it is required to offer RALs. However, it appears Block intends to continue offering RALs after 2006, stating that :

“We believe that the RAL program is a productive product line for the Company and a useful product for our customers. .... It is our intention to continue to offer the RAL program in the foreseeable future.

“ Loss of the RAL program could adversely affect our operating results. In addition to the loss of revenues and income directly attributable to the RAL program, the inability to offer RALs could indirectly result in the loss of retail tax clients and associated tax preparation revenues, unless we were able to take mitigating actions”<sup>48</sup>

Block has improved RAL disclosures, due in part to consumer advocacy and to its agreement with ACORN, discussed in Section VIII below. It informs clients first of the free options to receive refunds from the IRS, including the ability to receive refunds in 8-15 days with e-file and direct deposit.<sup>49</sup> It reviews a side-by-side comparison charge of all refund delivery options, and the cost of each.<sup>50</sup> If a client gets a RAL, it gives the client a “Facts About Refund Anticipation Loans” document.<sup>51</sup>

According to Block, nearly 5 million of its customers are unbanked or use banks only occasionally.<sup>52</sup> Block has formed several partnerships to provide refund delivery or check cashing services. It has a pilot in several cities offering the “Debit Plus Card,” a

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Tax Masters, *2004 Amendment to Second Amended and Restated Refund Anticipation Loan Operations Agreement*, August 20, 2004.

<sup>43</sup> H & R Block, *America’s Tax and Financial Partner*, January 2004, on file with the authors.

<sup>44</sup> H&R Block, 2003 Form 10-K at 11.

<sup>45</sup> *Id.*

<sup>46</sup> H&R Block, 2004 Form 10-K at 27.

<sup>47</sup> These payments were \$3.5 million in 2004, and will be \$4.25 million in 2005 and \$5 million in 2006. Second Amended and Restated Refund Anticipation Loan Operations Agreement, Exhibit 10.27 to H&R Block, 2003 Form 10-K.

<sup>48</sup> H&R Block, 2004 Form 10-K at 27.

<sup>49</sup> H&R Block, *American’s Tax and Financial Partner*, January 30, 2005.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> H&R Block, 2005 U.S. Tax Interactive Press Kit – Reality Check, January 2005.

stored value card that can be used as a substitute for RALs. The Debit Plus Card is discussed in more detailed in Section VII. In Los Angeles, Block launched a pilot program to provide tax services in Nix Check Cashing locations.<sup>53</sup> Nix Check Cashing has partnered with Union Bank to provide banking services through Nix's storefront locations.<sup>54</sup>

H&R Block has a cross-marketing relationship with ACE Cash Express, involving placement of self-service check cashing machines in its offices.<sup>55</sup> This year, Block has formed a partnership with 7-Eleven, whereby Block customers can cash their RAL checks up to \$7,500 at 7-Eleven check cashing kiosks in 11 states.<sup>56</sup>

In December 2003, Block had revealed that it was being investigated by the Securities and Exchange Commission over its disclosures to investors relating to RAL litigation.<sup>57</sup> This investigation appears to have spurred at least one shareholder class action alleging Block violated securities law.<sup>58</sup>

### HSBC/Household Bank

Previously, Household had established an arrangement with ITLA Capital Corporation for ITLA to originate the RALs, which Household would then buy immediately from ITLA.<sup>59</sup> In 2004, Household announced that its parent, HSBC, would use its newly minted national bank charter to originate RALs, making HSBC directly responsible for making these usurious loans.<sup>60</sup> Moreover, HSBC is now using its own name as the branding on its RAL program – the website now refers to HSBC Taxpayer Financial Services.<sup>61</sup>

In 2003, HSBC/Household originated 7.7 million RALs, a 10% increase from 2002, in which Household originated 7 million RALs.<sup>62</sup> However, HBSC/Household's RAL income was \$185.4 million, representing a 23% decrease from its record \$240 million in RAL income from 2002, and even less than its \$198.3 million in RAL income from

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<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> See NCLC/CFA 2004 RAL Report at 10; NCLC/CFA 2003 RAL Report at 9.

<sup>56</sup> Press Release, *H&R Block Clients Can Cash Their Checks in Less Than Two Minutes at 7-Eleven Stores' Vcom Kiosks*, PR Newswire, January 26, 2005.

<sup>57</sup> *H&R Block Inc.: SEC Investigation is Related to Refund-Anticipation Loans*, Business Briefs, Wall Street Journal, December 15, 2003, at A10.

<sup>58</sup> *White v. H&R Block*, 2004 WL 1698628 (S.D.N.Y. July 28, 2004) (dismissing investor class action because the statute of limitations had expired).

<sup>59</sup> NCLC/CFA 2004 RAL Report at 8.

<sup>60</sup> Jonathan D. Epstein, *HSBC Takes Over Tax Refund Loan Business Run by Household*, Buffalo News, July 8, 2004.

<sup>61</sup> See [www.hsbcdfs.com](http://www.hsbcdfs.com).

<sup>62</sup> Household International, *2003 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 7 [hereinafter "Household 2003 Form 10-K"].

2001.<sup>63</sup> HSBC/Household attributed the decrease in income to higher funding costs, “participation payments” (i.e., payments to H&R Block) and credit losses.<sup>64</sup>

The following is the HSBC/Household price structure for RALs in 2005, for both H&R Block<sup>65</sup> and in general.<sup>66</sup> At least for the general rates, there appears to be an increase of about \$5 for the loan fee for loans ranging from \$501-\$2,000, and an increase of \$10 for loans of \$2,001-\$7,000.<sup>67</sup>

**HSBC/Household 2005 RAL Fee Schedule for H&R Block**

<b>Amount of Loan</b>	<b>H&amp;R Block (est)</b>
\$200-\$500	\$29.95
\$501-1,000	\$39.95
\$1,001-\$2,000	\$69.95
\$2,001-\$3,700	\$99.95
\$3,701-\$9,999	\$109.95

**HSBC/Household 2005 RAL Fee Schedule – Independent Preparers**

<b>Amount of Loan</b>	<b>General</b>
\$200-\$500	\$34.95
\$501-1,000	\$49.95
\$1,001-\$1,500	\$69.95
\$1,501-\$2,000	\$79.95
\$2,001-\$7,000	\$114.95

It appears that H&R Block offices represent only about 50-60% of HSBC/Household’s RAL business. Block represents only 60% of the RALs made by HSBC/Household (4.65 million out of 7.7 million RALs). Block offices make up only 9,200 of the 17,300 (or 53%) outlets with which HSBC/Household does RAL business.<sup>68</sup>

Jackson Hewitt

Jackson Hewitt is the second largest tax preparation chain in the country, preparing 2.8 million returns in 2003, or 2.1% of all individual tax returns.<sup>69</sup> Its main bank partner for RALs and other tax financial products is Santa Barbara Bank and Trust (SBBT);

<sup>63</sup> Household 2003 Form 10-K at 37.

<sup>64</sup> *Id.*

<sup>65</sup> H&R Block, *Refund Anticipation Loan Pricing*, January 13, 2005, on file with the authors. Block’s fees appear to be about \$5-15 less than for other tax preparers.

<sup>66</sup> From HSBC’s website at [www.hsbctaxpayerfinancialservices.com/htax/ERO/Ind?cmd\\_static=eroExpRefLoan](http://www.hsbctaxpayerfinancialservices.com/htax/ERO/Ind?cmd_static=eroExpRefLoan). The fees include both HSBC’s stated finance charge as well as the dummy account fee.

<sup>67</sup> NCLC/CFA 2003 RAL Report at 6.

<sup>68</sup> Household 2003 Form 10-K at 7.

<sup>69</sup> Jackson Hewitt, Final Prospectus, June 22, 2004, at 47. Data from IRS SPEC, Return Information Database for Tax Year 2002, July 2004.

however, Jackson Hewitt also has a partnership with HSBC/Household, which makes about 20% of the RALs and refund anticipation checks brokered by Jackson Hewitt.<sup>70</sup>

Jackson Hewitt was formerly part of Cendant, a large multinational corporation. In June 2004, Cendant spun off Jackson Hewitt.<sup>71</sup> As a result, we have obtained a great deal of information about Jackson Hewitt's RAL and tax refund financial product business from the company's prospectus from its initial public offering.

Jackson Hewitt's prospectus reveals the startling fact that 29% of the company's revenues are derived from RALs,<sup>72</sup> a much higher percentage than its biggest competitor, H&R Block. Forty percent of the company's revenues are from tax refund products in general, such as RALs, refund anticipation checks, its "Gold Guarantee" product, and brokering "Holiday Express Loans" made by SBBT.<sup>73</sup>

Jackson Hewitt's revenue stream from RALs is also interesting because the company actually brokers about as many refund anticipation checks as RALs.<sup>74</sup> In 2003, Jackson Hewitt brokered about 975,000 RALs out of 2.4 million tax financial products.<sup>75</sup> Note that for 2003, 34.8% of Jackson Hewitt's customers got a RAL and 89.2% got some sort of tax financial product.<sup>76</sup>

Jackson Hewitt's prospectus also has information for 2004. In that year, the company prepared 3.1 million returns<sup>77</sup> and sold 2.8 million tax refund products, including 1.1 million RALs.<sup>78</sup> Thus for 2004, 90% of JH customers got some sort of financial product and 35.5% got a RAL. In addition, 32% of Jackson Hewitt customers specifically got a refund anticipation check.<sup>79</sup>

Jackson Hewitt's RAL revenues have increased dramatically over the past few years. The company earned \$60.6 million in RAL and refund anticipation check-related fees in 2004, as compared to only about \$20 million in 2001.<sup>80</sup> Until recently, Jackson Hewitt earned fees from RALs two ways: 1) a portion (up to \$14.55) of the \$25 dummy account fee charged for RALs and refund anticipation checks;<sup>81</sup> and 2) a portion of the loan fee.<sup>82</sup> This year, Jackson Hewitt has a new arrangement with SBBT, in which it will receive a

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<sup>70</sup> Jackson Hewitt, Final Prospectus, June 22, 2004, at 30.

<sup>71</sup> *Id.* at 1.

<sup>72</sup> Jackson Hewitt, Final Prospectus, June 22, 2004, at 3.

<sup>73</sup> *Id.* at 13.

<sup>74</sup> *Id.* at 51.

<sup>75</sup> *Id.* at 35-36. This represents an increase of 20.5% increase from 2002, in which Jackson Hewitt made 809,000 RALs. *Id.* at 36.

<sup>76</sup> These percentages are based on an estimate that Jackson Hewitt prepared 2.8 million returns in 2003. Press Release, *Tax Season 2003 Brings Jackson Hewitt Near 3 Million Tax Return Mark*, July 23, 2003.

<sup>77</sup> Jackson Hewitt, Final Prospectus, June 22, 2004, at 47.

<sup>78</sup> *Id.* at 35.

<sup>79</sup> *Id.* at 51.

<sup>80</sup> *Id.* at 29-30.

<sup>81</sup> *Id.* at 29. The dummy account fee is the fee allegedly charged for the deposit account used to receive the consumer's tax refund from IRS to repay a RAL.

<sup>82</sup> *Id.* at 30.

fixed fee of \$16 per RAL, instead of a portion of the loan fee, plus another \$2 per RAL if loan losses do not exceed a certain amount.<sup>83</sup> However, Jackson Hewitt's arrangement with HSBC/Household has not changed, and it receives a portion of the finance charge with that bank.<sup>84</sup>

#### Santa Barbara Bank & Trust/Pacific Capital Bancorp

Jackson Hewitt's RAL partner, Santa Barbara Bank & Trust (SBBT), a subsidiary of Pacific Capital Bancorp, originated 4.6 million RALs and refund anticipation checks in 2003.<sup>85</sup> Since its product mix is one-third RAL and two-thirds refund anticipation checks,<sup>86</sup> we estimate SBBT made 1.53 million RALs in 2003. It earned \$39.7 million in RAL fees in 2003 and \$19.8 million in refund anticipation check fees.<sup>87</sup> About 35% of the bank's pre-tax earnings come from RALs and refund anticipation checks.<sup>88</sup>

SBBT reported that its 2004 RAL and refund anticipation check volume increased to approximately 5.1 million.<sup>89</sup> The growth was primarily in refund anticipation checks, resulting in a product mix of 69% refund anticipation checks and 31% RALs.<sup>90</sup> This means that SBBT made about 1.58 million RALs in 2004. The bank earned \$42 million in RAL fees and \$21 million in refund anticipation check fees for 2004.<sup>91</sup>

The following is SBBT's price structure for RALs in 2005.<sup>92</sup>

**SBBT 2005 RAL Fee Schedule**

<b>Amount of Loan</b>	<b>Loan Fee w/o EITC</b>	<b>Loan Fee with EITC</b>
\$300- \$500	\$29	\$34
\$501-1,000	\$44	\$49
\$1,001-\$1,500	\$64	\$69
\$1,501-\$2,000	\$79	\$84
\$2,001-\$5,000	\$94	\$99

<sup>83</sup> *Id.* at 39.

<sup>84</sup> *Id.* at 30.

<sup>85</sup> Pacific Capital Bancorp, *Form 10-Q: Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended June 30, 2004*, at 71. [hereinafter "PCB June 30, 2004 Form 10-Q"]

<sup>86</sup> Pacific Capital Bancorp, *2003 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 59. [hereinafter "PCB 2003 Form 10-K"]

<sup>87</sup> PCB 2003 Form 10-K at 58.

<sup>88</sup> *Id.* at 10.

<sup>89</sup> PCB June 30, 2004 Form 10-Q at 71.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.* at 75.

<sup>92</sup> SBBT, *2004 Program Newsletter for Tax Professionals*, available at the Taxwise website at [www.taxwise.com/inc/content-managed/pdf/05Update.pdf](http://www.taxwise.com/inc/content-managed/pdf/05Update.pdf).

## Other industry players

Independent preparers have a large share of the commercial tax preparation market. Independent preparers can range from licensed professionals, such as attorneys and certified public accountants, to any person who wishes to hang a “shingle” and make money preparing taxes.<sup>93</sup> The federal government regulates return preparers only minimally,<sup>94</sup> and only two states (California and Oregon) license preparers.<sup>95</sup>

Some independent preparers have expressed a disdain for RALs, but others promote the product.<sup>96</sup> The American Institute for Certified Public Accountants, which represents primarily licensed CPAs, has urged the enactment of legislation that “restricts, or outright prohibits, the use and availability of refund anticipation loans.”<sup>97</sup>

According to IRS data, there were 71 million returns prepared by paid tax preparers in 2003.<sup>98</sup> In 2003, Block prepared 16.3 million returns,<sup>99</sup> Jackson Hewitt prepared 2.8 million returns,<sup>100</sup> and third largest chain Liberty Tax prepared about 1 million returns.<sup>101</sup> This totals less than 21 million returns. Thus, independent preparers prepared over 50 million tax returns, or about 70% of all paid preparer returns, in 2003.

There is little data as to how many RALs were sold through these independent preparers. We know that HSBC/Household has a relationship with approximately 5,600 tax preparers, most of whom we assume are independent preparers.<sup>102</sup> We also know that Block-facilitated RALs only account for 4.65 million of the 7.7 million RALs made by HSBC/Household in 2003 - although Jackson Hewitt may account for some of the non-Block RALs.

In addition to HSBC/Household and Santa Barbara Bank & Trust, there are a handful of other banks that make RALs. The largest of these banks is Bank One, which merged in 2004 with J.P. Morgan Chase. Bank One’s RAL was raised as an objection to the merger by consumer advocates and activists.<sup>103</sup> ITLA Corporation, which was

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<sup>93</sup> National Taxpayer Advocate, *FY 2003 Annual Report to Congress*, December 31, 2003, at 270. (“Anyone can prepare federal tax returns for others for a fee regardless of his or her education, training, experience, skill, or knowledge.”) The Good Government Act, H.R. 1528, would have established a licensing and certification scheme for tax preparers. See Section X for a further discussion of that legislation.

<sup>94</sup> For a summary of the federal requirements for tax preparers, see National Taxpayer Advocate, *FY 2003 Annual Report to Congress*, December 31, 2003, at 270.

<sup>95</sup> Cal. Bus. & Prof. Code §§ 22250 to 22259; Or. Rev. Stat. §§ 673.605 to 673.740.

<sup>96</sup> See, e.g., Ted Needleman, *The E-Filing Experience*, *The Practical Accountant*, October 1, 2004 at 35 (quoting independent tax preparers on their opinion of RALs).

<sup>97</sup> *AICPA Supports Preparer Registration in ‘Good Government’ Bill*, *Tax Notes Today*, 2004 TNT 136-18, July 15, 2004.

<sup>98</sup> Data from IRS SPEC, Return Information Database for Tax Year 2002, July 2004.

<sup>99</sup> H&R Block, 2003 Form 10-K, at 4.

<sup>100</sup> Press Release, *Tax Season 2003 Brings Jackson Hewitt Near 3 Million Tax Return Mark*, July 23, 2003.

<sup>101</sup> Barbara Slavin, *Rush of Donations from USA is Immediate and Immense*, *USA Today*, December 30, 2004 at A1.

<sup>102</sup> Household 2003 Form 10-K at 7.

<sup>103</sup> Russ Wiles, *Chase - Bank One Merger Review Airs Dirty Laundry*, *Arizona Republic*, June 27, 2004, at 4D.

HSBC/Household's former bank partner in RALs, earned approximately \$14.3 million from RALs in 2004 versus \$14.6 million in 2003.<sup>104</sup>

Republic First Bancorp makes loans through its First Bank of Delaware unit, which also rents its charter to payday loan companies. Republic announced plans to spin off First Bank of Delaware in late 2004.<sup>105</sup> Despite the fact that First Bank of Delaware accounted for two-thirds of Republic's profits in early 2004, one analyst applauded the move stating "it's a good idea to separate the two companies along risk lines" because RALs and payday loans have "riskier, more volatile earnings streams" and "potential acquirers wouldn't want that blemish."<sup>106</sup> RALs and payday loans were described as "two lines of business that regulators dislike, investors fear, and acquirers avoid altogether."<sup>107</sup>

### Fringe Providers

There are a handful of high cost or "fringe" financial services providers that make RALs. One example is World Acceptance Corporation, a consumer finance company that offers RALs and tax preparation services.<sup>108</sup> AMSCOT Financial, a check casher and payday lender, also offers both RALs and tax preparation.<sup>109</sup>

Another example is Jaco Oil Co., which operates gas station convenience stores. It has developed a "financial-services" center at seven of its locations that offers checking cashing, payday loans, tax preparation services, and RALs. (Yes, you can get your taxes prepared at a gas station convenience store!)<sup>110</sup>

## **VII. Next Generation of Refund Delivery Products**

Stored value cards have emerged as the next generation of tax-time financial products. They work like debit cards to make purchases and withdraw cash, but are not linked to a regular bank account. SVCs are often called "prepaid debit cards," and are sometimes branded as a type of Mastercard or VISA card. They can be used to deliver either the tax refund itself, or the proceeds of a RAL.

Stored value cards are not inherently good or bad. Done right, they can be a low-cost method of delivering tax refunds quickly, as they can deliver the speed of an e-filed/direct deposit refund for taxpayers without a bank account. Whether a stored value card is a good deal for consumers depends on the details of the card program. These programs vary widely in terms of the cost, convenience, and level of consumer protection.

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<sup>104</sup> ITLA Capital Corporation, *Form 10-Q: Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, for the Quarterly Period Ended September 30, 2004*, at 23.

<sup>105</sup> John Reosti, Spinoff Plan For 2 Risky Loan Lines, *American Banker*, November 2, 2004 at 1.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> World Acceptance Corporation, Hoover's Company Basic Records, December 15, 2004.

<sup>109</sup> [www.amscotfinancial.com/taxService/index.htm](http://www.amscotfinancial.com/taxService/index.htm).

<sup>110</sup> Alison Embry, *Money Matters: From Check Cashing to Wire Transfers, Financial Services Give Customers a One-Stop Convenience Benefit*, *Convenience Store News*, July 12, 2004 at 67.

In some cases, the stored value card is not an alternative to a RAL, but simply an additional product on top of the RAL that siphons off more fees from the taxpayer. For example, SBBT offers a “Cash Card,” which it promotes to tax preparers as a way to deliver the proceeds of a RAL or a refund anticipation check.<sup>111</sup> SBBT is encouraging tax preparers to move customers to the card by offering a \$1,000 bonus for processing 200 cards.<sup>112</sup> In addition to paying fees for both the Cash Card and a RAL or refund anticipation check, customers will pay \$3.50 per ATM withdrawal and \$2.50 per point-of-sale transaction.<sup>113</sup>

HSBC/Household is offering the “Cashwise Card” in partnership with the developers of the Taxwise tax preparation software program. HSBC/Household is promoting the card to independent tax preparers as a “new and better way [for consumers] to get their refund loans.”<sup>114</sup> Thus, it appears to be an additional product on top of a RAL when obtained through paid preparers. However, HSBC/Household has also promoted the Cashwise card as a way to provide “faster refund at a much lower cost than a refund loan,” which suggests the product is available without getting an expensive RAL or a refund anticipation check. HSBC/Household charges \$30 for the Cashwise card, plus \$1.25 for ATM withdrawal (first 5 are free), and \$3 for print statements.<sup>115</sup> In a disturbing move, the versions of Taxwise that the IRS has officially distributed to Volunteer Income Tax Assistance sites contain a promotion for the Cashwise card.<sup>116</sup> This would appear to be an inappropriate promotion of a private product, and creates the impression that IRS has endorsed or approved the Cashwise Card.

In 2004, Bank One offered a stored value card for free tax preparation programs that had no initial fee and charged \$1.50 per ATM withdrawal (with 2 free withdrawals per month), and had no point-of-sale transaction fee.<sup>117</sup> H&R Block has a pilot in several cities that offers the “Debit Plus Card,” a stored value card issued by Bank of America that can be used as a substitute for RALs. It costs \$25 initially, \$1.50 per ATM withdrawal (1 free per month), and has free point-of-sale transactions.<sup>118</sup> This card also permits the taxpayer to have tax preparation fees deducted from the refund prior to loading the funds onto the stored value card.

Consumer protections are also an issue for stored value cards. Consumer advocates, including NCLC and CFA, have urged the Federal Reserve Board to apply the protections of the Electronic Funds Transfer Act to stored value cards.<sup>119</sup>

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<sup>111</sup> SBBT, *2004 Program Newsletter for Tax Professionals*, available at the Taxwise website at [www.taxwise.com/inc/content-managed/pdf/05Update.pdf](http://www.taxwise.com/inc/content-managed/pdf/05Update.pdf).

<sup>112</sup> *Id.*

<sup>113</sup> [https://cisc.sbbtral.com/tax\\_professionals/disbursement\\_methods.asp#cashcard](https://cisc.sbbtral.com/tax_professionals/disbursement_methods.asp#cashcard).

<sup>114</sup> <http://taxwise.com/products/individual/bankproducts>.

<sup>115</sup> Email from Marcy Wenzler, Indiana Legal Services, January 26, 2005. We do not have information on POS transaction fees for the Cashwise Card.

<sup>116</sup> *Id.*

<sup>117</sup> Memorandum from Bank One to Austin Asset Building Coalition, February 9, 2004, on file with authors.

<sup>118</sup> H&R Block, *The H&R Block Debit Plus Card*, 2005, on file with the authors.

<sup>119</sup> Consumers Union, et al, Comments to the Federal Reserve Board’s Notice of Proposed Rulemaking on Regulation E, Docket No. R-1210, October 28, 2004.

In addition to offering a potentially less expensive method of getting a quick refund, stored value cards may be useful in moving unbanked consumers toward the financial mainstream, if the issuer is willing to provide additional features. Helpful additional features include offering education to clients about using an account, providing a record keeping system, offering savings accounts and individual development accounts, and providing products such as low cost money orders and foreign remittances.

NCLC has produced a guide for free tax preparation programs interested in offering a stored value card program for their clients, entitled “Selecting a Stored Value Card: Issues for VITA Sites.”<sup>120</sup>

### **VIII. National and Local Advocacy Efforts**

In August 2004, about two dozen free tax preparation programs, national advocacy groups, and grassroots organizations gathered to discuss the issue of RALs. Out of that meeting, several organizations formed ad hoc working groups to develop (1) a national agenda on RALs; (2) market research tools to learn more about why consumers get RALs; and (3) guidance on alternatives to RALs.

The first group developed “A National RAL Platform: Issues and Options.” This document contained a list of reform options for potential federal legislation, state or local regulation, and administrative actions by the IRS or Treasury Department. The goal of the National RAL Platform is to promote, facilitate and coordinate efforts to address RALs in communities nationwide. A summary of the reform options is included at the end of this report, and the full document is available at the NCLC website at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation). The second group developed a survey tool about why consumers use RALs. The work of the third group in developing guidance for free tax preparation programs on offering alternative financial products is discussed in Section IX below.

ACORN continues its efforts to oppose RALs.<sup>121</sup> State and local ACORN groups have also promoted RAL legislation based on the NCLC Model Act. On January 13, 2005, ACORN announced that it had struck an agreement with H&R Block on RALs, establishing a partnership that will include EITC outreach in 65 cities and enhanced disclosures about the costs and speed of different refund options.<sup>122</sup> Part of the settlement included Block’s agreement to drop its administrative fee for RALs and refund anticipation checks.<sup>123</sup> ACORN has also focused its advocacy efforts on Jackson Hewitt, and on January 11, 2005 announced that it was suspending protests because Jackson-Hewitt had entered into serious negotiations. ACORN announced that

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<sup>120</sup> Attached as Appendix A and available at

[www.consumerlaw.org/initiatives/refund\\_anticipation/content/BuildingBetterStoredValueCard.pdf](http://www.consumerlaw.org/initiatives/refund_anticipation/content/BuildingBetterStoredValueCard.pdf).

<sup>121</sup> ACORN Financial Justice Center, *Increasing Incomes & Reducing the Rapid Refund Rip-Off*, September 2004; ACORN Press Release, *On Tax Day ACORN Protests Jackson Hewitt and Warns of What’s to Come*, April 15, 2004; Sandra Fleishman, *Activists Target Jackson Hewitt; Tax Service’s Loans Denounced as Rip Offs*, Washington Post, December 24, 2004.

<sup>122</sup> ACORN Press Release, *H&R Block And ACORN Partner To Help Working Families Claim And Keep More Of What They’ve Earned This Tax Season*, January 13, 2005.

<sup>123</sup> *Id.*

Jackson Hewitt already agreed to eliminate the RAL application fee in 50 of its markets.<sup>124</sup> Jackson Hewitt has also agreed to improve its disclosures.<sup>125</sup>

The Children's Defense Fund has focused its attention on RALs as part of its efforts to promote the EITC and Child Tax Credit. Both the national organization and state CDF's have issued reports analyzing RAL usage.<sup>126</sup>

Several other state and local consumer organizations, some of whom are CFA members, have organized advocacy efforts regarding RALs, including advocacy for state laws regulating the loans. These organizations include the California Reinvestment Coalition,<sup>127</sup> Iowa Coalition Against Abusive Lending, New Mexico PIRG, and the Maryland Consumer Rights Coalition.

## **IX. Alternative Refund Products**

Some free tax preparation programs have explored the idea of offering tax refund financial products as a way of attracting and reaching out to potential clients. One of the ad hoc groups discussed in Section VIII developed guidance for free tax preparation on offering alternative RALs, non-loan tax financial products, and stored value cards. This guidance is available from the NCLC website at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation).

The Community Action Committee of the Lehigh Valley and Rising Tide Community Loan Fund produced a paper on their exploration into developing a low-cost alternative product.<sup>128</sup> They found that one barrier to developing an alternative RAL product could be the fact that HSBC/Household has a patent on the RAL process. In particular, HSBC/Household has patented the technique of establishing the special "dummy account" to receive direct deposit of the refund to repay the loan.<sup>129</sup> A way to avoid patent issues may be to establish a regular deposit account instead of the dummy account, which would not be temporary and could be used by low-income taxpayers to save part of their refund.

## **X. Legislation**

One state and one city passed laws regulating RALs in 2004. In addition, the California Legislature passed a RAL law, but it was vetoed by Governor Schwarzenegger. The following is a summary of these laws and the California bill:

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<sup>124</sup> ACORN Press Release, *ACORN Suspends Jackson Hewitt Protests*, January 11, 2005.

<sup>125</sup> *Id.* See also Jackson Hewitt Ushers in Tax Season 2005, January 10, 2005.

<sup>126</sup> Children's Defense Fund, *How You Can Help Working Families: Recommendations to Address Costly Tax Preparation*, available at [www.childrensdefense.org/familyincome/taxpolicy/taxpreparation.pdf](http://www.childrensdefense.org/familyincome/taxpolicy/taxpreparation.pdf); Children's Defense Fund Minnesota, *Keeping What They've Earned: Working Minnesotans and Tax Credits*, updated January 2004.

<sup>127</sup> Press Release, *California Reinvestment Coalition Advises That Consumers Beware!! Tax Refund Anticipation Loans (RALs) May Cost More Than You Think*, January 20, 2005. California Reinvestment Coalition also played a key role in consumer advocacy concerning H&R Block's application for a thrift charter. See NCLC/CFA 2004 RAL Report at 8.

<sup>128</sup> Community Action Committee of the Lehigh Valley & Rising Tide Community Loan Fund, *Refund Anticipation Lending Report*, August 2004.

<sup>129</sup> *Beneficial Franchise Co. v. Bank One, N.A.*, 2001 WL 290366 (N.D. Ill. March 22, 2001) (patent involves "'creation of a special purpose loan/deposit account to receive the electronic refund transfer...'" )

## Connecticut<sup>130</sup>

Connecticut passed a law that imposes disclosure requirements on tax preparers who facilitate RALs. It does not impose substantive limitations on RALs. The disclosures include: (1) the tax preparation fee; (2) the loan fee schedule; (3) any electronic filing fee; (4) the APR under the Truth-in-Lending Act; (5) the estimated total cost of the RAL, estimated date for receiving the RAL; (6) the availability of e-filing; (7) the estimated time for receiving a refund with e-filing and direct deposit; and (8) a statement that the consumer is responsible for repaying the RAL if the IRS does not issue the expected tax refund. There are no mandatory language or font requirements, but the disclosures must be on a separate document.

## Seattle

The Seattle City Council passed an ordinance<sup>131</sup> requiring RAL facilitators to make certain disclosures. These disclosures must be made in a separate document using mandatory language in 14 point font. The disclosures include (1) that the taxpayer has a choice in how to receive her refund; (2) the timing and availability of receiving a refund directly from the IRS without fees, disclosed before describing any bank products; (3) disclosure of refund anticipation check pricing; (4) disclosure of RAL pricing; and (5) a warning that a RAL is a loan and must be repaid even if the IRS reduces or denies the taxpayer's refund. The facilitator is also required to provide examples of RAL APRs.

If the taxpayer asks for a RAL, the facilitator must provide a notice using mandatory language in certain fonts that (1) the taxpayer need not take out a RAL to get tax preparation services; (2) the warning that the loan must be repaid; and (3) disclosure of the RAL fees, the amount the taxpayer will receive in hand, and the RAL APR. There are also mandatory disclosures for refund anticipation checks and other bank products.

The facilitator must offer disclosures in both English and Spanish, and must provide a point-by-point oral explanation. The ordinance also requires facilitators to post some of these requirements using 28 point type.

The Connecticut and Seattle laws are in addition to already-existing RAL laws in Illinois,<sup>132</sup> Minnesota,<sup>133</sup> North Carolina,<sup>134</sup> Wisconsin,<sup>135</sup> and New York City.<sup>136</sup>

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<sup>130</sup> Connecticut Gen. Stat. § 42-480 (effective October 1, 2004).

<sup>131</sup> ACORN Press Release, *Seattle Passes Anti-RAL Legislation*, September 24, 2004.

<sup>132</sup> Comp. Stat. Ann. ch. 815, § 177/1, *et seq.*

<sup>133</sup> Minn. Stat. § 270.30.

<sup>134</sup> N.C. Gen. Stat. §§ 53-245 to 53-254.

<sup>135</sup> Wis. Stat. §§ 421.301 and 422.310.

<sup>136</sup> Section 20-739 of the Administrative Code of the City of New York.

### California bill<sup>137</sup>

The California bill was the strongest bill passed by a state legislature to date. It used portions of the NCLC Model Act, although instead of a rate cap, it established a fiduciary duty on the part of tax preparers toward their customers. Unfortunately, Governor Schwarzenegger vetoed the bill stating it “establishes an additional registration program for an industry that is already regulated.” Apparently, Governor Schwarzenegger did not realize that RALs are nowhere near well regulated, as there are mainly the handful of weak requirements of IRS Publication 1345, and the disclosure requirements of the Truth in Lending Act.

The California bill would have required RAL facilitators to register, file a fee schedule, and display a fee schedule with a statement that the taxpayer has the option of e-filing without getting a RAL. It included disclosures in mandatory language using mandatory fonts. It prohibited cross-lender debt collection, misrepresentations about RALs, fraud, arranging for check cashing, and facilitating a RAL for which the fee was not the same as the fee in the facilitator’s filed fee schedule.

On the federal level, in October 2004, Senator Daniel Akaka (D-HI), along with Senators Jeff Bingaman (D-N.M.) and Dick Durbin (D-Ill.), introduced S.2947 – the Taxpayer Abuse Prevention Act, which would prohibit RALs secured by the Earned Income Tax Credit.<sup>138</sup> The bill would also eliminate the Debt Indicator Program, prohibit cross-lender RAL debt collection, and prohibit inclusion of a mandatory arbitration clause in a RAL agreement.<sup>139</sup> Representative Janice D. Schakowsky (D-Ill.) introduced a companion bill, H.R. 5340, in the House of Representatives in October 2004.

In addition, Senators Bingaman and Akaka had previously introduced S.685-the Low Income Taxpayer Protection Act of 2003. The registration provisions and RAL disclosure provisions of that bill eventually were incorporated into H.R. 1528 - the Tax Administration Good Government Act. This bill was passed in the Senate in May 2004, and the House passed a similar bill, but differences in the bill were not reconciled.<sup>140</sup>

Finally, state legislators introduced RAL bills based in part on the Model RAL Act in Arizona,<sup>141</sup> New York,<sup>142</sup> Ohio,<sup>143</sup> and Texas.<sup>144</sup> The model law is available on NCLC’s website at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation) or can be obtained by contacting NCLC at 617-542-8010. A RAL bill focusing only on disclosure was introduced in Vermont.<sup>145</sup>

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<sup>137</sup> A.B. No. 2868.

<sup>138</sup> The Taxpayer Abuse Prevention Act, S. 2947, 108th Cong. (2004).

<sup>139</sup> *Id.*

<sup>140</sup> 2004 *Tax Notes Today* 192-59, October 4, 2004.

<sup>141</sup> H.B. 2655, 46th Leg., 2nd Sess. (Ariz. 2004).

<sup>142</sup> S. 7167 and A. 10918 (N.Y. 2004).

<sup>143</sup> S.B. No. 213, 125th Gen. Assem., Reg. Sess. (Ohio 2004).

<sup>144</sup> H.B. 398 (Tex. 2005).

<sup>145</sup> S. 211

## XI. Other State and Federal Agency Activities

State, local, and federal authorities continue to focus on RALs in varying degrees. The New York City Department of Consumer Affairs (DCA) conducted inspections of several dozen tax preparers to determine whether they were complying with the New York City RAL ordinance and giving taxpayers the mandatory copy of the “Taxpayer Bill of Rights.”<sup>146</sup> DCA found that 60% of Block offices were clearly disclosing the difference between RALs and other refund products, and 100% were complying with the RAL ordinance’s advertising requirements and handing out the Taxpayer Bill or Rights.<sup>147</sup> Ten percent of Jackson Hewitt offices and 20% of independent preparers were cited for failing to hand out the Taxpayer Bill of Rights.<sup>148</sup> In addition, DCA reached an agreement with Jackson Hewitt over charges of deceptive promotion of RALs. Jackson Hewitt agreed to pay a \$125,000 fine, and nine individual Jackson Hewitt franchisees agreed to fines totaling \$18,000.<sup>149</sup>

The state Attorneys General of California and Iowa again issued advisories warning consumers in their states to avoid RALs.<sup>150</sup> In Massachusetts, the Commissioner of Banks, Commissioner of Revenue, and Director of Consumer Affairs were part of a joint February 2004 press conference organized by NCLC highlighting the dangers of RALs.<sup>151</sup>

The Mississippi Commissioner of Banking and Consumer Finance issued a consumer advisory about the high cost of RALs,<sup>152</sup> and warned tax preparers who facilitate RALs that they needed to obtain licenses under the Consumer Loan Broker Act and could only charge up to 3% of the loan as a fee.<sup>153</sup> The Commissioner also warned check cashers that brokering RALs was not covered under their ability to provide tax preparation services granted by the Mississippi check casher law, and thus check casher needed a consumer loan broker license to offer RALs.<sup>154</sup> Subsequently, the Mississippi Legislature amended the Consumer Loan Broker Act to exempt certified public accountants from the licensing requirements of the Act.<sup>155</sup> The amendments also permit loan brokers to charge a minimum of \$25 as a broker fee, and give the Commissioner enforcement power over unlicensed loan brokers.<sup>156</sup>

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<sup>146</sup> Press Release, New York City Department of Consumer Affairs, Consumer Affairs Releases Preliminary Results of Tax Preparer Enforcement and Monitoring for 2004 Season, April 5, 2004, available at [www.ci.nyc.ny.us/html/dca/pdf/pr40504.pdf](http://www.ci.nyc.ny.us/html/dca/pdf/pr40504.pdf).

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> Press Release, *Attorney General Lockyer Urges Consumers to Avoid Expensive Loans Disguised as ‘Instant’ Tax Refunds*, January 26, 2005; Iowa Attorney General Tom Miller, *Rapid Tax-Refund Loans: Costly Way to Gain Few Days on Tax Refund*, Daily Nonpareil, January 26, 2005.

<sup>151</sup> Bruce Mohl, *State Urges Low-Income Taxpayers To Avoid Refund Loans*, Boston Globe, February 5, 2004.

<sup>152</sup> Emily Wagster Pettus, *Tax-Refund Loans Can Cost Plenty*, Biloxi Sun-Herald, February 2, 2004, at 5.

<sup>153</sup> Memorandum from Commissioner John Allison re: Department Warns Mississippi Tax Preparers They May Have to Obtain a License to Provide Refund Anticipation Loans, August 19, 2003.

<sup>154</sup> Memorandum from Commissioner John Allison to All Licensed Check Cashers re: Refund Anticipation Loans, October 3, 2003.

<sup>155</sup> 2004 Miss. Laws Ch. 370.

<sup>156</sup> *Id.*

RALs sometimes become the issue of agency action because they are involved in tax fraud cases.<sup>157</sup> The Director of the IRS Criminal Investigation Division's Refund Crimes Unit noted that 80% of fraudulent e-filed returns are tied to either a RAL or other refund financial product.<sup>158</sup> He noted that e-file fraud had increased by more than 1,400 percent since 1999, and that approximately 1 in every 1,200 e-filed returns was phony, compared with a rate of about 1 in every 5,000 four years ago.<sup>159</sup> The Financial Crimes Enforcement Network (FinCEN) issued a warning to banks in August 2004 regarding RAL fraud.<sup>160</sup> FinCEN noted that while the amount of fraud had exploded in the last few years, there were only two Suspicious Activity Reports concerning RAL fraud in its database.<sup>161</sup> FinCEN noted that "To make this type of loan appealing to the public, funds are made immediately available, leaving little time for the lender to perform due diligence to prevent fraud"<sup>162</sup> As one commentator noted, the IRS has a fraud detection system, but "it may take the IRS three or more weeks to process the return, especially in the peak of the spring filing season. Meanwhile, the RAL lenders have processed the loan within a couple of days of the return being filed, the money is in the hands of the bad guys, and they can disappear without a trace,..."<sup>163</sup>

One agency that has taken only modest enforcement action concerning RALs is the Internal Revenue Service. The IRS has a handful of rules governing the marketing of RALs, contained in IRS Publication 1345.<sup>164</sup> Among other rules, IRS Publication 1345 prohibits improper or misleading RAL advertisements.<sup>165</sup> In September 2001, the IRS informed H&R Block that the use of the phrase "your money" in reference to RALs would violate this rule by misleading consumers into thinking the RAL was the taxpayer's actual refund.<sup>166</sup> However, the IRS appears not to have penalized Block in any way. In addition, the IRS does not make these types of warning letters public, so we have no way of telling whether the agency has issued subsequent warnings concern television advertisements promoting same day RALs that are termed "Money Now" or "Instant Money".

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<sup>157</sup> See, e.g., *United States v. Kissi*, 2004 WL 2903720 (S.D.N.Y. Dec. 15, 2004) (tax fraud involving RALs); *United States v. Ankamah*, 2004 WL 744487 (S.D.N.Y. Apr. 6, 2004) (same); *United States v. Ledesma*, 313 F.Supp.2d 662 (S.D. Tex 2004)(same); *United States v. Mbage*, 2003 WL 21383369 (S.D.N.Y. June 16, 2003)(same); David Harper, *Fifth Relative is Sentenced in Tax Fraud*, Tulsa World, August 10, 2004, at A14; Associated Press, *Coast Woman Accused of Faking Tax Filings For Larger Returns*, Sun Herald, Mar. 3, 2004. Other examples of tax fraud cases involving RALs are on the Department of Justice's website at various pages, [www.usdoj.gov](http://www.usdoj.gov) (search "refund anticipation loan").

<sup>158</sup> Allen Kenney, *IRS Official Shines Spotlight on E-Filing Fraud*, Tax Notes Today, 2004 TNT 130-4, July 6, 2004.

<sup>159</sup> *Id.* Note that the IRS reinstated the Debt Indicator in 1999, which the IRS dropped in 1995 due to the role of RALs in tax fraud. See NCLC/CFA 2002 RAL Report at 20.

<sup>160</sup> FinCEN, the SAR Activity Review, Issue 7, August 2004, at 15.

<sup>161</sup> *Id.* at 17.

<sup>162</sup> *Id.* at 17.

<sup>163</sup> Gail Perry, *Electronic Filing Fraud: Latest Tax Scam's Got Legs*, Accounting Today, August 9, 2004, at 3.

<sup>164</sup> Publication 1345 was revised in November 2004. While the rules regarding RALs were re-organized, the only substantive changes appear to be: (1) the RAL rules now also cover non-loan tax financial products, such as a REFUND ANTICIPATION CHECK; and (2) an additional requirement that the preparer must disclose all fees to be deducted from the refund, and the cash in hand that the taxpayer will receive. A summary of the RAL rules in IRS Publication 1345 is discussed in the NCLC/CFA 2002 RAL Report at 17-18.

<sup>165</sup> IRS Publication 1345 at 45.

<sup>166</sup> Letter from Director Jo Ann N. Blank, IRS Individual Electronic Filing Division, to H&R Block Tax Services, September 30, 2001.

## **XII. Update on Court Cases**

RAL litigation continues to be active, despite the fact, as we discussed in prior reports, the major RAL lenders have included mandatory arbitration clauses in their loan documents to insulate themselves and their tax preparation partners from liability.<sup>167</sup> H&R Block had stated its belief that the inclusion of arbitration clauses had “taken away” the issue of RAL litigation.<sup>168</sup> However, a couple of cases have been able to defeat these mandatory arbitration clauses, based on the fact that RAL Agreements are “adhesion” contracts in which the arbitration provisions are very one-sided in favor of the lender and preparer. In contrast, the federal Court of Appeals for the Seventh Circuit upheld the arbitration clauses, finding that one-sided form agreements are acceptable because they promote efficiency.

### Carnegie v. Household International

This was the global settlement for \$25 million that abruptly snuffed out a number of class action proceedings brought against Block and Household.<sup>169</sup> In April 2002, the federal Court of Appeals for the Seventh Circuit overturned the approval of the settlement and sent the case back to a different judge,<sup>170</sup> who rejected the settlement and fired the attorneys for the class.<sup>171</sup>

In March 2004, the court dismissed many of the claims in the case, but permitted the case to go forward under the Racketeer Influenced and Corrupt Organizations (RICO) Act and, with respect to Household, breach of contract.<sup>172</sup> She also certified the class, a decision which the Seventh Circuit upheld on the basis that the defendants had urged the district court to accept the same class for the purposes of the controversial \$25 million settlement earlier.<sup>173</sup> The Seventh Circuit stated “having reaped a benefit from their pertinacious defense of the class treatment of the case for purposes of settlement they cannot now be permitted to seek a further benefit from reversing their position.”<sup>174</sup>

### Carbajal v. H&R Block Tax Services<sup>175</sup>

This was one of the lawsuits against RAL lenders and tax preparers over the practice of cross-lender debt collection.<sup>176</sup> *Carbajal* involved claims against Household, H&R

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<sup>167</sup> NCLC/CFA 2004 RAL Report at 17-18; NCLC/CFA 2002 RAL Report at 27.

<sup>168</sup> H & R Block, *Conference Call Responding to Texas Judge Ruling*, November 7, 2002, available at 2002 WL 100547400 (statement of Block CEO Mark Ernst).

<sup>169</sup> *Zawikowski v. Beneficial Nat'l Bank*, 2000 U.S. Dist. LEXIS 11,535 (N.D. Ill. 2000). This settlement and the controversy surrounding it are discussed in the NCLC/CFA 2002 RAL Report at 25.

<sup>170</sup> *Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277 (7<sup>th</sup> Cir. 2002). The Seventh Circuit decision is discussed in the NCLC/CFA 2003 RAL Report at 15.

<sup>171</sup> *Reynolds v. Beneficial Nat'l Bank*, 260 F.Supp.2d 680 (N.D. Ill. 2003). This decision is discussed in the NCLC/CFA 2004 RAL Report at 17.

<sup>172</sup> *Carnegie v. Household International*, 220 F.R.D. 542 (N.D. Ill. 2004).

<sup>173</sup> *Carnegie v. Household International*, 376 F.3d 656 7<sup>th</sup> Cir. 2004), *cert. denied*, -- S. Ct. --, 73 USLW 3394 (2005).

<sup>174</sup> *Id.* at 660.

<sup>175</sup> 372 F.3d 903 (7<sup>th</sup> Cir. 2004).

Block, and other RAL lenders for violation of the federal Fair Debt Collection Practices Act, the Equal Credit Opportunity Act, and Illinois consumer protection laws. The Seventh Circuit in this case affirmed the trial court's order sending the case to mandatory arbitration.<sup>177</sup>

In doing so, the Seventh Circuit rationalized that the “take-it-or leave” nature of the RAL agreement was acceptable because few consumer contracts are negotiated.<sup>178</sup> In other words, the Court believed because all consumer contracts feature one-sided bargaining power on the part of the lender, it's acceptable that this particular one-sided contract was so consumer-unfriendly. The Seventh Circuit also apparently failed to consider the fact that RAL agreements are often signed in an environment that not only precludes negotiation, but the opportunity to read or understand the agreement itself.<sup>179</sup>

The Seventh Circuit also made some astounding assumptions about the RAL business, stating its belief that one-sided form contracts are beneficial because “[f]orms reduce transaction costs and benefit consumers because, in competition, reductions in the cost of doing business show up as lower prices (here, a slightly lower rate of interest on the loan).”<sup>180</sup> The Court apparently has not seen the astronomical prices of RALs, nor read its own prior opinions discussing the predatory nature of RALs.<sup>181</sup> The Court also apparently has not noticed there is little competition or “shopping around” for RAL prices, which differ between the handful of RAL lenders by only a few dollars.

#### McNulty v. H&R Block<sup>182</sup>

This case was technically not a lawsuit over RAL practices. Instead, it challenged H&R Block's imposition of the “e-filing fee” in Pennsylvania. However, Block had attempted to compel arbitration in this case on the basis of the arbitration clause in the RAL Agreement. In stark contrast to the Seventh Circuit in Carbajal, the Pennsylvania Supreme Court denied the motion to compel arbitration in part on the basis that the arbitration clause in the RAL Agreement was unconscionable towards consumers. The Pennsylvania court noted that the RAL Agreement is a contract of ‘adhesion’, and that

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<sup>176</sup> The practice of cross-lender debt collection is discussed in the initial NCLC/CFA 2002 RAL Report at 24. These cases are discussed in more detail in the NCLC/CFA 2004 RAL Report at 19-20.

<sup>177</sup> *Carbajal v. H&R Block Tax Services*, 372 F.3d 903 (7th Cir. 2004).

<sup>178</sup> *Id.* at 906.

<sup>179</sup> For example, the client in one RAL case describes how she was handed a stack of documents and instructed to sign and initial them, without an opportunity to read them. *See* Complaint, *Hood v. Santa Barbara Bank & Trust*, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara March 18, 2003), available at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation). *See also*, Dateline NBC, Transcript, *Diminishing Returns; Hidden Camera Investigation Of Tax Preparation Offices And Their Hidden Fees*, April 9, 2004 (describing an application process for a REFUND ANTICIPATION CHECK in which there is “a flash of paperwork” and “a lot of fine print,” but the customer is “only shown signature pages--a lot of them.”).

<sup>180</sup> *Carbajal v. H&R Block Tax Services*, 372 F.3d at 906.

<sup>181</sup> *Kleven v. Household Bank*, 334 F.3d 638,640 (7th Cir.), *cert. denied*, 540 U.S. 1073 (2003) (“The bargain struck [for a RAL] is a good one for only one of the two parties. Guess which one?” “an attack on RALs based on fairness and equity would certainly have some appeal.”)

<sup>182</sup> 843 A.2d 1267 (Pa. 2004).

the arbitration provision unreasonably favors Block, in that it required the consumer to pay a \$50 fee that exceeded the \$37 e-filing fee at issue in the case.

### Credit Services Organization Act cases

A number of states have credit services organization laws that regulate both credit repair organizations and “any person or organization who assists or offers to assist consumers in obtaining an extension of credit,” i.e., loan brokers.<sup>183</sup> Since tax preparers who offer to arrange RALs are loan brokers, they should be covered by these state credit services organization laws.<sup>184</sup> These laws typically require registration, bonding, certain disclosures, and a right to cancel. They also usually prohibit deception and restrict advance payments. In addition, some of these laws provide that any contract for services which does not comply with the statutes’ requirements shall be treated as void.

There have been at least two cases filed against H&R Block alleging violation of state credit services organization laws. The first case, Firtion v. H&R Block,<sup>185</sup> was a small claim case in Ohio that settled. The second case, Cummins v. H&R Block, is a class action brought in West Virginia.<sup>186</sup> In December 2004, the plaintiffs overcame a significant hurdle in this case by obtaining certification of a class of all H&R Block customers in West Virginia who had gotten a RAL from January 1, 1994 through the present.<sup>187</sup> This case also survived a motion to compel arbitration, with the West Virginia court holding that the arbitration provision in the Household RAL Agreement was one-sided, unconscionable, and would unconscionably impair the rights of consumers under West Virginia law.<sup>188</sup>

### Hood v. Santa Barbara Bank & Trust

Hood v. SBBT<sup>189</sup> is a class action challenging cross-lender debt collection under California’s debt collection and unfair trade practices laws. NCLC is co-counsel for the putative class in this case. Hood v. SBBT survived an initial motion to dismiss in 2004.<sup>190</sup>

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<sup>183</sup> A full explanation of these laws and their remedies is discussed in NCLC, Fair Credit Reporting, § 15.3 (5th ed. 2002 and Supp.).

<sup>184</sup> For a more detailed discussion of this theory, see NCLC Reports – Consumer Credit and Usury Edition (January/February 2002). At least one state has exempted tax preparers from the scope of their credit services organization act. See, e.g., Okla. Stat. tit. 24, § 132.

<sup>185</sup> Complaint, Firtion v. H&R Block (Cleveland Municipal Court – Small Claims Division), on filed with the authors.

<sup>186</sup> Complaint, Cummins v. H&R Block, Civil Action No. 03-C-134 (Circuit Court of Kanawha County July 29, 2003).

<sup>187</sup> Order Granting Plaintiffs’ Motion for Class Certification, Cummins v. H&R Block, Civil Action No. 03-C-134 (Circuit Court of Kanawha County December 30, 2004).

<sup>188</sup> Order Denying Defendants’ Motion to Compel Arbitration, Cummins v. H&R Block, Civil Action No. 03-C-134 (Circuit Court of Kanawha County June 1, 2004).

<sup>189</sup> See Complaint, Hood v. Santa Barbara Bank & Trust, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara March 18, 2003), available at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation).

<sup>190</sup> Decision and Order on Defendants’ Demurrer and Motion to Strike, Hood v. Santa Barbara Bank & Trust, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara September 2004).

## Basile v. H&R Block

The plaintiffs in this Pennsylvania case had previously scored a victory when the Pennsylvania Superior Court concluded that Block owed its customers a fiduciary duty arising from a confidential relationship.<sup>191</sup> However, in December 2004, the same court upheld an order decertifying the class, effectively ending the viability of the case.<sup>192</sup>

## **XII. Reforms**

The following is a summary of the reform options contained in the National RAL Platform: Issues and Options, discussed in Section VII and available at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation). The National RAL Platform was developed by a workgroup that included the following members: Jordan Ash, ACORN; Amy Brown, Consultant, Annie E. Casey Foundation; Deborah Cutler-Ortiz, Children's Defense Fund; Jean Ann Fox, Consumer Federation of America; Sarah Ludwig, Neighborhood Economic Development Advocacy Project; David Marzahl, Center for Economic Progress; and Chi Chi Wu, National Consumer Law Center. Please note that this list does not include all conceivable options, and workgroup members did not necessarily endorse all options equally.

### *A. Options for Federal Legislation*

1. Ban RALs.
2. Ban RALs that are secured by EITC refunds.
3. Cap RAL fees.
4. Establish a licensing scheme for tax preparers and/or facilitators.
5. Prohibit or regulate abusive features of RALs, including:
  - a. debt collection by set-off of a tax refund.
  - b. mandatory arbitration clauses.
6. Modify IRS administrative goals re: reaching the 80% e-file rate.
7. Require better disclosures on RALs, including:
  - a. mandatory warning language and text size
  - b. wall postings
  - c. amend the Truth in Lending Act to prohibit unbundling of fees, so that the disclosed APR reflects the true costs of getting a RAL.
8. Dramatically simplify tax code for low-income filers.
9. Fund "banking the unbanked" programs.

### *B. Options for State or Local Regulation*

1. Cap RAL fees by regulating facilitators.
2. Impose a duty on return preparers to act in the best financial interests of their customers.
3. Establish a registration scheme for RAL facilitators.
4. Require better disclosures on RALs, including:

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<sup>191</sup> Basile v. H&R Block, 777 A.2d 95 (Pa. Super. Ct. 2001)

<sup>192</sup> Basile v. H&R Block, --- A.2d ---, 2004 WL 2785841 (Pa. Super. Ct. Dec. 6, 2004).

- a. mandatory warning language.
  - b. wall postings.
  - c. require disclosure of special “RAL interest rate” that includes all RAL fees.
5. Regulate advertising of RALs.
6. Prohibit or regulate abusive features of RALs, including:
  - a. debt collection by set-off of a tax refund.
  - b. certain aspects of mandatory arbitration clauses.
  - c. referrals to check cashers or permitting check cashing on the premises.
7. Regulate check cashing fees for RALs and refund checks.
8. No RALs based on state tax refunds.

*C. Options for Treasury/IRS Administrative Action*

1. Speed IRS refund turnaround time to 48–72 hours.
2. Eliminate the debt indicator program.
3. Improve and expand the Advance EIC.
4. Prohibit RALs from being made through the Free File program.
5. Amend IRS privacy regulations to strengthen protections against use of taxpayer information to cross-market financial products.
6. The Federal Reserve Board should apply the consumer protections of the Electronic Funds Transfer Act to stored value card products that receive tax refund or RAL proceeds.

## Appendix A

### *Selecting a Stored Value Cards: Issues for VITA sites*

Chi Chi Wu, National Consumer Law Center

November 2004

If you want to help your clients avoid RALs, check cashers, and other high priced refund products, a stored value card may be one option. A stored value card can deliver the speed of an e-filed/direct deposit refund for taxpayers without a bank account. A stored value card works like a debit card to make purchases and withdraw cash, but is not linked to a regular bank account. Stored value cards are often called “prepaid debit cards” and branded as a type of Mastercard or VISA cards.

Whether a stored value card will work well for your clients depends on the details of the card program. These programs vary widely in terms of the cost, convenience, and level of consumer protection. Here are some important issues to consider when selecting a stored value card program.

#### **1. Financial Soundness**

Don't use a stored value card unless you know the provider is financially sound. Some cards are issued by banks. Other card issuers are non-banks. If you select a stored card company that goes out of business, your clients could lose the money that is still on their stored value cards.

- *See if you can get a bank to offer a stored value card in conjunction with your program.* Not only might a bank be more willing to partner with your program as a community service, a stored value card through a bank may be safer for your clients.
- *Ask the bank to set up the program with FDIC insurance.* This avoids the risk that your clients could lose some of their money if the card issuer goes out of business.

#### **2. Consumer Protections**

It is not clear whether stored value cards that are not tied to an individual account give consumers the same protections that apply to bank debit cards. These protections, which are part of the federal Electronic Funds Transfer Act, are important to protect the client's tax refund monies. They include:

- a. The right to get funds “recredited,” that is, returned to the account, within 10 business days after a theft or error, unless the bank can show within that time frame that there was no theft or error.
  - b. Restricting the amount of loss when the card is stolen to \$50 if the loss is reported within two business days after discovery, or to \$500 if the loss is reported within 60 days after the bank statement with the unauthorized transaction on it.
  - c. The right to a periodic statement.
- *Ask the issuer to provide consumer protection equal to bank debit cards.* Unless and until the application of these protections is clarified by federal regulators, VITA programs should either ensure that separate accounts be set up for each client who uses a stored value card, or should ask the issuer to provide all the consumer protections of the Electronic Funds Transfer Act.

- *Don't rely solely on the VISA and MasterCard "zero liability" policies. The "zero liability" policies aren't the same as the Electronic Funds Transfer Act. These policies are voluntary, and don't cover the all of the circumstances where federal law provides protection. For example, MasterCard's policy does not apply if there are two or more instances of theft or unauthorized use of a card in one year. Visa's policy does not apply if the card is used "outside the VISA system," i.e., when the card is used at an ATM or in some debit card transactions where the consumer uses a PIN instead of signing a receipt.*

### 3. **Fee Structure.**

You do not want too many or too high fees – otherwise clients will not be saving money over a RAL or refund anticipation check product.

- *Ask for a fee structure that is as favorable as the one for a bank account with a debit card.*
- *Make sure the fee structure is set in writing and cannot be changed for at least a year.*
- *Look for a stored value card with:*
  - \* no fee or less than a \$5 fee to open or "activate" the account.
  - \* no monthly fee or a low monthly fee of \$3 or less per month.
  - \* no fee for an account statement.
  - \* no fee for transactions at the bank's own ATMs, or at least 2 free transactions and ATM fees of \$1 or less after that.
  - \* no fee for point-of-sale transactions (when the client uses the card at a store like a debit card).
  - \* no inactivity fee.
  - \* no fee or a fee less than \$5 to replace the card.
  - \* at least one way to check balances and account activity for free.
  - \* no fee to speak with customer service, or at least no fee to use an automated phone system.
  - \* if the card can be reloaded, i.e., more funds added to the card, no fees to reload the card.
  - \* no fee to get the funds out and or close the account.

Note that the above fee structure represents a best-case scenario for the consumer, but it may not be possible to find a card that meets all of these criteria. Do your best to find a card that meets as many of them as possible.

### 4. **ATM Access**

The number and location of ATMs where the card can be used without an ATM surcharge also will affect the cost of the card. This surcharge is a fee charged by the ATM's owner, and is in addition to the bank's own ATM fee – so in some cases, a consumer will be assessed 2 fees at an ATM.

- *Ask for a list of ATMs that will be available without an ATM surcharge.*

### 5. **Promotional Materials**

- Be sure that the promotional material that the taxpayers receive from the card issuer includes the fee schedule, so that they can see all the fees before they decide whether to agree to a card.

## 6. Overdraft Policy

You do not want a stored value card if the card issuer permits intentional overdrafts, i.e., overdrafts when the issuer's computer records show that a transaction will overdraw an account. All cards have the risk of accidental overdraft, but allowing intentional overdrafts is a form of payday lending. Intentional overdrafts are a very expensive way to borrow money. They can create a debt treadmill that is very hard to escape.

- *Ask the card issuer to design the card program to prohibit intentional overdrafts and minimize accidental ones.*
- *Look for the lowest overdraft fee, under \$20 if possible. Some cards have overdraft fees of up to \$35.*

## 7. Language Access

- *Ask the card issuer what languages customer service will be provided in. Will taxpayers be able to receive all card information, and telephone customer service, in a primary language other than English?*
- *If the card issuer offers promotional material about the card in languages other than English, be sure that the issuer gives taxpayers all of the information in that language. Most importantly, the fee schedules and cardholder agreement should be in any language that promotional materials are in.*
- *If many of your clients have a primary language other than English, find a card issuer that offers telephone customer service in that language.*

## 8. Moving Clients to the Mainstream

There are ways to make a stored value card a first step toward improved financial stability for low-income taxpayers. Ask the bank if it is willing to help in these additional ways:

- *Provide education to clients about the use of the stored value card. Topics should include how to keep track of transactions, the difference between online and offline transactions, and how to avoid overdrafts.*
- *Provide a record keeping system for clients. This may help clients become accustomed to using and reconciling a bank account.*
- *Offer checking accounts and checking-type accounts with debit cards plus low-cost money orders in addition to stored value cards. This may help unbanked taxpayers to move into the traditional banking system.*
- *Offer savings accounts or individual development accounts (IDAs) to unbanked taxpayers.*
- *Waive barriers to opening checking or savings account. In particular, ask the bank to waive a listing in ChexSystems or a similar service for prior problems with a checking account, for all clients who successfully manage a stored value card for one year.*
- *Offer low cost ways to send foreign remittances, i.e., money out of the U.S., using the stored value card.*
- *Offer low cost money orders or other ways to pay bills with the funds on the stored value card. Many landlords do not accept debit card payments.*

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