



Consumer Federation of America



For Immediate Release
January 16, 2007

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DOWN, BUT NOT GONE: QUICK TAX REFUND LOANS CONTINUE TO GOUGE TAXPAYERS

*Number of Refund Anticipation Loans Declined in 2005; Nearly 10 Million Still
Sold To American Taxpayers in 2005*

BOSTON – Some of America’s most cash-strapped taxpayers – those from low- and moderate-income families – spent nearly \$1 billion in the latest year recorded for what is almost always an unnecessary product: the so-called “refund anticipation loan” at income tax time.

With another tax season gearing up, consumer advocates at the National Consumer Law Center (NCLC) and Consumer Federation of America (CFA) are warning taxpayers to steer clear of refund anticipation loans (RALs), one of the most avoidable tax-time expenses. New figures reveal that RALs drained about \$960 million in loan fees, plus over \$100 million in other fees, from the wallets of nearly 9.6 million American taxpayers in 2005.

“Taxpayers can save themselves over a billion dollars by just saying ‘no’ to quick tax refund loans,” says NCLC staff attorney Chi Chi Wu. “These loans take a chunk out of your hard earned tax refund, and they expose you to the risk of unmanageable debt if your refund doesn’t arrive as expected.”

RALs Examined

RALs are extremely high-cost bank loans secured by the taxpayer’s expected refund -- loans that last about 7-14 days until the actual IRS refund repays the loan. That’s the first indicator of just how unnecessary most RALs are: Most taxpayers could have their refund in two weeks or less even without the costly loan.

“Taxpayers who want quick refunds can get them in two weeks or less by using electronic filing and having refunds directly deposited into their own bank accounts,” says Jean Ann Fox, director of consumer protection for CFA, “That’s a quick refund, and it’s also free.”

RALs cost from about \$30 to over \$125 in loan fees. Some tax preparers also charge a separate fee, often called an “application” or “document preparation” fee, of about \$40. The effective annual interest rate (APR) for a RAL can range from about 40% to over 500%. If application

fees are charged and included in the calculation, the effective APRs range from about 57% to over 1,100%.

Consumer use of RALs dipped significantly in 2005, but remain at disturbingly high levels. Using the most recent data available from the IRS, NCLC and CFA calculate that approximately 9.6 million taxpayers received RALs in the 2005 tax filing season (for tax year 2004). For that year alone, about 1 in 13 tax returns involved a RAL. Although high, these 9.6 million RALs represent a significant decline from the 12.4 million RALs reported for 2004 (for tax year 2003). The reasons for this decline are not certain, but may include increased public scrutiny around RALs, better consumer awareness, and improved data reporting requirements by IRS.

This year, a RAL for an average refund of around \$2,500 will cost about \$100 at some tax preparers, translating into an effective APR of 150%. However, H&R Block has lowered the fee for RALs in that range by 40%, to \$60. Block has reported that these RALs bear an APR of 36%; however, that figure does not include the fee for the temporary “refund account” in its calculation, which if included about doubles the APR.

A RAL loan fee is in addition to tax preparation fees averaging \$150 and, in some cases, an application fee of about \$40. H&R Block does not charge an application fee, but some other franchise offices of commercial chains, as well as independent tax preparers, may charge a fee. A RAL for \$2,500 will bear an effective APR of about 200%, based on \$100 RAL loan fee and \$40 application fee.

Tax preparers and their bank partners also offer an “instant” same day RAL for an additional fee, from \$20 to \$55. In addition, the industry has been pitching “holiday” and “pay stub” RALs, which are made prior to the tax filing season, before taxpayers receive their IRS Form W-2s and can file their returns. Pay stub RALs are made in January using the year-end pay stub information, while holiday RALs are made by tax preparers during November and December. The National Consumer Law Center and Consumer Federation issued a report in November 2006 on these products, available at www.consumerlaw.org/action_agenda/refund_anticipation/content/PaystubRALsReport.pdf.

Better Alternatives to RALs

Taxpayers tempted by RALs should considered cheaper and better alternatives. For example, both the Volunteer Income Tax Assistance (VITA) program and AARP’s TaxAide offer free tax preparation for low-income taxpayers. The IRS Free File program is available for taxpayers who earn \$52,000 or less, and RALs are no longer marketed through that program. (www.irs.gov)

Some of the free tax preparation programs can also help taxpayers open bank accounts, which allow them to take advantage of the speed of a direct-deposited refund using electronic filing. This year the IRS is allowing taxpayers to electronically deposit their tax refunds in up to three accounts with Form 8888. Refunds can be split by depositing into both checking and savings accounts. H&R Block has unveiled a new electronic debit-card based bank account in which customers can direct deposit refunds, a less expensive option than a RAL.

Risks of RALs

In addition to their high costs, RALs can be a risky proposition. A RAL must be repaid even if the taxpayer's refund is denied, is smaller than expected, or frozen (something that the National Taxpayer Advocate has noted happens to hundreds of thousands of taxpayers, particularly Earned Income Tax Credit recipients). If the taxpayer cannot pay back the RAL, the lender may send the account to a debt collector. The unpaid RAL will also show up as a black mark on the taxpayer's credit record. If the taxpayer applies for a RAL or other refund financial product from a commercial preparer next year, she may find that her next year's refund gets grabbed to repay this year's unpaid RAL debt. The California Attorney General's Office recently reached a settlement that required Jackson Hewitt to reform its procedures surrounding this form of debt collection, as well as with respect to other practices, and to pay \$4 million in consumer refunds and \$1 million in penalties and costs. (Information about the California Attorney General's case is available at <http://ag.ca.gov/>).

Information from tax returns will be shared with the lending bank when consumers apply for refund anticipation loans. As long as a taxpayer signs the right form, IRS rules permit tax return information to be shared with a third party. The IRS held public hearings in April 2006 on proposed changes to its privacy rules but has not issued new rules for this tax season.

"Tax returns are a financial data goldmine for marketers," said Jean Ann Fox, director of consumer protection for Consumer Federation of America. "Look closely at every form that requires your signature to stop tax preparers from using your information for purposes other than filing the tax return."

Upcoming Report

NCLC and CFA will be publishing their annual comprehensive report on the RAL industry, regulation, and litigation later this month. The report will be available on NCLC's website at www.consumerlaw.org or on CFA's website at www.consumerfed.org

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NCLC 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 organizations, who represent low-income and elderly individuals on consumer issues.

CFA is a nonprofit association of some 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.