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END IN SIGHT FOR QUICKIE TAX LOANS

Latest NCLC/CFA Report Documents Twilight of the Refund Anticipation Loan

BOSTON – As tax season goes in full swing, this may be the last year in which tax preparers and their partner banks are able to skim hundreds of millions of dollars from tax refunds by selling refund anticipation loans (RALs). The National Consumer Law Center (NCLC) and Consumer Federation of America (CFA) issued their annual report today on the RAL industry, entitled "End of the Rapid Rip-Off: An Epilogue for Quickie Tax Loans," available at www.nclc.org/images/pdf/high_cost_small_loans/ral/report-ral-2011.pdf.

The NCLC/CFA report documents how regulatory actions by the IRS and banking regulators may potentially spell the end of RALs. The report also takes a look-back at RAL lending in prior years, finding that the loans drained the refunds of about 7.2 million American taxpayers in 2009, costing them in the neighborhood of $606 million in loan fees, plus over $58 million in other fees. In addition, another 12.9 million taxpayers spent $387 million on related financial products to receive their refunds.

"We will be glad to see the last of these high-cost, high-risk loans," declared Chi Chi Wu, NCLC Staff Attorney. "It's not a moment too soon to stop multi-million dollar corporations from skimming off the tax refunds of hard-working families."

Background on RALs

RALs are bank loans secured by the taxpayer's expected refund -- loans that last about 7 to 14 days until the actual IRS refund repays the loan. Using the most recent data available from the IRS, NCLC and CFA calculate that about 7.2 million taxpayers received RALs in the 2009 tax filing season (for tax year 2008). This represented a 14% drop from the 8.4 million taxpayers who took out a RAL in the 2008 filing season.

RALs are mostly marketed to low-income taxpayers, including recipients of the Earned Income Tax Credit (EITC), the nation's largest federal anti-poverty program. According to IRS data, 87% of taxpayers who applied for a RAL in 2009 were low-income, and nearly two-thirds (64%) were EITC recipients

In addition to RALs, refund anticipation checks (RACs) are another product offered by tax preparers and their partner banks. With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund check. After the refund is deposited, the bank issues the consumer a check or prepaid card and closes the temporary account. Consumers without a bank account may pay extra to then cash the RAC check. RACs generally cost about $30. In 2009, about 12.9 million taxpayers received a RAC.

In 2011, RAL availability is more limited, but the loans are more expensive. For example, Republic Bank states that it charges $61.22 for a RAL of $1,500, which translates into an APR of 149%. If the refund exceeds $1561.22, the taxpayer will be charged another $29.95 when the remainder of the refund arrives in the form of a RAC, for a total of $91.17 in fees.

Tax preparers may also charge their own fees in addition to a RAL or RAC fee charged by the bank. These add-on fees can range from $25 to several hundred dollars.

Changes in the RAL Industry

During the past year, there have been a number of major developments in the RAL industry. Concerns over RALs have prompted a number of regulators to take action against them. Collectively, these developments signal the end of RAL lending.

"We are pleased that the IRS and bank regulators may have effectively put an end to loans that siphon off hundreds of millions in taxpayers' hard-earned money and federal benefits meant to lift hard-working Americans out of poverty," said Jean Ann Fox, Director of Financial Services for CFA.

In August 2010, the IRS announced it would stop providing the Debt Indicator, a service that helped tax preparers and banks make RALs by acting as a form of credit check. The Debt Indicator revealed whether a taxpayer's refund would be paid or would be intercepted for government debts. Consumer advocates had strongly urged termination of the Debt Indicator, and applauded the IRS's action (see http://www.nclc.org/images/pdf/high_cost_small_loans/ral/pr-ral-irs-debt-indicator-08-10.pdf).

In April 2010, JP Morgan Chase voluntarily exited the RAL market. Chase had been one of the three biggest RAL providers, serving about 13,000 independent preparers. This left many independent preparers without a source of RALs.

In October 2010, the Office of Thrift Supervision issued a supervisory directive to MetaBank, effectively prohibiting that bank from making RALs. Previously, MetaBank had announced its intent to make RALs, and was expected to be the RAL partner for Jackson Hewitt. MetaBank also had previously provided Jackson Hewitt with a "pay stub" RAL in the form of its iAdvance line of credit on a prepaid card. The OTS directive resulted in the termination of the iAdvance program, citing "unfair or deceptive acts or practices."

In December 2010, the Office of the Comptroller of the Currency issued a directive prohibiting HSBC from offering RALs. HSBC had been H&R Block's RAL-lending bank partner. This followed a similar OCC action in December 2009 that forced Santa Barbara Bank & Trust, which had been Jackson Hewitt's main RAL lending partner, out of the RAL market.

As a result of the OCC and OTS's actions and the departure of JPMorgan Chase, there were only three state-chartered banks this year making RALs—Republic Bank & Trust, River City Bank, and Ohio Valley Bank/Fort Knox Financial Services. All three banks are small banks, and have only a fraction of JPMorgan Chase's or HSBC's RAL lending capacity. Republic is the RAL lending partner for both Jackson Hewitt and Liberty Tax Service in 2011.

On February 10, 2011, Republic announced that its federal regulator, the FDIC, had notified the bank that the practice of originating RALs without the benefit of the Debt Indicator is unsafe and unsound. Ohio Valley Bank received a similar notice, and its Board of Directors voted to discontinue making RALs. River City Bank also announced that it would exit the RAL business after the 2011 tax season, following conversations with the FDIC.

The FDIC's actions signal that the three remaining RAL lending banks have been forced out of the RAL market. Two of the banks have accepted the FDIC's decision, but Republic Bank & Trust has stated it will appeal the decision to an administrative law judge, and potentially to a federal court. Unless Republic's appeal is successful, the FDIC's actions mean there will be no banks left that could make RALs in 2012, effectively ending the product.

The Future of Tax-Time Financial Products

Even with the end of RALs, low-income taxpayers still remain vulnerable to profiteering. Tax preparers and banks continue to offer RACs, which can be subject to significant add-on fees and may represent a high-cost loan of the tax preparation fee. Consumer advocates recommend taxpayers consider alternatives to RACs.

"Consumers should think about opening a real bank account to get their refunds fast, instead of paying $30 for a one-time use account," recommended Jean Ann Fox of CFA.

Another option is prepaid debit cards, including any existing payroll or prepaid card that the taxpayer already has. There are prepaid card options specifically targeted for tax time, such as the Get It Card from Advent Financial Services or the H&R Block Emerald Card. A few even permit taxpayers to have the costs of tax preparation deducted from their refunds. Earlier this year, the U. S. Department of Treasury announced a pilot project to offer 600,000 low-cost prepaid cards to families who may not have a bank account to receive their tax refunds, a move applauded by consumer advocates.

Consumer advocates recommended that taxpayers be cautious when considering other types of prepaid card options. "As with any financial product, taxpayers should compare costs and consumer protections when choosing among prepaid cards," recommended Chi Chi Wu, NCLC Staff Attorney. More information on prepaid cards is below.

Another development is that the IRS has stated it will explore the idea of permitting a portion of tax refunds to go directly to pay for tax preparation. A split refund option would allow taxpayers to pay for preparation fees out of their refunds without the need for a RAC. Consumer advocates have supported the idea, if properly limited in amount to prevent abuse.

Other potential future developments could be less beneficial. Unscrupulous preparers could partner with non-bank lenders to make RALs, perhaps employing tactics used by high-cost loan companies. Finally, the reforms that have signaled the end of RAL lending have been issued by the IRS and banking regulators. With different regulators, these decisions could be reversed easily.

Q&A ON PREPAID CARDS

What is a Prepaid Card?
Prepaid cards are debit cards that hold consumer funds but are not tied to an individual bank account. Often Visa- or MasterCard-branded, they work like bank debit cards but may not have the same consumer protections. For example, some cards do not offer statements or have protections against theft or unauthorized use that are as strong as cards linked to a regular bank account.

What should I look for in a Prepaid Card?
As with any financial product, you should consider the cost, especially any activation, monthly, ATM, balance inquiry and other fees. Also make sure the card protects you in case of loss or theft and that you can get statements or other forms of transaction information to monitor your balance, fees and charges. Avoid any prepaid card that allows you to overdraw the card and charges a hefty fee for doing so.

Where can I find more information about Prepaid Cards?
Resources on prepaid cards include:
National Consumer Law Center: http://www.nclc.org/issues/prepaid-debit-cards.html
Consumers Union: http://www.defendyourdollars.org/pdf/2010PrepaidWP.pdf (Appendix A has a chart comparing different prepaid cards)

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

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