



Consumers' aides say new 'pay-stub' loans, based on projected tax returns, are costly and risky

Warning on bank 'Santa'

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Consumer advocates are up in arms over a type of tax refund-related loan they say is being marketed earlier and more widely than ever during this holiday season.

The loans, arranged by tax preparers in partnership with banks, are based on the size of a consumer's expected tax refund for 2006. Called "pay-stub" loans because the refunds are estimated by looking at a recent paycheck, they are a variation of traditional "refund anticipation loans." Those products, known as RALs, aren't available until late January or early February, when employers send out W-2 forms reporting final wages, taxes already withheld and other important information.

This year, instead of waiting until the beginning of January - the month when most pay-stub loans have been made - tax preparers increasingly began marketing the loans in November as a way to meet holiday expenses, consumer advocates say. Because of that, sales of the loans are likely to "reach levels not seen before," said Chris Keeley, a spokesman for the New York City-based Neighborhood Economic Development Advocacy Project, or NEDAP, which promotes fair access to credit.

Critics see risks

Advocates say pay-stub loans aren't a good deal for consumers because they are expensive and more risky than traditional refund-anticipation loans, which also carry hefty fees. By offering the loans as early as November, banks and tax preparers are taking advantage of the "anxious feeling that people can get around the holidays," Keeley said.

Tax preparers and banks say pay-stub loans provide consumers with an extra option for receiving funds, and that the cost and other conditions of the loans are fully disclosed. The loans tend to be expensive for banks because of their short-term nature, small size, and because they are often made without a credit check, Fritz Elmendorf, a spokesman for the Consumer Bankers Association, said.

"We'd agree that the consumer should be aware of" all of the loans' terms, Elmendorf said. "It's

definitely caveat emptor [buyer beware]."

No data is available to estimate how many pay-stub loans have been made, and at what cost to consumers, advocates say. But using Internal Revenue Service data, the National Consumer Law Center and the Consumer Federation of America have reported that about 12 million U.S. taxpayers paid more than \$1 billion in fees for traditional RALs in 2004.

Also mining IRS data, NEDAP says that in 2003 more than 62,000 traditional refund anticipation loans were obtained on Long Island, at a total cost of about \$30 million. Nearly 70 percent of all RALs on Long Island were made to taxpayers meeting the Internal Revenue Service's definition of "low-income" filers, according to NEDAP.

Impact on poor

Advocates say refund anticipation loans are especially likely to be harmful to low-income workers who qualify for the Earned Income Tax Credit, the nation's largest antipoverty program for working families. In a report to Congress last June, Nina Olson, the National Taxpayer Advocate, said there is a "government interest" in delivering the tax credit to beneficiaries "without intermediaries siphoning off fees."

On an annualized basis, fees charged for pay-stub and traditional refund anticipation loans can soar into the high triple digits. Moreover, because pay-stub loans usually must be repaid with a "balloon payment" in mid-February, most tax filers who use them do so by taking out a traditional RAL, adding an extra layer of expense, Keeley said.

For instance, he said, a pay-stub loan for \$1,200 marketed by one tax preparer costs at least \$81 in fees. If the taxpayer later returns to the same preparer for a traditional RAL to repay the pay-stub loan, and increases the loan to \$1,700, another \$135 is charged, for a total of \$216.

With either a pay-stub loan or a traditional RAL, a consumer is responsible for payment in full even if the expected refund falls short. But taking out a pay-stub loan is particularly risky because the lack of a W-2 increases the chance of basing such a loan on incomplete or missing information, advocates say. For instance, they say a tax preparer might not know about an IRS lien on the refund to pay child support or a student loan debt, or be aware of a client's other sources of income.

Lenders cite cautions

A spokeswoman for the nation's second-largest tax preparer, Jackson Hewitt, which began selling a pay-stub loan product called Holiday Express Loan in November, said in an e-mail that the company "takes disclosure seriously" and makes sure consumers receive information on other options available to them. She said that for a \$600 loan, the bank fee would total \$65.

H&R Block, the biggest tax preparation firm, said in an e-mail that its pay-stub loan product, Instant Money Advance Loan, also offered beginning in November, is cheaper than competitors' products, and that clear disclosures are made "so that clients can make informed

choices."

A spokeswoman for HSBC, a bank that makes tax-refund connected loans through H&R Block and Jackson Hewitt, said HSBC makes sure consumers are told about terms and costs, and that people who choose such loans receive prices that are "reasonable" compared with other unsecured short-term credit alternatives. The loans, she said in an e-mail, "allow consumers a choice of wider access to funds for holiday expenses and end-of-year bill payment."

Santa Barbara Bank & Trust, which Jackson Hewitt's Web site says also funds that tax preparer's pay-stub and traditional refund anticipation loans, didn't respond to a request for comment.

Although it has not done so during the holidays, JPMorgan Chase will offer pay-stub loans for the first time from Jan. 2 through the end of the month, acting through independent tax preparers, Tom Kelly, a spokesman for the bank, said. The bank will make sure consumers know what the costs are, he said.

"There is a little more risk" associated with pay-stub loans, Kelly said. But "for consumers who want to have access to their expected refund sooner, this gets them their money two, three, or four weeks sooner than they might otherwise be able to get it."

Looking at loans

Tax refund anticipation loans for 2003. Figures do not include holiday or "pay-stub" versions.

Nassau

Number of loans 27,234

Average fees per loan \$227

Total fees paid \$6.2 million

Low-income filers' fees \$4.2 million

Suffolk

Number of loans 34,834

Average fees per loan \$227

Total fees paid \$7.9 million

Low-income filers' fees \$5.6 million

Source: Neighborhood Economic Development Advocacy Project

The definitions

Refund anticipation loan (RAL): a short-term loan based on a taxpayer's anticipated income tax refund, projected with the help of a W-2 form.

"Pay-stub" loan: a variation on an RAL that is offered before W-2s are available, with the expected tax refund projected from the customer's most recent pay stub.

Holiday loan: a pay-stub loan marketed in November and December as a way to provide money for holiday-related expenses.

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