

## Poor Communities and Advocates Fight Tax-time Deception

*With low-income people most likely to need fast returns on their annual filings, predatory lenders swarm underserved communities to offer "advances" at exorbitant interest rates -- but resistance has begun taking hold.*

**New York City; Feb. 11, 2005** – As tax-time draws near, millions of low-income Americans will rush to obtain a cash advance on their tax returns in the form of a short-term loan to help pay bills or buy groceries. At tax service storefronts dotting impoverished neighborhoods across the country, employees dressed as Uncle Sam and the Statue of Liberty will greet them at the door -- a marketing gimmick aimed at a quintessentially American blend of pride and economic anxiety.

Awash in congenial advertising, consumers might not realize they are borrowing money that already belongs to them, and this "instant" refund does not come cheap. According to the most recent data, by processing so-called Refund Anticipation Loans (RALs), every year, corporate agencies skim well over \$1 billion dollars off of people's Earned Income Tax Credits. Also known as EITCs, the tax credits are specifically geared toward easing the tax burden faced by low-income Americans.

Despite some government regulations on high-cost, short-term loans like RALs, advocates say service providers easily find ways to gut people's refunds through heavy service deductions.

National and local advocacy groups are mobilizing against opportunistic lenders that prey on low-income taxpayers through legislative action to curb predatory lending, direct pressure on corporations, and financial literacy campaigns.

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To help protect low-income communities from exploitation, the Association of Community Organizations for Reform Now (ACORN) is campaigning in 65 cities against deceptive RAL practices. Joining other community-based organizations, ACORN also works on the ground to cultivate alternatives to commercial services by providing free tax assistance and electronic filing services.

The objective is to help low-income neighborhoods make the most effective use of the EITCs by keeping wealth within the community. Analysts at the Brookings Institution think tank calculate that EITCs, averaging almost \$1,800 per household, not only buoy struggling families, but also improve local economic sustainability, cutting the number of households burdened by "severe housing costs" by 18 percent.

But standing between these benefits and low-income households are a dearth of financial know-how and the brokering agents that profit from people's financial burdens.

Financial service agencies push RALs as a way of making ends meet sooner, but in reality, say consumer advocates, these loans are far from a good deal, or even a fair one. In 2003, consumers took out more than 12 million RALs, costing over \$1 billion in loan fees alone, not including other processing payments that accompany tax services, according to a report issued last month by the National Consumer Law Center (NCLC) and Consumer Federation of America (CFA).

With astronomically high interest rates that may exceed 700 percent, plus high processing fees, these short-term loans basically provide taxpayers their refunds one or two weeks in advance of when they would ordinarily receive them using the electronic tax filing system.

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Chi Chi Wu, an attorney with the NCLC and primary author of the joint NCLC-CFA report, argues that RALs are "probably useless" for the majority of taxpayers, but many people do not fully grasp the convoluted terms of the loans. Moreover, RALs carry the risk that, if for some reason the government does not deliver the expected return, the taxpayer must repay the difference. "You're talking about a two-, three- or even four-thousand dollar loan that they're on the hook for," said Wu -- a huge setback for "people who are probably low-income and live paycheck to paycheck."

The temptation of obtaining a refund as soon as possible may be overwhelming for some. "We live in [an] 'I want it now' society, and a lot of people are enticed by that idea that they can get it just a few days quicker," said Mary Ruth Herbers, director of the Center for Economic Progress, an Illinois-based financial assistance nonprofit.

According to the CFA-NCLC report, in 2003 nearly 60 percent of all RALs -- about 7 million -- went to EITC-eligible households. As a major federal anti-poverty initiative, EITCs have provided a modest cushion for the working poor since 1975. A two-child household earning less than \$35,000 a year is eligible for a \$4,300 credit, based on a sliding scale. In 2003, the program granted \$38.2 billion to 21.7 million recipients, according to the Internal Revenue Service.

That same year, however, EITC-eligible taxpayers cumulatively spent an estimated \$1.09 billion in Refund Anticipation Loan processing and other tax preparation fees. Total loan surcharges for RALs, averaging \$75 per consumer, amounted to \$519 million, and service providers poached over \$1 billion in additional "tax preparation," "administrative" and "application" fees.

When the NCLC administered a survey of over 2,000 households, it found that 80 percent of RAL recipients earned a yearly income of \$35,000 or less, and that the majority did not have an education level above high school. Blacks and Hispanics reported taking out RALs at rates of over 28 and 21 percent respectively, compared to 17 percent among whites. Families with children, who benefit the most from EITCs, reported using RALs at twice the rate of single respondents.

**"Nobody I know is against financial literacy, but I think that this is a structural problem; it calls for structural response." --Sarah Ludwig, NEDAP**

According to community activists, the demographics are not coincidental; underserved communities are prime real estate for profiteering lenders. Sarah Ludwig, director of the New York City-based nonprofit Neighborhood Economic Development Advocacy Project (NEDAP), pointed out that after mapping out the geographic distribution of RALs throughout the city, NEDAP found "an absolute correspondence between the racial composition of the community and where the tax refund loans are concentrated."

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nearly one in five NCLC survey respondents had used a RAL at some point, most were not even aware the RAL was actually a loan. The majority of respondents said that had they been informed that they could get a refund for free by waiting a week longer, they would have chosen the slower option.

Government action to protect consumers has been limited. On the federal level, report the NCLC and CFA, the IRS has instituted guidelines against deceptive RAL marketing, but has proven sluggish in issuing penalties. According to the Government Accountability Office, in 2002 the IRS monitored 1,412 electronic tax preparers -- or one percent of the entire industry -- and disciplined 215 for poor business practices, largely through "written reprimands."

Policies of federal "preemption" for nationally chartered banks generally strip state and local governments of regulatory authority over the large banks that issue RALs. Local governments can, however, regulate individual service providers, who act as brokering agents. For example, ACORN recently helped establish a RAL regulatory ordinance in Seattle to mandate full disclosure of tax return options.

Still, storefront lenders may circumvent local laws by operating in partnership with national banks or banks from non-regulated states.

The case of New York City -- where 189,000 RALs were issued in 2002, according to the Brookings Institution -- demonstrates what happens to regulations en route from legislative chambers to the streets. Although the official cap for short-term loan interest rates is 25 percent, City Council Members complained last December that lenders easily avoid this restriction through affiliations with non-local banks.

City ordinances also require that loan advertisements clearly display the full financial implications of the transaction, and just last month, New York State Assembly member Catherine Nolan introduced an amendment to the state banking law to enhance disclosure. Yet while the city's Department of Consumer Affairs boasts of penalizing duplicitous tax preparers and boosting compliance rates, advocates still contend that the city too often fails to protect underserved communities.

Ludwig of NEDAP said that last year, the organization's investigation of local tax service storefronts found misleading posters about accelerated refunds plastered prominently in neighborhoods. A survey of local tax preparation offices by the City Council's Investigation Department discovered that 37 percent did not disclose to customers the full costs associated with RALs.

Pressured by government regulations and consumer advocates, some companies have instituted their own disclosure policies, but with reportedly mixed results. Two of the largest RAL brokers, Jackson Hewitt and H&R Block, have negotiated with ACORN on improving their practices. H&R Block spokesperson Janine Smiley said that the company was working to reform disclosure and administrative policies for RALs. Even when no local regulations exist, said Smiley, "We're exceeding the needs of clients in terms of helping them make an informed decision."

ACORN spokesperson Allison Conyers told *The NewStandard* that her organization aims "to reform the industry and make this a more friendly industry for low- and moderate-income people."

ACORN's protests against Liberty Tax in 60 cities may be generating more resistance than reform. The group drafted a Liberty Tax Customer's Bill of Rights that declares: "Tax preparers like Liberty Tax siphon off billions of dollars from our neighborhoods with these loans. We are more than a pocket to be picked!"

For its part, Liberty Tax responded by threatening to sue for slander, claiming that the company -- not its clientele -- is the real victim of deceptive messaging. Founder and Chairman John Hewitt claimed that Liberty's flashy marketing scheme, which features employees dressed as Lady Liberty, is simply a matter of "brand-name recognition," and that his company keeps customers better informed of their options than Liberty's larger rivals.

The popularity of RALs, argued Hewitt in an interview with *TNS*, is due not to deception, but to "the customers wanting their money as quickly as possible and demanding that service. It's not something that we would ever try

to talk a customer into."

Whatever the root cause of RAL fever, critics nonetheless suspect the credit industry's main objective of expanding profits fundamentally conflicts with the interests of underserved communities.

Drawing on her experience in Chicago, Herbers of the Center for Economic Progress observed, "There are lots of disclosures" in the RAL paperwork, but "they're in little teensy-weensy fonts." While companies may have official policies about informing consumers of their choices, she said, "we certainly hear back that that's not always the case."

In the end, Herbers concluded, "the market's the market."

Ludwig is similarly skeptical about relying on profit-minded corporations to implement "best practices" codes, which in her view, typically "aren't really worth the paper they're written on" anyway. She stated, "I haven't heard from anybody that we've talked to that those 'best practices' are being adhered to."

Consumer advocates point out that reluctance of lenders to illuminate the fine print is compounded by a lack of financial literacy among low-income taxpayers. "The forms aren't simple," said Wu, "and a lot of the taxpayers who are getting this credit may have limited educational or literacy levels... or be intimidated by the system."

Nonprofit organizations offer a partial solution by combining free tax services with community outreach. ACORN and the Center for Economic Progress have initiated public education campaigns that promote free, nonprofit tax services while warning consumers of high-cost loans. Herbers said that the demand for free services is growing fast enough to overstretch her organization's capacity. This year, the center hopes to file 24,000 tax returns for its clients, up from about 22,700 last year and 19,500 in 2003.

Heightened financial awareness might be contributing to the slight drop in number of RALs taken out nationwide to 12.15 million in 2003 from 12.7 million the year before, according to the NCLC-CFA report.

But advocates point out that for low-income people, the struggle to get what they have earned and what they pay for is year-round. The tax-time RAL marketing blitz is just one part of a host of notoriously deceptive transactions, like debt-inducing paycheck advance loans and predatory mortgage lending, which continually threaten vulnerable communities.

According to Ludwig, raising awareness alone will not combat systemic credit issues facing low-income people: "Nobody I know is against financial literacy, but I think that this is a structural problem; it calls for structural response."

Tax-season deception raises the question of why companies can so freely exploit the financial difficulties that create a market for RALs in the first place. Ludwig reflected that these loans represent a "discriminatory, more expensive, predatory array of financial services that predominate in lower-income communities."