



## Refund Anticipation Loans Continue to Harm Low-Income Taxpayers

Government Slow to Rein In Short-Term, High-Interest Loans

*Martha C. White*  
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Despite years of efforts to rein in the practice, lightly regulated tax preparers will be permitted to continue peddling high-cost refund anticipation loans once again this tax season to the most vulnerable filers, as tougher rules to curb the practice languish in bureaucratic purgatory. Refund anticipation loans, or RALs, promise near-instant refunds, but the catch is that they're very short-term and very expensive loans, according to Christopher Kukla, senior counsel for government affairs at the Center for Responsible Lending. "In terms of APR, these things carry a rate of 50 up to 1,000 percent," he said, adding that the rate is often hidden in a bevy of ancillary fees. Watchdog groups have been waging a policy battle against RALs for years, working with agencies like the IRS and the Office of the Comptroller of the Currency. The government has been slow to respond to concerns, despite an ever-growing body of evidence about the harm these loans cause low-income filers.

Groups including the National Consumer Law Center and the Consumer Federation of America have mounted multifaceted campaigns to remove refund anticipation loans from the marketplace, but reform efforts have only crept forward. The OCC, which oversees many of the banks that provide the loan funding — including industry giants like HSBC and JPMorgan Chase — issued internal guidance for its examiners back in 2007 pertaining to the training and supervision of third-party tax prep firms, but it wasn't declared public policy until this year. The office also waited until this year to issue a consumer advisory about RALs. "This was in direct response to the advocacy we've been doing, but it's still really weak," said Dory Rand, president of the Woodstock Institute.

The IRS has previously examined whether or not it should be legal for tax preparers to sell financial products. This January, though, in a move that frustrated watchdog groups, the agency decided to establish a task force to study RALs and the legality of allowing tax preparers to share filers' financial information with lenders. Advocates like Jean Ann Fox, director of financial services for the Consumer Federation of America, are unhappy with the longer timeline creating this task force will entail. "We were disappointed this is as far as they went," she said. "The IRS could have dealt with this to put a stop to it." The IRS also announced plans in January to regulate the tax preparation industry, requiring tax preparers to follow ethical guidelines, undergo professional education and testing. Creating and implementing these standards will take a few more years, despite the six months' worth of research that preceded the January announcement.

The stakes are so high because RALs prey on the most disadvantaged Americans. Groups like the Neighborhood Economic Development Advocacy Project, which offers assistance to low-income New York City residents, says RAL providers deliberately target poor, uninformed recipients of the Earned Income Tax Credit, many of whom are outside the realm of mainstream banking and rely on lightly regulated fringe products. In 2007, more than 80 percent of RALs in New York City were made to low-income citizens, and more than 60 percent went to EITC recipients. In some low-income neighborhoods, close to one in five taxpayers took out a refund anticipation loan. "These areas are some of the lowest-income areas in the country," said Alexis Iwanisziw, NEDAP program associate. "This money should really be staying in the community and staying with the families."

The primary concern is that tax preparers, especially independent shops, can play fast and loose with the facts they give consumers because they never come under scrutiny from the banks making the loans. According to the Woodstock Institute's Rand, Chase, the bank responsible for supplying the loans to some 13,000 mom-and-pop tax prep outfits, only instituted a mystery shopping program this January, in response to Woodstock Institute queries about compliance with the OCC guidance.

In 2008, mystery-shopping programs conducted by watchdog groups found that customers received incomplete and sometimes inaccurate information about RALs and the costs they would incur. While new requirements on disclosures, marketing terminology and customer education have all been announced by the OCC, the agency is giving tax preparers another year to comply with these new regulations. Even the new disclosure requirements aren't foolproof, points out Chi Chi Wu, staff attorney at the National Consumer Law Center. "The problem with any sort of

written disclosures is they're not that useful when [a customer] gets a RAL," she said. "They get another piece of paper in the stack. It may not be something they look at right away." By the time the tax filer looks through his or her paperwork, the charges have already been applied against their refund.

The big appeal of these loans, the Woodstock Institute's Rand points out, is the prospect of instant money. Already, taxpayers who e-file and elect to receive their refund via direct deposit generally get their returns within two weeks. If the IRS sped up its payments to taxpayers outside the mainstream banking system and allowed them to receive that money on a debit card similar to those used for other benefits, the appeal of RALs would be diminished. "These improvements the IRS could make would eliminate a need for refund anticipation loans," Rand said.

"We think as a federal policy change, one very obvious thing that needs to happen is that the EITC should be prohibited from being used as collateral in a loan," said Sarah Ludwig, co-director of NEDAP. This practice is prohibited when it comes to other federal benefits like Social Security, and Ludwig says Congress should extend this prohibition to the EITC. "If that loophole was closed, it would to a large extent cut off RALs at the pass," she said. The Consumer Federation's Fox says legislation that would limit interest rates to 36 percent would protect taxpayers, but it has stalled in Congress. There is stiff resistance not only from fringe lenders but from mainstream financial services firms against a federal usury cap inclusive of fees and surcharges, since this would apply to other types of loans, such as credit cards, as well.

Both the number of RALs and the total cost of obtaining these loans has dropped slightly in recent years, in part due to market forces that made borrowing money everywhere harder to do. In 2006, 8.7 million RALs were issued at a cost of \$833 million, which dipped to 8.4 million and \$738 million in 2008. Fox says while this is heartening, leaving these loans on the marketplace makes too many taxpayers vulnerable to exploitation. "The volume's been dropping over the years, but it's time to take care of this at the policy level. This is deviating taxpayer money. Do you want to give part of your tax refund to a big bank?"

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