

Jackson Hewitt Reaps Profit, Skepticism on 69% Tax-Refund Loan

Bradley Keoun

April 7 (Bloomberg) -- Jackson Hewitt Tax Service Inc.'s Money Now, a new short-term consumer loan, is boosting the tax preparer's profit and shares. The gains may not last.

A New York franchisee says she tries to steer people away from the loans because fees and interest can reach a 69 percent annual rate. Jackson Hewitt's founder, John Hewitt, says the loans, which use year-end pay stubs to anticipate tax refunds, are unwise. And three analysts who follow the Parsippany, New Jersey-based company say the loan may lure regulator scrutiny.

As 134 million Americans face deadlines this month for filing tax returns, Jackson Hewitt, the No. 2 U.S. preparer, is cashing in on a \$1.6 billion market for so-called refund- anticipation loans. The revenue from Money Now helped its profit beat all estimates in the quarter ended Jan. 31. The shares surged 53 percent in a year, more than the 11 percent climb in the Standard & Poor's 500 Index.

California Attorney General Bill Lockyer has investigated Jackson Hewitt's tax-refund lending since at least 2003.

"Our investigation and our discussions with Jackson Hewitt involve all of its practices, all of its products along these lines," says Thomas Dresslar, a Lockyer spokesman, without commenting directly on the Money Now loan. Lockyer's office hasn't brought any lawsuits against Jackson Hewitt, Dresslar says.

Jackson Hewitt declined to comment on criticism of the Money Now loan program, or on the California inquiry into refund- anticipation loans beyond the company's statements in filings with regulators.

Consumer Disclosure

The company said in a May 2004 filing with the U.S. Securities and Exchange Commission, five weeks before its initial public offering on the New York Stock Exchange, that "California has expressed concerns that our business practices related to the facilitation of these products may violate California's unfair competition laws or its laws governing unfair or deceptive business practices."

Lockyer's focus has been on proper disclosure to consumers. For the past two years, he has called on Californians to avoid refund-anticipation loans, saying the poor are vulnerable to sales pitches that promise "quick cash."

Last year, California passed a law requiring tax preparers to post a fee schedule for refund-anticipation loans and make disclosures in writing.

State usury laws, which typically cap interest rates at 36 percent, don't apply to federally chartered banks that provide tax loans to Jackson Hewitt's customers, says Chi Chi Wu, a staff attorney at the Boston-based National Consumer Law Center, a non-profit group that studies consumer lending.

`Wary of Scrutiny'

Scott Schneeberger, an analyst with New York-based Lehman Brothers Holdings Inc., says the Money Now program may draw unwanted examination from regulators already looking at tax preparer lending.

``We will be wary of scrutiny from regulators and advocacy groups," Schneeberger says. ``This is probably the single largest risk factor facing Jackson Hewitt."

Jackson Hewitt said on March 1 that earnings in the quarter ended Jan. 31 rose 39 percent to \$24.5 million, or 69 cents a share. The company's shares climbed 53 percent to \$30.89 in the 12 months ended yesterday.

Jennifer Pinnick, an analyst with New York-based Morgan Stanley, shares Schneeberger's concern.

``There has been some controversy regarding this loan and its high implied interest rates," Pinnick wrote in a note to investors on March 2. ``It may attract increased regulatory scrutiny."

Financing Charges

To make a Money Now loan, Jackson Hewitt uses an employee's year-end pay stub to prepare a preliminary tax return, and the form is submitted with a credit application to banks, Jackson Hewitt Chief Executive Officer Michael Lister, 52, said in a conference call with analysts and investors on March 1.

The Money Now financing with a pay stub is quicker than waiting for the traditional refund loan, which requires borrowers to present a federal W-2 statement detailing income withheld for taxes.

The bank levies a financing charge of 3 percent and a \$45 fee, Jackson Hewitt spokeswoman Sheila Cort says. For the maximum loan amount of \$1,900, that works out to \$102, which equates to 69 percent interest on an annual basis assuming a one-month period for the loan, she says.

Money Now loans are typically made for no more than a month because customers are obliged to return to Jackson Hewitt once they get a W-2 form, most often by February, according to the National Consumer Law Center. That means customers could avoid the \$45 fee on the Money Now by waiting a few weeks for their W-2s and taking out a traditional tax refund loan.

Royalties, Fees

The company receives payments from the bank and royalties from franchisees, according to the company's annual report filed last July. Jackson Hewitt keeps about \$25 of the fees on a Money Now loan, according to Mark Sproule, an analyst with San Francisco-based Thomas Weisel Partners Group Inc. The bank gets the rest.

``The fees associated with the enhanced product may draw the notice of regulators and consumer advocates," Sproule wrote in a Feb. 24 note to investors. ``Consumer groups and attorney generals are unlikely to see the new product positively."

Kiki Fieger, 54, the franchisee who owns four Jackson Hewitt outlets in the New York City borough of Queens, says she finds the Money Now program so objectionable that she tries to discourage customers from taking out the loans. Even so, borrowers often feel they have no choice because they must pay for rent or food, Fieger says.

“The rates on these things are exorbitant, and we fully disclose that to the taxpayer prior to doing any work,” she says. “But no matter how much you try to talk them out of it, they want it.”

H&R Block

More than half of all tax-refund loan customers were recipients of the Earned Income Tax Credit, the U.S. government's largest anti-poverty program, according to a report in January based on 2004 Internal Revenue Service data by the National Consumer Law Center and Consumer Federation of America.

The consumer-advocacy groups estimate that \$904 million of the program's \$38.7 billion in all credits was diverted to pay the loan fees.

Tax refund loans aren't unusual. H&R Block has also been scrutinized for its lending practices. Lockyer sued H&R Block, the biggest U.S. tax preparer, on Feb. 15, accusing the Kansas City, Missouri-based company of violating California and U.S. laws by deceiving mainly low-income customers who took out refund-anticipation loans and illegally withholding tax refunds.

Regulator Concern

The state seeks \$20 million in civil penalties and “hundreds of millions” more in victim compensation, Lockyer said in announcing the suit.

H&R Block made misleading and deceptive statements to consumers, including portraying the transaction as a “refund” or “instant money” rather than as a loan, steered customers to check-cashing centers that gave “kickback” payments to the company and conspired with banks in unfair debt-collection practices, he said.

H&R Block said on Feb. 15 that the filing had no legal or factual merit. Nine days later, H&R Block Chief Executive Officer Mark Ernst said on a conference call to discuss earnings that he steered clear of offering loans similar to the Jackson Hewitt Money Now financing that are based on paycheck stubs rather than W-2 forms.

“This product is really not a good value for consumers,” Ernst, 47, said of the Money Now financing. “This looks like another variation on refund loans, only worse.”

‘Like Payday Lending’

Jackson Hewitt said March 1 that Money Now loans helped lure customers and boost the number of returns it processed in the quarter ended Jan. 31 to 1.3 million, a 19 percent increase, from the year-earlier period. H&R Block reported a 2.2 percent drop in clients served to 3.8 million during the same time and attributed some of the decline to Jackson Hewitt's new program.

H&R Block also said its profit in the quarter was cut by \$31 million for payments to settle a class-action lawsuit brought by customers in 26 states who claimed it charged unreasonable interest rates on tax-refund loans.

Jackson Hewitt's founder, who left Jackson Hewitt in 1997 to found Virginia Beach, Virginia-based Liberty Tax Service, now the third-largest U.S. tax preparer, says the Money Now loans are a bad deal. He says they resemble loans made in anticipation of paychecks, with fees with annual percentage rates of 390 percent that can trap borrowers.

“These pay-stub loans are just like payday lending, which is coming under intense scrutiny,” says Hewitt, 56.

Interest Payments

Money Now loans are targeted to consumers living paycheck to paycheck, critics say.

“This is one more product that's totally geared toward people who are having trouble making ends meet,” says Sarah Ludwig, executive director of the New York-based Neighborhood Economic Development Advocacy Project.

Not all clients that take out Money Now loans are desperate for cash, says Wayne Lallman, co-owner of a 17-office Jackson Hewitt franchise in greater Omaha, Nebraska. Some customers are willing to pay for the convenience of getting a refund advance, and about 500 of 900 of his franchise clients who applied for loans were qualified, he says.

“There is something other than ignorance that drives someone to want to get their money, even if you do have to pay a fee to have it for a short period of time,” says Lallman, 39.

A customer entitled to a tax refund of \$2,150 this year will pay an average of about \$100 for a traditional tax-refund loan based on a W-2 form, according to the National Consumer Law report.

Consumer Lawsuits

The loans are outstanding for the one or two weeks it takes for the IRS to process an electronically filed return and pay the refund by direct bank deposit, so the annualized interest rate works out to about 178 percent, the study found.

Jackson Hewitt said it faces consumer lawsuits over its traditional tax-refund loans -- those based on a W-2 form -- in California and New York. State laws in California and New York penalize lenders for deceptive practices.

Myron Benton, who took out refund-anticipation loans for the tax years 2000, 2001 and 2002, alleged in his suit in New York state court in Manhattan that Jackson Hewitt understated the equivalent annual interest rates on its refund loans by about 37 percent and concealed the company's financial incentives in providing the loans.

Jackson Hewitt said of the suit in a March 17 filing with the SEC: “While this matter is at a preliminary stage, the company believes it has meritorious defenses and is contesting this matter vigorously.”