



Consumer Federation of America



September 12, 2008

By Overnight Mail

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Re: Republic Bancorp Application No. R2-2008-0202

Dear Mr. Reich, Mr. Dwyer, and Mr. Ryan:

We are writing on behalf of the California Reinvestment Coalition, Community Reinvestment Association of North Carolina, Consumer Federation of America, National Consumer Law Center (on behalf of its low-income clients) and Neighborhood Economic Development Advocacy Project to oppose Republic Bancorp's application for a charter conversion from a bank holding company to a savings and loan holding company. We also request that OTS hold a formal, public meeting pursuant to 12 C.F.R. § 516.170 to discuss the issues in this comment.

We have several concerns regarding Republic's operation as a thrift, including: 1) Republic's current practices in arranging expensive refund anticipation loans (RALs), primarily to low-income taxpayers; and 2) Republic's Currency Connection product,

which enables check cashers and payday lenders to deliver Social Security, SSI and other benefits to unbanked recipients, charging them high fees for second class accounts and denying them control over their benefits. Republic has also had a troubling history of providing payday loans through third-party storefronts such as Advance America.

Indeed, Republic has been the subject of regulatory action by the FDIC over its RAL and payday lending businesses. With the recent step-up in enforcement by the FDIC, it is not surprising that Republic chose to have the financial institution that results from this merger no longer under the supervision of the FDIC. Indeed, the FDIC had expressed concerns in a recent Congressional hearing over products like Currency Connection.

Republic must be required to address the issues raised by its RAL and Currency Connection products before being given approval for its application. Republic must cease making RALs or at least lower its prices and establish strong controls in its RAL lending. Republic's Community Reinvestment Act plans should take its RAL lending and Currency Connection products into account, *i.e.*, Republic must engage in community reinvestment in all communities in which it lends and takes deposits, including communities in which it makes RALs and offers Currency Connection. Finally, Republic must be forbidden from using a thrift charter to offer other high cost financial products and services, such as payday loans, including through its prepaid cards.

The undersigned groups note that we and other groups have requested a public meeting on this matter, but have not yet received a response from the OTS on this request. Finally, the undersigned groups note that we did not receive the 865 pages of Republic's application from OTS until September 11, 2008. Not having had adequate time to review the entire submission, we reserve the right to add supplemental comments.

#### **A. Republic Must Terminate or Reform its RAL Business before its Application is Approved.**

##### 1. Republic's RAL Business Harms Consumers

Republic should be required to terminate or reform its tax refund anticipation loan (RAL) activities as a condition of obtaining a thrift charter. Republic's RAL activities exploit vulnerable, low-income consumers, especially those who receive the Earned Income Tax Credit (EITC). In addition, some of its activities may violate the Federal Fair Debt Collection Practices Act, 15 U.S.C. § 1692 *et. seq.*

Republic is one of the handful of banks in the nation that makes RALs, which are short-term, high-risk loans secured by a taxpayer's anticipated tax refunds. According to its most recent Securities and Exchange Commission (SEC) Form 10-K, Republic earned about 11% of its income in 2007 from RALs and other tax-related financial products, and even more (17% and 18%) in 2006 and 2005. We believe this income has increased dramatically in 2008 due to Republic's new partnership with Jackson Hewitt.

The National Consumer Law Center and Consumer Federation of America have published annual reports discussing the problems and harms posed by RALs, available at [http://www.consumerlaw.org/issues/refund\\_anticipation/index.shtml](http://www.consumerlaw.org/issues/refund_anticipation/index.shtml). In short, RALs are extremely expensive. Republic's fees for RALs range from \$34 to \$125. Based on a typical federal refund in 2006 of \$2,600, a consumer who receives a Republic RAL will pay \$110, which is the highest fee in the industry as discussed below. In addition, the tax preparer will charge both a preparation fee – anywhere from \$75 to \$300 - and sometimes “document preparation,” “e-filing” or other fees that can range from \$25 to over \$250. (A chart of fees paid by consumers in Philadelphia, PA, and Durham, NC can be found at the end of a recent report discussing mystery shopper testing conducted by some of the undersigned groups, included in Appendix 3).

RAL are expensive because the loans last about one to two weeks. What many taxpayers don't realize is that if they use electronic filing and have their refunds direct deposited into their own bank accounts, they can receive a refund in 8-15 days. Because these loans are so short in duration, they carry effective annual percentage rates from 40% to over 500%. RALs drained the refunds of nearly 9 million American taxpayers in 2006, at the cost of nearly \$1 billion in loan fees. Another 10.8 million taxpayers spent \$324 million on other tax financial products to receive their refunds.

RALs skim off hundreds of millions in EITC benefits. Nearly two thirds of RAL borrowers are EITC recipients, despite the fact they make up only about 17% of taxpayers overall. RALs drained over \$600 million from the EITC program in 2006.

RALs also present significant risks to consumers. Many RAL consumers are not aware either that the product is a loan or of the risks of this loan. If a consumer's refund is denied, the consumer ends up on the hook for the loan. This obligation imposes a substantial hardship, because the consumer usually has not budgeted to repay this loan from regular, periodic income. It subjects the consumer to expensive late fees, debt collection harassment, and a damaged credit history. In addition, some RAL lenders, including Republic, use cross-bank cooperative agreements to collect back debts from RAL customers. If a taxpayer owes money to one RAL lender from a prior year and applies for a second RAL from a different bank, the second bank repays the delinquent amount to the first bank before remitting the refund to the taxpayer. We believe that such cross-bank debt collection may violate the Federal Fair Debt Collection Practices Act, 15 U.S.C. § 1692 *et. seq.*, and should be prohibited.

## 2. Republic's Questionable Tax Preparer Partners

Many of the RAL lending banks have significantly reduced or reformed their RAL business. In contrast, Republic has sought to expand this abusive, high cost practice. Other RAL lending banks have reduced the number of tax preparers that they work with and/or have instituted better screening and control of these preparers. For example, HSBC shed most independent tax preparers from its client base to reduce the risk of reputational damage. JPMorgan Chase self-reports that it too has shed independent tax preparers as a result of more stringent screening and a lower fee

structure. In contrast, Republic Bank not only continues to provide services to independent tax preparers, but is actively seeking to increase its partner base and RAL loan volume.

In fact, Republic vigorously pursued independent preparers this past tax season with advertising on its website promising “Fast and Aggressive RAL Approvals.” Republic even touted that “95% of RAL applications are approved with most checks released within minutes of the IRS acknowledgement.” (Copy of these advertisements are provided in Appendix 1 to this comment.)

The result is that Republic Bank may be accepting independent tax preparers who are not acceptable to the other RAL banks. Unfortunately, independent tax preparers attracted by “aggressive RAL approvals” may be those who have inadequate controls on both return preparation and loan originations and therefore have a higher risk of defaults and regulatory noncompliance. Indeed, the most recent National Taxpayer Advocate’s Report to Congress raised concerns that RALs provide tax preparers with an incentive to take unduly aggressive or improper tax return positions in order to artificially inflate refund claims. The IRS has commenced a rulemaking proceeding requesting comment as to whether RALs encourage inflated refund fraud. When preparers inflate refunds, the result may be an unpaid refund and a defaulted RAL for the lending bank.

The independent preparer sector includes a subgroup that is extremely problematic – the fringe preparers. Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. They also include retailers, such as jewelry and furniture stores, and in immigrant communities consist of businesses that offer travel services, “notario” services, and quickie foreign divorces.<sup>1</sup> Republic’s aggressive pursuit of independent preparers exposes the bank to the risk of disproportionably partnering with these fringe tax preparers.

Indeed, mystery shopper testing conducted by the Community Reinvestment Association of North Carolina found one of the most shocking examples of incompetent tax preparation came from a preparer who offered Republic loans. The preparer was employed by a small loan company/payday lender in Durham, and her error bordered on outright tax fraud. In the tester’s own words:

After sitting in the office for an hour or so, [the preparer] said that there was a problem that she did not know how to handle. The problem was that there was a \$5000 [fictional number] “dividend” that we must pay taxes on. With the dividend, our return would only return \$100. If she was to “ignore” it, then we would receive \$3000 in returns. She then called her “tax people,” who told her that we do not need to report the dividends and just ignore it.

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<sup>1</sup> For more information on fringe preparers, *see* Comments of National Consumer Law Center, Consumer Federation of America, et al. regarding Advance Notice of Proposed Rulemaking - Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products, April 7, 2008. A copy is included in Appendix 4.

Not only had this preparer given advice to commit tax fraud, she also missed the fact that this tester also had profits from the sale of stock shares, a second source of investment income. This tester, who was a law student and understood tax law, ultimately chose to withdraw from the testing and concluded:

My experience with [this preparer] has been a scary one. I say that mainly because the lack of confidence in the preparer's ability to competently complete our return even though she was generally nice. Furthermore, the other lady in the office was constantly on the phone hounding people for money. I do not know everything that was said but it seems like she was making many threats and at times, she was verbally abusive.

This example is discussed in the RAL Mystery Shopper Report included in Appendix 3.

While the independent sector has its share of fringe preparers, the commercial tax preparation chains are not without their share of problems either. In 2007, the Department of Justice sued five Jackson Hewitt franchisees that operated 125 tax preparation offices for their role in preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. As a result of the fraud perpetrated by these Hewitt franchises, Hewitt's RAL lending partner, Santa Barbara Bank & Trust, was forced to charge-off \$22 million in RAL losses. Interestingly, in the next tax season, Jackson Hewitt added a new RAL lending bank – Republic Bank & Trust. Note that the number of RALs and similar products arranged by the Hewitt franchises under contract with Republic would account for 70 percent of the business done by Republic in 2007. Thus, the Jackson Hewitt deal brought a substantial increase in RALs for Republic – RALs arranged by a preparer chain with a history of poor controls that led to significant fraud and loan defaults.

Finally, it is worth noting that Republic has gotten in trouble before over its RAL business. In 2004, the Federal Deposit Insurance Corporation gave Republic a poor Community Reinvestment Act rating of “Needs to Improve” based in part on a “pattern or practice of substantive violations of equal credit opportunity laws in the Refund Anticipation Loan product ...”<sup>2</sup>

### 3. Republic's RALs are the Most Expensive

Republic's RALs are among the most expensive and harmful to consumers. Some RAL lending banks or their partner preparers, including HSBC (for H&R Block RALs) and JPMorgan Chase, have significantly reduced the fees on their RALs. In contrast, Republic has not. The following is a chart of RAL fees from 2008 for a typical refund of \$2,600.<sup>3</sup>

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<sup>2</sup> Federal Deposit Insurance Corporation, Division of Supervision and Consumer Protection, Community Reinvestment Act Performance Evaluation - Republic Bank & Trust Co., October 4, 2004, at 2.

<sup>3</sup> This is a modified version of the chart from Chi Chi Wu and Jean Ann Fox, *Coming Down: Fewer Refund Anticipation Loans, Lower Prices from Some Providers, But Quickie Tax Refund Loans Still Burden*

Preparer/Bank	RAL fee (including Refund Account Fee)	APR (including Refund Account Fee)	Application/ Processing Fee	Total Fee	APR with Application Fee
H&R Block/HSBC	\$57.85	83%	none (but add \$20 if a paper check is issued for the RAL)	\$57.85	83%
Santa Barbara Bank	\$96	140%	up to \$40	up to \$136	up to 194%
JPMorgan Chase	\$58	83%	\$10 “technology fee” charged in 2008	\$68	98%
Republic Bank & Trust	\$110	161%	Unknown	---	at least 161%

Even Santa Barbara Bank & Trust, while it has more expensive fees for RALs of \$2,600, has reduced prices for smaller RALs under \$1,000.

The higher cost loans may reflect shared fees to the independent tax preparers for directing their clients to Republic Bank. (See <https://www.republicrefund.com/ERO-Support/ERO-Incentives.aspx> for a listing of the incentives that Republic pays to tax preparers when they make a RAL.) The pricing in this case may be indicative of the nature of Republic Bank’s business strategy, with the bank working with the most unqualified and ethically challenged tax preparers. We anticipate that Republic Bank will consequently have greater difficulty with regulatory compliance issues.

#### 4. RALs Present a Liquidity Issue for Republic

A careful analysis of Republic’s most recent annual report to the SEC reveals that the growth in Republic’s RAL business has presented a liquidity issue for Republic. In its SEC Form 10-K for 2007, Republic discusses how its RAL lending depends upon the availability of a larger securitization structure in order to make money. What is not said is that this securitization structure has been struggling for some time now. The evidence of that is in the increasing amounts of capital that Republic has had to devote to its RAL business. In 2007, the company had to set aside \$274 million in funds for its Tax Refund Services division. That is a big change from the previous two years, when greater net income was derived from a unit that consumed just \$205,000 and \$1.77 million, respectively, in 2006 and 2005. The following table is derived from Republic’s 2008 SEC Form 10-K:

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*the Working Poor*, National Consumer Law Center and Consumer Federation of America, March 2008, at 11, available at [http://www.consumerlaw.org/issues/refund\\_anticipation/content/RAL2008Report.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/RAL2008Report.pdf).

(in thousands)

	2007	2006	2005
RAL Income	\$2,805	\$4,668	\$5,531
Assets Utilized for TRS	\$274,889	\$205	\$1,770
Net Interest Margin	17.2%	60.5%	108.4%
RAL Income/Net Inc.	13.3%	20.5%	23.3%
RAL Assets/Assets	9.52%	0.007%	0.065%

## B. Republic's Currency Connection Product

Republic is one of very few banks using check cashers, payday lenders and other fringe financial providers to deliver Social Security, SSI and other benefits to unbanked recipients, charging them high fees for second class accounts and denying them control over their benefits. As with RALs sold through tax preparers and payday loans provided through Advance America, Republic's Currency Connection product is a high-cost financial product provided through third parties. Both the Inspector General for the Social Security Administration and the FDIC<sup>4</sup> expressed concern during a recent Congressional hearing about the role of payment through nonbank entities.

Under the law commonly referred to as EFT'99, federal benefits recipients must receive their payments by direct deposit unless they claim a hardship. Instead of providing full-fledged bank accounts that provide consumers with control of their funds and all of the applicable consumer protections, products such as Currency Connection set up a master account to receive exempt funds in the name of the recipient. The beneficiary then goes to the check cashing outlet to receive and then cash the "check" printed to deliver their funds, or the funds are loaded onto a prepaid debit card. Of course, steep fees are charged for this arrangement at every step - to set up the account, to deliver each payment, and to cash each check.

For example, Currency Connection's fees for its paper "Cashier's Check" product includes a \$3 or \$4 fee to Republic for the first direct deposit per month, plus a \$3 fee for each additional deposit. Republic's storefront partner, which is called an Electronic Funds Issuer (EFI), can charge customers an additional \$1 to \$5 fee for printing a paper check to deliver the funds, for a total of up to \$9 per check. (A copy of documents showing these fees is included in Appendix 2).

In addition, recipients must pay a fee to cash the check. Currency Connection does not set limits on the fee check cashers can charge. Thus, ACE Cash Express, a large check cashing/payday loan chain that has a private label Currency Connection version called "CheckDirect," charges 2% to cash a paper check. For a Social Security recipient who receives \$800 in benefits, it would cost \$21.95 monthly just to access her funds via

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<sup>4</sup> See Statement of Steve Fritts, Associate Director, Risk Management Policy and Examination Support Branch, Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation, Testimony Before the Subcommittee on Social Security of the House Committee on Ways and Means, June 24, 2008.

CheckDirect (\$3 fee for Republic, \$2.95 for ACE to print the check plus \$16 to cash the check). Ironically, the recipient pays these fees for a product that simply converts the electronic payment made by Treasury back into a paper check and then cashes it.

Currency Connection's prepaid debit card product comes with similarly high fees, including \$19.95 to set up the account and a monthly \$19.95 service fee. ATM transactions at Republic ATMs are free, but Republic charges \$2 each time a customer uses another bank's ATM plus whatever surcharge the "foreign" ATM imposes. Point-of-sale or balance inquiry fees are \$1 each. (A copy of documents showing these fees is included in Appendix 2). While Currency Connection charges fees as high as or higher than many bank debit cards, it is unclear whether its cards are subject to Regulation E protections for such things as unauthorized transfers, dispute resolution, and disclosures.

Recipients who are enrolled in third-party direct deposit accounts such as Currency Connection have no direct control over their funds. The bank deducts its fees and the fees charged by the check casher or third party that delivers the "check" or prepaid debit card. More problematic is that the contracts for such products often include fine print that permits the bank to hand over exempt funds to make loan payments on behalf of the recipient before delivering the rest. For example, Republic's contracts for Currency Connection authorize both the bank and the third party EFI to withdraw funds from the deposit to repay obligations to either the bank or the EFI. The Agreement states:

***You agree that the Bank may, unless prohibited by law, debit funds from your Account to pay all or portions of any amounts you may owe the Bank or your EFI. You acknowledge that the Bank may set-off against your Account in order to recover any ineligible benefits or payments you may have withdrawn if the Bank is obligated to return the funds to the entity that originates your payment ("Direct Deposit Originator"). Either you, or the Bank may transfer or close your Account at any time. Upon Account closure, the Bank will return to you the available balance in your Account less any fees or charges, claims, set-offs, or other amounts you owe the Bank or EFI.*** (Emphasis added; copy included in Appendix 2)

Indeed, Currency Connection touts its service to payday lenders and other loan companies to "**enhance(s) collection efforts for in-house lending.**" (See Appendix 2).

In addition to assisting payday lenders and other creditors in collecting their debts, Currency Connection offers its own source of credit -- an optional "Overdraft Honor" Feature which turns its prepaid card into a credit instrument. Overdraft Honor fees are \$34 per overdraft plus \$6 per day up to \$30. (See Appendix 2) It is available to Currency Connection customers who receive at least \$400 per payment. **A Social Security recipient who elected the Overdraft feature would be charged about 200% APR for a cash advance**, assuming the loan was outstanding for a full month. A recipient who overdrew on the card a week before the next SSI deposit was due would pay 834% APR. Overdraft loans are repaid out of the next deposit into the account. This



gives the bank first claim on exempt funds to repay exorbitantly priced loans. Currency Connection's Overdraft feature also appears to violate Section 207 of the Social Security Act, which prohibits assignment of benefits to pay debts.<sup>5</sup>

Finally, a deeper problem with programs such as Currency Connection is that they lure unbanked and low-income consumers into the check cashing or payday loan store, keeping them dependent on these fringe providers and exposing them to even more abusive products. One of the benefits touted by Republic for Currency Connection is that: "Check cashers can ensure their customers will come back month after month with the Currency Connection DirectDeposit Program. Enroll in this FREE program to become a Republic Bank Electronic Funds Issuer and start increasing your customer retention and overall profitability." (See Appendix 2). Banks should be helping low-income and unbanked consumers to open reasonably-priced bank accounts, not driving them into the arms of check cashers and payday lenders.

### C. Conclusion

Republic has demonstrated a pattern of reaping unfair profits from low-income consumers by encouraging them to use high costs loans and products, such as RALs, payday loans, and its Currency Connection product. The company's conversion to a thrift charter should not allow it to continue to engage in these egregious practices, while making minimal CRA commitments to the communities that it is exploiting. The undersigned groups respectfully request that OTS deny Republic's application or require Republic to reform its RAL and Currency Connection business as a condition of granting the application.

The undersigned groups also request a formal meeting on Republic's application to discuss these issues. Thank you very much for your attention to this matter.

Chi Chi Wu  
National Consumer Law Center

Jean Ann Fox  
Consumer Federation of America

Sarah Ludwig, Josh Zinner &  
Alexis Iwanisziw  
Neighborhood Economic Development  
Advocacy Project

Kimberly S. Jones  
California Reinvestment Coalition

Peter Skillern  
Community Reinvestment Association of NC

cc: The Honorable Barney Frank  
The Honorable Christopher Dodd  
The Honorable Maxine Waters

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<sup>5</sup> SSA, POMS, GN 02402.045.B, *Direct Deposit and Assignment of Benefits*. A request for direct deposit that assigns or transfers the right to future payment to someone other than the beneficiary is an assignment of benefits.



**APPENDIX 1 –**  
**PAGES FROM REPUBLIC’S RAL WEBSITE**





# 1. Fast and Aggressive RAL Approvals

95 % of RAL applications are approved with most checks released within minutes of the IRS acknowledgement.

TOP TEN WAYS TO EXPERIENCE THE DIFFERENCE



1

2

3

4

5

6

7

8

9

10





## 2. Highest RAL Incentives

Year after year, we offer EROs the most lucrative incentive package available so you are well compensated for the work you do to process loans for your customers.

TOP TEN WAYS TO EXPERIENCE THE DIFFERENCE



1

2

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10



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## ERO Support

[Overview](#)[Support Options](#)[Marketing Assistance](#)[Training Seminars](#)[ERO Incentives](#)

### The Best Incentives Available

Earn up to \$16 per RAL customer!

[Read More »](#)

### Contact Us

Republic Bank  
Tax Refund Solutions  
P.O. Box 2348  
Louisville, KY 40201

### Sales

888-676-2056

### Customer Service

866-491-1040

### ERO LOGIN

Internet Explorer 6.0 or higher is required

EFIN

Password



## ERO Incentives

**RAL Volume** - \$6 per RAL

**NowRAL** - \$3 per NowRAL

**Federal ERC/ERD** - \$5 per ERC/ERD

**State ERC/ERD** - \$2 per ERC/ERD

### RAL Performance

RAL Loan Loss %	Incentive Per RAL
0.00%	\$7
0.01 - 0.25%	\$5
0.26 - 0.50%	\$4
0.51 - 0.75%	\$3
0.76 - 1.00%	\$2

### Optional Flexi-Pricing earns an additional \$5 per Federal ERC/ERI

**Here's how it works:** we give you the freedom to earn additional money on the Federal and State ERCs & ERDs. After assessing the competition in your business positioned in the marketplace, you can choose to add any amount between \$0 and \$10. When the checks print at your office, the add-on amount is and will be paid to you as an additional incentive after tax season.

To take advantage of this flexible option, simply select your add-on amount when you sign up or renew with Republic Bank:

1. When you sign up or renew with Republic Bank
2. By logging into your TIC account on [republicrefund.com](http://republicrefund.com)

*All incentives are calculated as of May 31 and paid by June 15. Minimum of 100 RALs/NowRALs/Federal ERCs/ERDs to qualify for all incentives. RAL incentives are for NowRALs only. All incentives are subject to change.*

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[HOME](#)[PRODUCTS](#)[ERO SUPPORT](#)[PARTNERS](#)[S](#)[CONTACT](#)**ERO LOGIN**Internet Explorer 6.0 or  
higher is required

EFIN

Password



## Products

[Overview](#)[Refund Anticipation Loans](#)[Electronic Refund Checks &  
Deposits](#)[Disbursement Options](#)[Pricing](#)[Check Cashing Options](#)

## 2007/2008 RAL Pricing

**RAL PRICING**

Loan Amount	Fee
\$3,501-\$8,000	\$125
\$2,001-\$3,500	\$110
\$1,001-\$2,000	\$80
\$501-\$1,000	\$44
\$500 and less	\$34



### The Best Incentives Available

Earn up to \$16 per RAL customer!

[Read More »](#)

### Contact Us

**Sales**

888-676-2056

**Customer Service**

866-491-1040

**NowRAL PRICING**

Loan Amount	Fee
\$585	\$85
\$1,085	\$85
\$1,585	\$85

## 2007/2008 ERC/ERD Pricing

**ERC/ERD PRICING**

Product	Fee
Electronic Refund Check	\$30
Electronic Refund Deposit	\$30
State ERC or ERD	\$10

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**APPENDIX 2 –**  
**CURRENCY CONNECTION MATERIALS**




[CARD ISSUERS](#)
[CHECK CASHERS](#)
[CONTACT US](#)

#### Card Issuers

- ▶ Card Products
- ▶ Referral Rebates
- ▶ EFI Support
- ▶ Marketing Support
- ▶ FAQs
- ▶ Sign Up

#### Check Cashers

- ▶ Check Products
- ▶ EFI Support
- ▶ Marketing Support
- ▶ FAQs
- ▶ Sign Up

#### Customer Application

#### Contact Us

#### Home

## CHECK CASHERS: CHECK PRODUCTS

### [Direct Deposit Program](#)

#### Direct Deposit Program

Check cashers can ensure their customers will come back month after month with the Currency Connection Direct Deposit Program. Enroll in this program to become a Republic Bank Electronic Funds Issuer (EFI) and start increasing your customer retention and overall profitability.

#### How It Works

- Sign up customers for the direct deposit of payroll, government benefits, child support, unemployment, retirement or any other regular direct deposit to Republic Bank
- Funds are deposited (government benefits are usually sent 2-4 days early) and checks are printed at your location through free Republic Bank software
- Checks are cashed at your business month after month

#### What it Costs

- \$4.00 Republic Bank Fee to customer for each direct deposit check printed over \$50.00.
- \$3.00 Republic Bank fee to customer for each direct deposit check printed under \$50.00.
- \$3.00 Republic Bank fee to customer for each direct deposit payroll check printed
- Fees will be charged for each check, including reprints
- \$0.50 Live Agent Fee per call (four (4) free per month)
- EFI has option to charge additional check printing fee ranging from \$1 to \$5

#### Benefits to Check Casher

- Pay nothing to offer this value-added service
- FREE checks and software provided by Republic Bank
- FREE customer service provided by Republic Bank
- Great tool for customer retention and growth
- Enhances collection efforts for in-house lending
- No returned checks due to insufficient funds

#### Benefits to Customer

- Government benefit checks available 2 – 4 days earlier than mailed checks
- Eliminates worrying about lost or stolen checks
- Funds are FDIC insured


[CARD ISSUERS](#)
[CHECK CASHERS](#)
[CONTACT US](#)

#### Card Issuers

- Card Products
- Referral Rebates
- EFI Support
- Marketing Support
- FAQs
- Sign Up

#### Check Cashers

- Check Products
- EFI Support
- Marketing Support
- FAQs
- Sign Up

#### Customer Application

#### Contact Us

#### Home

## CARD ISSUERS: FREQUENTLY ASKED QUESTIONS

1. [Who would offer Currency Connection?](#)
2. [Who would sign up for Direct Deposit Services through Currency Connection?](#)
3. [What are the costs for the Debit Card Customer?](#)
4. [What benefits will the Debit Card Customer have?](#)

### 1. Who would offer Currency Connection?

Electronic Funds Issuer (EFI):

- Check Cashers
- Pawn Shops
- Retail/Grocery Stores
- Finance Companies
- Tax Preparers
- Churches and other organizations
- Employers

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### 2. Who would sign up for Direct Deposit Services through Currency Connection?

Direct Deposit Customer:

- "Unbanked" individuals who receive some sort of recurring payment or benefit
- Individuals who live in a mostly cash economy
- Individuals who prefer not to work with banks because of past history or personal preference
- Individuals whose employer has made direct deposit mandatory
- Individuals who cannot get a bank account because they have been reported to CheckSystems for misusing a previous bank account

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### 3. What are the costs for the Debit Card Customer?

Card Program:

- \$19.95 account setup fee
- \$19.95 monthly service fee
- Free RBT ATM transactions, \$2.00 non-Republic ATM transaction fee
- \$1.00 Point-of-Sale or Balance Inquiry fees
- \$0.50 live agent fee per call (four (4) free calls per month)

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### 4. What benefits will the Debit Card Customer have?

- Mastercard logo card
- Able to choose a debit card rather than a check
- Debit card access at POSs and ATMs across the nation
- PIN number
- Secure FDIC insured deposits
- Safer than carrying cash



ACE CheckDirect Deposit Account Application and Agreement

FAX OR MAIL THIS FORM TO ACE CHECKDIRECT PROCESSING. FAX No. 1-866-758-3982. FOR MORE INFORMATION, CALL 1-877-757-3400

Complete all information using capital letters

Form with fields for First Name, M.I., Last Name, Social Security Number, Birthdate, Address, Apt. #, City, State, Zip Code, Phone, and Mother's Maiden Name.

Form section for 'CHECK THE TYPES OF DEPOSITS YOU RECEIVE' including checkboxes for Payroll/Pension, Tax Refund, and Other. Includes fields for Employer Name and Employer Phone, and a section for Government Benefits with two tables for Beneficiary SSN, Name, and Type.

Identification Information section with text: 'Identification Information (Two forms of ID must be presented. At least one must be a current picture ID from Group A)'. Includes fields for Group A (Drivers License, DMV/BMV State ID, Military ID, US Passport/Resident Alien ID), ID#, ID Issue Date, ID Expiration Date, and Location of Issuance. Also includes a statement for EFIs and Group B (Govt. issued Soc. Sec. Card, Visa/MC/Discover, Union Membership Card, Check Cashing Card, Prior Client, Student Id, Emp. ID).

Other Charges: Your Electronic Funds Issuer (EFI) in offering this service to you may automatically impose an additional disbursement charge. Ask your EFI for information regarding additional charges, if any, you may be assessed.

ACE CheckDirect Deposit Account Agreement
I certify that I am entitled to the payments identified above, and that I have received, read, and understood the information contained in the "New Customer Packet". By signing this form, I authorize my payment to be sent to Republic Bank & Trust Company ("The Bank") to be deposited to the designated Account.

By submitting this Application and Agreement ("Agreement"), you hereby authorize the Bank to establish a non-interest bearing deposit Account ("Account") in your name, to receive the electronic deposit ("Direct Deposit") being paid to you. Your Account will open upon receipt and approval of your Application and Agreement.

You hereby appoint your EFI to act on your behalf regarding your Account. You authorize your EFI to provide and receive personal, non public information regarding you, including but not limited to all Account activity and all related information maintained by the Bank. You agree that the Bank may, unless prohibited by law, debit funds from your Account to pay all or portions of any amounts you may owe the Bank or your EFI. You acknowledge that the Bank may set-off against your Account in order to recover any ineligible benefits or payments you may have withdrawn if the Bank is obligated to return the funds to the entity that originates your payment ("Direct Deposit Originator").

Either you, or the Bank may transfer or close your Account at any time. Upon Account closure, the Bank will return to you the available balance in your Account less any fees or charges, claims, set-offs, or other amounts you owe the Bank or EFI. The terms and conditions of this Agreement, including the fees and charges listed in this Agreement, are subject to change and you will be notified of such changes at least (30) calendar days prior to the effective date of the change, by mail, to your mailing address on record. By maintaining your Account after the effective date of the change, you agree to be bound by the changes. If no deposits are received or no disbursements are taken over a period exceeding forty-five (45) calendar days, your Account will be closed and all subsequent direct deposits will be returned to the Direct Deposit Originator.

Signature \_\_\_\_\_ Date \_\_\_\_\_ Store No. \_\_\_\_\_
Last Four Digits of Sales Associate Social Security Number \_\_\_\_\_

## **Republic Bank & Trust Company**

### **Currency Connection Overdraft Honor Rules and Restrictions**

As used in this Policy, the terms “you” and “your” refer to account holders and the terms “we” and “us” refer to Republic Bank & Trust Company. Overdraft Honor is not a line of credit. It is a discretionary program and not a right or obligation guaranteed to you. We agree to pay your overdrafts including any applicable fees up to the applicable Overdraft Honor Limit when your account meets the good standing requirements listed below. Good standing may include, but is not limited to, any or all of the following criteria and is subject to change without notice:

- Your account has been open and active at least 60 from the date of your first regular direct deposit (excluding payday loans and Moneygrams) for a \$200 Overdraft Honor Limit.
- You are receiving regular direct deposits, excluding payday loans and Moneygrams, (at least 3 in the last 60 days) to cover withdrawals consistent with your past practices.
- You have received \$400 or more in direct deposits in your account in the past 30 day period.
- You are not in default on any loan or other obligation to us.
- You are not subject to any legal or administrative order or levy.
- Your account is not overdrawn more than 30 days.

We have adopted this discretionary overdraft policy to provide for the highest efficiency in managing customer overdrafts consistently and fairly. We may pay and permit transactions for items, including ATM withdrawals, debit card transactions, preauthorized automatic debit, telephone-initiated transfers or other electronic transfers (Items) when you do not have sufficient available funds, up to the Overdraft Honor Limit. An insufficient funds/overdraft fee of \$34 per Item will be assessed for each Item that is submitted for which you do not have sufficient available funds in your account to cover the Item when it is processed each evening. A \$6 daily overdraft fee will be assessed each business, up to a maximum of 5 days, the account is overdrawn. The \$34 per item fee will be assessed for the first 2 for Items that we pay each day under the Overdraft Honor program and for the first 10 Items that are returned unpaid each day.

**It is our current practice to process account activity each evening for Items received prior to the daily cut off time. We sort Items for processing by crediting all deposits first followed by the processing of all debits in dollar amount order from high to low. Your account balance is adjusted downward equal to the amount of each Item processed. An insufficient funds/overdraft fee will be charged for each Item if the amount of the Item is greater than the account balance at the time the Item is**

**processed. Overdraft Fees, Returned Item Fees and Daily Overdraft Fees will reduce the available balance of an account which will impact the availability of the Overdraft Honor limit. In the event the Overdraft Honor Limit is exceeded the Bank may return Items at our discretion to maintain the account balance within the Overdraft Honor Limit. All Items processed are subject to an overdraft fee if not paid with available funds. All Items returned for non-sufficient funds are subject to a \$34 returned Item fee. Multiple \$34 charges for overdraft and non-sufficient funds may be assessed for a business day when multiple Items are paid and/or returned in accordance with this Policy. For example, if in one day you make the following deposits and the following Items are due for payment, under the Overdraft Honor Program, the following would result:**

Transaction		Balance after transaction
Deposit	\$100.00	\$ 200.00
Check	\$250.00	\$( 50.00)
ATM debit	\$ 80.00	\$(130.00)

**The above transaction sequence would result in overdraft charges totaling \$68 (\$34 per Item) plus a \$6 daily overdraft charge for each business day the account remains overdrawn.**

If a transaction is presented for payment on your account and an overdraft occurs, pursuant to your Depositor's Account Agreement you agree to pay us the amount of any overdraft and applicable fees immediately, without notice or demand from us. Each account holder is jointly and severally responsible under the Depositor's Account Agreement for paying any overdraft amounts.

It is the policy of Republic Bank & Trust Company to operate in accordance with all applicable regulatory safety and soundness standards. Your Depositor's Account Agreement sets out your duties, obligations and rights of the Depositor, the Authorize Signatories and the Bank with regard to your Currency Connection account. Your Depositor's Account Agreement shall control in the event of any conflict between this Overdraft Honor Policy and your Depositor's Account Agreement.

If you would like to have your account removed from the Overdraft Honor Program you may do so, but please understand that all accounts are subject to overdraft fees. If your account is not part of the Overdraft Honor Program it the Bank's policy to charge a return check fee of \$34 per Item, together with the \$6 daily overdraft fee, and return all returnable Items presented for payment if funds are not available.

To cancel your participation in Overdraft Honor please submit your request in writing to:

Overdraft Honor Department  
Republic Bank & Trust Company  
601 West Market Street  
Louisville, KY 40202

Or contact us at 1-888-584-3600.



**APPENDIX 3 –**  
**RAL MYSTERY SHOPPER REPORT**



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# TAX PREPARERS TAKE A BITE OUT OF REFUNDS:

## MYSTERY SHOPPER TEST EXPOSES REFUND ANTICIPATION LOAN ABUSES IN DURHAM AND PHILADELPHIA

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April 2008



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Tax Preparers Take a Bite out of Refunds:  
Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham  
and Philadelphia

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TESTING CONDUCTED BY:

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## SUMMARY

Nonprofit groups in Philadelphia and Durham conducted 17 “mystery shopper” tests of paid tax preparers. The results reveal an industry that varies tremendously in terms of providing consumers with information about refund anticipation loans (RALs), and in its overall quality of services.

Test results found that a significant number of preparers still do not inform taxpayers that a RAL is a loan. Three preparers in Durham and two in Philadelphia did not explain to testers that a RAL is a loan. Two other preparers in Philadelphia made this disclosure only after being questioned by testers.

Even when testers were told that a RAL is a loan, there were confused because many preparers did not give clear price information about RALs, other bank product options, and tax preparation fees. Only one preparer in either city informed the tester of the option to receive a fast, free refund by e-file and direct deposit.

Five testers were given RALs or other bank products by default. One tester was only given a RAL as an option; one was only given the option of a RAL or other bank product; and at least three others were automatically required to pay charges for bank products for state refunds.

One of the most disturbing test results involved the quality of tax preparation. Several preparers made serious errors that significantly affected tax liability. Two testers were required to file amended returns to fix errors and one tester withdrew after the preparer advised him not to include investment income on a return, essentially recommending tax fraud.

Independent preparers vary greatly in their treatment of taxpayers. Many of them charged multiple ancillary fees, including one preparer who charged \$324 in such fees. One independent preparer turned out to be primarily a gift shop and the other was a small loan lender. However, another independent preparer steered both testers who went to her office away from RALs.

## **A. Introduction**

Every year, hundreds of millions of Americans undertake one of the most important and complicated financial tasks imaginable – filing their tax returns. Some will fill out a form with pen & paper, others will use a software program or website, and some will be helped by nonprofit programs. About 59% of taxpayers will pay a commercial preparer to complete their tax return.<sup>1</sup> This rate is an even higher 71% among recipients of the Earned Income Tax Credit (EITC), a refundable credit intended to boost low-wage workers out of poverty.

Despite the importance and complexity of this task, neither federal nor state governments comprehensively regulate tax preparers (the exceptions are California and Oregon). There are no minimum educational standards or certification to become a tax preparer. Seventy million Americans put their trust, their legal liability for taxes, and their financial health in the hands of unregulated paid preparers.

One of the thorniest problems with paid preparers is their role in promoting, selling and arranging refund anticipation loans (RALs). RALs are one to two week loans made by banks and facilitated by paid preparers, secured by the taxpayer's refund. RALs can be expensive, with some lenders charging fees that translate into triple digit Annual Percentage Rates (APRs). RALs cost taxpayers hundreds of millions of dollars every year, and expose taxpayers to unmanageable debt if a problem with a refund results in the loan being unpaid. In addition, there has been a history of deception and misinformation about RALs.

## **B. Testing Background**

This tax season, Community Legal Services in Philadelphia (CLS) and the Community Reinvestment Association of North Carolina (CRA-NC) conducted a “mystery shopper” project to examine paid preparer practices with respect to RALs. CLS and CRA-NC recruited 17 taxpayers to become testers, about 12 of whom received the Earned Income Tax Credit (EITC).

Testers were recruited and briefed about the nature of project. The testers were instructed to have their returns prepared and obtain RALs from commercial preparers. In Philadelphia, testers were interviewed by CLS personnel who wrote up narratives, or the testers wrote up the narratives themselves. In Durham, a consultant developed an interview form that the testers used to report their experiences. Copies of the narratives in the CLS tests are attached to this report. Also attached is a spreadsheet that summarizes the testing.

Testing was focused on RAL disclosures and practices; however, other issues became apparent, including the quality of tax preparation. Testers reported a variety of experiences, from preparers who actively discouraged testers from taking RALs to those that signed up testers for a RAL or other products by default. Testers documented a range of problems, abuses and misrepresentations involving RALs, which are analyzed below.

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<sup>1</sup> Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

Five tests were conducted in Philadelphia; two other testers had to withdraw because of problems with their returns. Eleven tests were conducted in Durham; one tester withdrew because of shockingly poor preparation, but his experience is discussed below.

Several testers were ultimately denied RALs but flipped into a “refund anticipation check” (RAC). 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 and closes the temporary account.

### **C. Observations on the Adequacy of RAL Disclosures**

One of the key issues in the testing was to determine whether RAL borrowers are adequately informed about the nature of RALs, their costs, and risks. The tests reveal that while some preparers are disclosing that a RAL is a loan, this disclosure is not uniformly made. Moreover, the fees, risks and other pertinent facts about the loan are not adequately explained.

#### **1. Failure to Disclose that a RAL is a Loan**

Three of ten testers (or 30%) in the Durham tests were not told that a RAL was a loan. The eleventh tester was not offered a RAL or RAC, and the twelfth tester never reached the issue because he withdrew due to poor quality tax preparation. For one preparer who did not explain that a RAL is a loan, the tester (TR) saw the watermark on the loan documents that disclosed the fact. Thus, many of the Durham preparers did fulfill the basic requirement of informing the taxpayer of the nature of a RAL, but the fact that 30% did not raises concerns.

In Philadelphia, the rate was much worse – 2 of the 5 preparers (40%) did not explain that a RAL was a loan, and two more (40%) did so only after questioning by testers. The CLS testers provided detailed narratives of their experiences. One tester (EF) described the lack of explanation at an independent preparer’s office, reporting that the preparer never explicitly referred to the RAL as a loan, nor were the loan terms disclosed until the moment of signing. EF concluded that: “The loan was poorly explained, verging on misrepresentation.” EF also explained:

I was then told that I had three options.

1. If I paid an additional \$48 I would receive my refund tomorrow.
2. I could pay \$42 and receive my refund in two weeks.
3. I could pay nothing and receive the refund in six weeks.

At no time did he refer to this as a loan. One could easily have thought he was just charging an extra fee for expedited service. At this point I asked what the total cost would be, including preparation. While he was rattling off the numbers he listed a \$53.46 fee to Chase. I then asked what Chase had to do with anything. He finally said that they were the bank that would be backing my Refund Anticipation Loan. I asked if the \$48 was pre-paid interest and he said “yes.”

Another tester [KH] had this to say about a different independent preparer:

The preparer always referred to the RAL, or refund anticipation loan, option by using the acronym "RAL." She never described it as a loan. The computer screen displaying the refund options did include the word "loan," but only once and in small print. When [KH] directly asked the preparer what a "RAL" was, the preparer told her, "It's the way you get your money faster."

A married couple of testers (A&VS) described a similar experience in a Jackson Hewitt office in Philadelphia. The Hewitt preparer only presented A&VS the options of a paper check taking 21-28 days, a RAC, a RAL, or an instant RAL. According to A&VS:

the preparer did not explain that the "RAL"/one day option was a loan. The preparer always referred to the option of taking out a refund anticipation loan by using its acronym, "RAL," and never once used the word "loan" to describe it.

## 2. Presenting the RAL as a Default, Without Presenting Other Options.

An especially egregious practice documented in the past has been signing taxpayers up for a RAL as a default, without presenting other options.<sup>2</sup> One tester (BK) appears to be a victim of this practice. A Liberty Tax preparer in Durham signed up BK for a RAL by default, and did not present her with other options. Also, a tester in Philadelphia (KH) was only presented with a RAL or RAC as an option, and not informed of free options.

The testing revealed another abusive practice -- requiring taxpayers to receive and pay for a RAC for a state refund. RAL banks do not offer loans on state refunds, but they do offer RACs for them. Three testers were automatically given a RAC for a state refund at a cost of \$10 when they received a RAL or RAC for their federal refund. This abuse was observed at two Jackson Hewitt offices in Philadelphia (A&VS and TM) and a Liberty office in Durham (OH). Since tax preparation fees could already be deducted from the RAL or RAC for the federal refund, imposing a \$10 fee for processing a state refund offers little benefit to the taxpayer, especially if the taxpayer has a bank account already.

## 3. Failure to Disclose Free E-File, Direct Deposit Option

Very few of the tax preparers in either city informed testers about the option to receive a refund in 8 to 15 days if they e-file and use direct deposit. In Philadelphia, all of the testers specifically noted that they were not offered the free e-file, direct deposit option. In Durham, only one tester (DL) reported that he was informed of the free e-file, direct deposit option.

The failure to disclose the ability to receive an e-file, direct deposit refund in 8 to 15 days is problematic because this is the primary method that taxpayers can receive a quick

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<sup>2</sup> Mystery shopper tests by CLS in both 2005 and 2006 reveals such incidents at both Jackson Hewitt and H&R Block. Letter from Irv Ackelsberg, Community Legal Services to Michael Lister President and CEO of Jackson Hewitt Tax Service Inc., April 4, 2006; Barbara J. Isenberg, *CLS's Deduction: H&R Block Deceptive*, Philadelphia Daily News, March 29, 2005.



refund without incurring any additional fees. Some states require disclosure of this free option, but in writing, not orally. Without such a disclosure, taxpayers may assume they need to wait several more weeks for a paper check by mail.

Furthermore, some testers were sold RACs, which cost \$30. RACs do not have an advantage in terms of speed over RALs. Also, some preparers charge ancillary fees, such as “document filing” and “e-file” fees, for RACs as well as RALs, making them almost as expensive as RALs. In fact, a couple of testers indicated that they got the impression a RAL was not that expensive because the preparer mentioned it was only a certain amount – e.g., \$9 or \$35 – on top of a RAC. One preparer erroneously told the tester (TM) it would be the same fee. When framed in this manner, some taxpayers may be tempted to take a RAL because they only focus on the marginal costs that the preparer emphasizes, not the total costs – nor the risks.

#### 4. Confusion

Even when preparers explained that a RAL was a loan, some of the testers were confused by the preparer’s explanation of the product and by the fees. A common theme in the testing reports is confusion and lack of transparency.

For example, one tester (SH) reported that when a Block preparer discussed a RAL with her, the preparer did say it was a loan “But the fees was an (sic) unclear; she just seemed to do a lot of things w/o explaining them.” This tester also reported:

When it came time to end the procedure, she asked a co-worker, who had just come in about some of the fees that I may or may not incur with the different options for refund receipt [sic]. Overall, she was very nice, but I left feeling a little confused and when it comes to money, that’s not the way you want to feel.

Another tester reported:

[KH] was asked to fill out a two-sided form with her personal information. On the back of the form were three options she could choose for receiving her tax refund, described as: (1) RAL (24-48 hours), (2) Direct Deposit (10-14 days) and, (3) Check by Mail (6-8 weeks). The fees for the various options were not disclosed, so [KH] asked the tax preparer if she had a fee schedule. The preparer told her that a fee schedule was not available, but all of the fees would be broken down for her once the return had been prepared.

The “Direct Deposit” option turned out to be a RAC, not the free e-file, direct deposit option. Later on, after the preparer finished completing the return, she again reviewed the options for receiving the refund proceeds, but this time omitted the free “Check by Mail” option.

Also, two testers (JC and OH) were denied RALs, and were flipped into RACs. In these cases, the preparers did not adequately explain that the testers would be given another product and they would be charged a fee. In fact, a Liberty preparer implied to one tester

(OH) whose RAL was denied that he would receive a check from the government, which was untrue.

The second tester (JC) reported when he returned to the office of an independent preparer “she also notified me that my RAL was converted to a PERC. I asked what a PERC was, and she could not explain in a manner I understood.” A third tester (GC) was denied a RAL and was so confused that she could not even explain whether she had been flipped to a RAC or had paid for the tax preparation out of pocket.

Testers also reported being confused by the “e-file”, “document preparation” and other ancillary fees imposed by independent preparers. One tester (RH) stated “She discounted her fee of \$100.00 [sic] dollars, she had originally said 75.00 so later on I noticed there was a fee for document preparation she never mentioned.”

##### 5. Rushing Clients through Documents Without Allowing Time To Comprehend Them

One of the problems we have discussed before is that written disclosures are not useful because taxpayers do not have the opportunity to review them. This phenomenon was observed in some of the tests.

One tester (DC) reported being handed:

a series of forms which [the preparer] did not elaborate on that I had to sign to get the RAL. She told me the expected amount, minus their fee, and the banks fee to write the check, but did not explain anything I did not ask. And even when asking it was a very surface answer to the question because they were closing at 9pm. . . . I signed a lot of forms with the cursory explanation of ‘this just means’ and I was told I could pick my check up around the 29<sup>th</sup> and the state would mail a check directly to my house a couple days later. After later reviewing the forms in my packet which I am not sure whether I signed off some of these there were deeper explanations of terms and conditions and other information which I am not sure whether I was presented or not because their was no place for signature or initials and they do not look familiar.

Another tester (EF) reported that when he tried to read the documents, the preparer at an independent store became anxious. EF recounted how:

The last thing I signed was the loan agreement. I began to read it over and he seemed anxious for me to just sign it and several times made comments to the effect that it was just paperwork laying out what we'd already discussed. The “contract” I signed is titled “Bank Product Information,” is extremely vague, and does not explicitly list the terms of the contract being entered into. I thought I remembered signing a contract with at least some more boilerplate language in it, but if I did it was not included in the packet he handed over to me. Furthermore, as opposed to the \$48 figure I had been quoted, the actual bank fee was \$63—with no explanation from [the preparer] as to the disparity between the two figures. Of course, only \$11

of this consisted of pre-paid interest with the rest consisting of various processing charges.

Being rushed seems to be another theme of the tax preparation process. For example, the lead plaintiff in a RAL class action, *Hood v. SBBT*, recounts how she was rushed through the process and told to “sign here and here” so that her paperwork could go in the next “batch.”<sup>3</sup> Another tester [TM] recounted how:

The preparer told [TM] that she did not want to keep her at Jackson Hewitt for too long, and she'd work to get her out of the office quickly. [TM] asked if she was being charged by the minute. The preparer cryptically answered, "Yes and no." She stated that there was not a per-minute charge, but the system tracks how long it takes to complete the taxes and she indicated that the fees were "time-based."

Finally, even when they were given adequate information, some testers had difficulty comprehending it. One tester (RH) noted that an independent preparer did show her a poster and pamphlet showing different options to receive a RAL or refund, and even asked her to read the information but “[s]incerely, there was so much info. I just scanned through it. It seemed they could charge me other fees, but she said only the 1%.”

#### 6. Dissemination Of Factually Incorrect Information

In a few instances, preparers gave factually incorrect information to testers about the impact of an unpaid RAL. One tester (EF) reported the following regarding an independent preparer:

I then asked if I would be responsible for any additional fees if the refund fell short of what he had projected. He assured me I wouldn't be responsible for any fees because “We deal with the government for you.”

Another tester (AR) reported that when she asked a Block preparer why the APR on a RAL was so high “she said that I wouldn’t need to worry about it, that’s just if the refund doesn’t come through from the IRS and if it turns out that I owe money.”

### **D. Tax Preparation Fees**

Tax preparation fees varied widely between tax preparers and in some cases, between offices of the same commercial chain. Fees ranged from \$75 to \$355; however, the lower prices were charged by independent preparers who appeared to add extra fees when a RAL or RAC was involved.

Of the chains, Block’s pricing was the most consistent – around \$180. Jackson Hewitt’s varied significantly, from \$200 to \$355. Only two testers went to Liberty Tax Services, but their fees differed significantly (\$173 versus \$281).

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<sup>3</sup> Complaint, *Hood v. Santa Barbara Bank & Trust*, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara March 18, 2003).

Most independent preparers tended to “unbundle” their fees, showing lower tax prep fees standing alone, but then adding various fees such as document preparation, e-filing, transmitter, service bureau and other ancillary fees. These fees increased the amount paid by testers. In one case, the preparer listed a tax preparation fee of \$87, but then added \$324 in document preparation, e-filing, transmitter, and service bureau fees. Examples from other reports or case studies confirm this.<sup>4</sup>

Most of the preparers did not give the testers price estimates for preparation ahead of time. Several testers in Philadelphia (TM, AR, A&VS) who specifically asked about the price of tax preparation were refused information. The commercial chains base their pricing by form, and thus claim they cannot provide an estimate before preparation begins. This failure to provide clear pricing makes comparison shopping difficult.

One reason often cited for why taxpayers use RALs is to pay for tax preparation, because the fee can be deducted from the loan proceeds. Several testers (RH, TM, TR, A&VS) reported being informed that this feature was a benefit of a RAL. One tester (TM) even reported that a Hewitt preparer disparaged the option of receiving a check from the IRS because TM would have to pay the tax preparation fees upfront.

## **E. Poor Quality Tax Preparation**

Several testers were the victims of poor quality tax preparation. The original intent of the testing had not been to document the quality of tax preparation, but the repeated instances of errors were quite disturbing. The most shocking example came from a tester (JS) in Durham who ultimately had to withdraw from the test project due to an error that bordered on fraud by an independent preparer that also was a small loan company/payday lender.

After sitting in the office for an hour or so, she said that there was a problem that she did not know how to handle. The problem was that there was a \$5000 [fictional number] “dividend” that we must pay taxes on. With the dividend, our return would only return \$100. If she was to “ignore” it, then we would receive \$3000 in returns. She then called her “tax people,” whom told her that we do not need to report the dividends and just ignore it.

Essentially, this preparer had given the tester advice to commit tax fraud. Furthermore, it turns out that this tester had both dividend income plus profits from the sale of stock shares. The preparer completely missed the second source of income. This tester,

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<sup>4</sup> In a case sent to us by a reporter in Baltimore, a tax preparer advertised a \$36 tax preparation fee and “Faster and Cheaper than H&R Block/Jackson Hewitt” but then charged a consumer \$185 for an “electronic filing fee” and \$10 for a “transmission/software” fee – a total of \$195 in ancillary fees. Another case sent to us by a Florida attorney shows a tax preparer who charged \$65 for tax preparation, and then charged \$49 for a “RAL Processing Fee,” \$15 for a “Federal Electronic Filing Fee,” and \$10 for mysterious “Other charges.”

who was a law student and understood tax law, ultimately chose to withdraw from the testing and concluded:

My experience with [the independent preparer] has been a scary one. I say that mainly because the lack of confidence in the preparer's ability to competently complete our return even though she was generally nice. Furthermore, the other lady in the office was constantly on the phone hounding people for money. I do not know everything that was said but it seems like she was making many threats and at times, she was verbally abusive.

A married couple in Philadelphia (A&VS) had a similar experience.

Unfortunately, [the preparer's] inexperience appears to have caused her to make mistakes on the tax forms she prepared and filed for A&VS. Mr. S. had received approximately \$3500 in unemployment compensation during the year, which should have been included with A&VS's other earned income when calculating their total income for the year. The preparer, however, failed to include the unemployment compensation as income, and instead erroneously categorized it as "repaid benefits." In addition, she failed to include the \$25 in interest income A&VS had earned even though A&VS had provided her with the 1099 tax form from their bank regarding the interest income. A&VS did not catch these errors while they were in the store and prior to the preparer filing their return. The preparer's mistakes caused A&VS's return to understate their income for the year, and overstate their refund by 600! As a result, they had to file an amended return.

Other testers reported errors such as:

- A Jackson Hewitt preparer in Durham who failed to enter the tester's (TR) tuition information.
- The Jackson Hewitt preparer who handled A&VS's return also had never seen a mortgage interest Form 1098 and did not know how to handle it.
- Both a Jackson Hewitt preparer and an independent preparer in Philadelphia made numerous errors in dealing with education credits. One of the testers (EF) who was affected by this error reported:

EF felt that his preparer's understanding of the Hope Credit and Lifetime Learning Credit left much to be desired. The preparer mistakenly told EF that the Hope Credit could be taken only four times, as opposed to two, and then conflated this requirement with the Lifetime Learning Credit. Ultimately, the preparer told EF that he was ineligible for both education credits. Instead, he prepared EF's return with a tuition deduction. The tuition deduction did yield a higher return for EF than a Lifetime Learning Credit would have, but unfortunately the preparer proceeded to use the wrong figure for EF's Adjusted Gross Income (AGI). Specifically, the preparer incorrectly calculated the qualified education expenses by treating a taxable education award as though it were an exempt scholarship. This mistake resulted in an additional tax liability of \$66 and a loss of \$134 worth of EIC. Ultimately, EF had to file an amended return

Two of the testers (A&VS and EF) were required to amend their returns because of preparer error.

Finally, at least two of the independent preparers turned out to be businesses that primarily sold other goods or services. As noted above, JS's preparer primarily served as a small loan lender/payday lender (payday lending is illegal in North Carolina, but the same company operates as a payday lender in South Carolina). The other independent preparer was part of a store that primarily operated as a gift shop (JC).

## **F. Privacy Issues**

The privacy of tax return information is always an enormous concern, because tax returns contain some of the most sensitive financial information that a taxpayer may have. Tax preparers are subject to confidentiality rules under Section 7216 of the Internal Revenue Code and IRS regulation.

Despite these rules, one tester (KH) noticed serious privacy transgressions by a preparer:

KH noticed Instant Tax Service compromised the security of its clients' sensitive information. Each tax preparer keeps a file folder with the name and Social Security number of each client who is scheduled to return to pick up a refund or RAL check. These files are prominently displayed behind the desk of each associate. The names and Social Security numbers can easily be read by anyone in the office.

## **G. Other Products: Audit Insurance**

In addition to RALs and RACs, commercial preparers often sell other products, particularly plans that supposedly protect taxpayers if an error by the preparer results in additional tax liability, called "audit insurance." In 2003, the Attorneys General of 42 states obtained a \$3.3 million settlement with H&R Block over that company's practices regarding its "Peace of Mind" guarantee.<sup>5</sup> Block agreed in the settlement to obtain the taxpayer's authorization before charging for the Peace of Mind product and to refrain from "recommending" its purchase.

Block preparers appear to be in compliance with the settlement, with one Block preparer offering but not recommending the product (AR) and another Block preparer who appeared to even steer the tester away from the product (MA).

On the other hand, one of the testers (DL) was automatically charged for the Jackson Hewitt "Gold Guarantee." Not only did the Hewitt preparer fail to obtain the

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<sup>5</sup> Gene Meyer, *H&R Block Pays \$3.3 Million to Settle "Peace of Mind" Dispute*, Kansas City Star, April 25, 2003.

tester's agreement to buy the product, the tester specifically declined the product yet was charged for it.

## **H. Conclusion**

The mystery shopper tests in Philadelphia and Durham reveal an industry that varies tremendously in terms of providing consumers with information about refund anticipation loans, and in its overall quality of services. Some preparers left testers confused, unclear about the nature of RALs or the associated fees, and made serious errors on the testers' returns. Many preparers did not give clear price information about tax preparation fees either, due in part to the fact these fees can be paid for out of a RAL, making taxpayers less sensitive to their costs.

While most preparers in Durham did inform the testers that a RAL is a loan, 30% did not, which is troubling. In Philadelphia, the compliance rate was worse, with only three preparers making this disclosure, two of whom did so only after being questioned by the testers. Furthermore, only one preparer in either city explained to the tester the option to receive a fast, free refund by e-file and direct deposit. And even when testers were told that a RAL is a loan, information about loan terms and fees were presented in a confusing and often rushed manner.

Some of the worst practices occurred with independent preparers. These preparers tended to charged multiple ancillary fees. One independent preparer turned out to be primarily a gift shop and the other was a small loan lender. A couple of independent preparers provided poor quality tax preparation, with one preparer essentially recommending that the tester engage in tax fraud. To be fair, however, the most ethical behavior in the testing appeared to come from one independent preparer in Durham who steered both testers who went to her office away from RALs. Thus, independent preparers vary greatly in their treatment of taxpayers.

**ATTACHMENT 1**  
**CLS TESTERS' NARRATIVES**



## Summary of "Mystery Shopper" Visit to Instant Tax Service February 13, 2008

**Mystery Shoppers:** KH  
Student  
Married, Filing Jointly  
Total Income: \$10,277  
Qualifies for: EITC, Tuition Deduction,  
Student Loan Interest Deduction

**Store:** Instant Tax Service 33 S. 52nd Street in Philadelphia  
Bank Partner: Santa Barbara Bank and Trust (SBBT)

**Total Charges:** \$ 486.75 in fees  
100%: Percentage of EITC lost due to fees: (486.75/334)  
35%: Percentage of refund lost due to fees (486.75/1392)

### *Breakdown of Charges:*

- \$ 87.00 tax preparation fees
- \$149.00 E-file fee
- \$ 40.00 tax preparer fee for bank documents
- \$ 15.00 transmission/software fee
- \$120.00 service bureau fee
- \$ 34.80 refund anticipation loan fee (disclosed as **85.082% APR**)
- \$ 30.95 "dummy bank account" fee for federal return
- \$ 10.00 "dummy bank account" fee for state return

### **Summary of Visit:**

KH visited the Instant Tax Service tax preparation site at 33 S. 52nd in West Philadelphia on February 13, 2008.

KH was asked to fill out a two-sided form with her personal information. On the back of the form were three options she could choose for receiving her tax refund, described as: (1) RAL (24-48 hours), (2) Direct Deposit (10-14 days) and, (3) Check by Mail (6-8 weeks). The fees for the various options were not disclosed, so KH asked the tax preparer if she had a fee schedule. The preparer told her that a fee schedule was not available, but all of the fees would be broken down for her once the return had been prepared. KH declined to choose a refund option and told her preparer that she wanted to wait to see what the fees would be before making a decision.

### *Poor Quality Tax Preparation Services*

The preparer then began completing KH's return. As a student, KH qualified for several education tax credits. The tax preparer, however, was unfamiliar with these credits. When the preparer asked her supervisor about KH and her husband's tuition expenses, he told her that she could claim "Hope Credit, Lifetime Learning Credit, or tuition deduction." He mentioned that the Hope Credit is only available for two years. The preparer asked KH if she had taken the Hope Credit previously, and KH replied that she had not, but her husband had, and she was fairly certain that her parents had taken the Hope Credit for her when she was an undergraduate. Instead of investigating or explaining the different options, the preparer prepared the return with a tuition deduction.

She also failed to deduct KH's student loan interest. In the end, the preparer's omission of this deduction did not cause KH to suffer financially because she had zero tax liability for the year. For some people, however, this omission would have made a difference in tax liability, and KH did not get the impression that her preparer understood that it did not matter in her case.

### *Failed to Explain Refund Options and Failed to Explain that a RAL is a Loan*

After the preparer finished completing the return, she turned her computer screen around to show KH the options for receiving her refund. The screen displayed two options: a RAL and a "Refund Deposit" option. The "Check by Mail" option that had been listed on the form that was initially presented to KH when she entered the store was not included on this screen, and the preparer did not mention it as an option.

KH's federal tax refund was \$1392, and her state refund was \$302. With a RAL, KH would receive \$915.25 through direct deposit within 24-48 hours, and a \$302 state refund direct deposit. With the "Refund Deposit" option, she would receive \$950.05 within 10-14 days, and a \$302 state refund direct deposit. At no point did the preparer show the total fee amount for these options; the fees were always disaggregated in a long list of various charges. When KH asked for the total fee amount, the preparer used a calculator to add all the charges. In the end, the total fees for a RAL were \$486.75; the total fees for the "Refund Deposit" option were \$451.95, a difference of \$34.80.

The preparer always referred to the RAL, or refund anticipation loan, option by using the acronym "RAL." She never described it as a loan. The computer screen displaying the refund options did include the word "loan," but only once and in small print. When KH directly asked the preparer what a "RAL" was, the preparer told her, "It's the way you get your money faster." The RAL, of course, is a loan, which carries a higher risk than the "Refund Deposit" option because it must be paid back with interest even if the borrower does not receive a full refund back from the IRS. The interest for the RAL offered to KH was disclosed as an estimated 85.1% APR.

The "Refund Deposit" was not simply a direct deposit of KH's refund from the IRS to her bank account. Instead, with the "Refund Deposit" option, the preparer would arrange to

have KH's refund deposited into a "dummy" bank account at Santa Barbara Bank & Trust (SBBT). Once the IRS deposits the refund into the account, the bank deducts its fees for the account and the preparer's tax preparation fees. The remainder of the refund would then be deposited to KH's bank account. A much cheaper option would have been for KH to pay the tax preparation charges up front and have the IRS electronically deposit her refund directly into her own bank account. The preparer, however, never informed KH of this option.

KH agreed to the RAL option and took out a refund anticipation loan. She was never shown, and she did not sign, the loan application and agreement. A copy was provided to her along with her federal and state tax forms at the end of the session. The only documents she signed were (1) a release allowing Instant Tax Service to use an electronic PIN (personal identification number) to electronically file her return, and (2) a "Bank Product Information" schedule of fees.

#### *Poor Privacy Protection*

During the course of her session with tax preparer, KH noticed Instant Tax Service compromised the security of its clients' sensitive information. Each tax preparer keeps a file folder with the name and Social Security number of each client who is scheduled to return to pick up a refund or RAL check. These files are prominently displayed behind the desk of each associate. The names and Social Security numbers can easily be read by anyone in the office.

## Summary of "Mystery Shopper" Visit to Quick Refund Income Tax March 18, 2008

**Mystery Shoppers:** EF  
Student  
Total Income: \$11674  
Qualifies for: EITC, Tuition Deduction

**Store:** Quick Refund Income Tax 4249 Walnut Street in Philadelphia  
Bank Partner: J.P. Morgan Chase Bank, N.A.

**Total Charges:** \$ 148.46 in fees  
61%: Percentage of EITC lost due to fees: (148.26/242)  
13%: Percentage of refund lost due to fees (148.46/1146)

### *Breakdown of Charges:*

\$ 60.00 tax preparation fees  
\$ 25.00 document preparation fee to Quick Refund  
\$ 10.00 transmitter fee  
\$ 10.00 technology access fee to Chase  
\$ 11.46 refund anticipation loan fee (disclosed as **33.157% APR**)  
\$ 32.00 "dummy bank account" fee for federal return

### **Summary of Visit:**

EF visited the Quick Refund Income Tax tax preparation site at 4249 Walnut Street in Philadelphia on March 18, 2008.

### *Disclosed Tax Preparation Charges Up Front*

Prior to arriving at the site, EF called Quick Refund Income Tax to inquire about its price schedule and to set up a time to have his taxes prepared. Over the phone he was quoted a price of \$55 to prepare a federal return and \$15 for each additional state return prepared. When he arrived at the office he saw the same price schedule for preparation displayed prominently in large type at the entrance and also posted on a wall of the office.

### *Poor Quality Tax Preparation*

EF was assigned a tax preparer, who asked him for his W-2 forms, which EF provided along with his 1098-T form for tuition expenses. The preparer did not follow this with any inquiry into EF's savings, financial resources, alternate sources of income, public benefits, student loan interest (despite being told EF was a student), or any further inquiry. The only questions EF was asked was his birthdate, SSN, where he lived, and if he had claimed an education credit in the last four years.

EF felt that his preparer's understanding of the Hope Credit and Lifetime Learning Credit left much to be desired. The preparer mistakenly told EF that the Hope Credit could be taken only four times, as opposed to two, and then conflated this requirement with the Lifetime Learning Credit. Ultimately, the preparer told EF that he was ineligible for both education credits. Instead, he prepared EF's return with a tuition deduction. The tuition deduction did yield a higher return for EF than a Lifetime Learning Credit would have, but unfortunately the preparer proceeded to use the wrong figure for EF's Adjusted Gross Income (AGI). Specifically, the preparer incorrectly calculated the qualified education expenses by treating a taxable education award as though it were an exempt scholarship. This mistake resulted in an additional tax liability of \$66 and a loss of \$134 worth of EIC. Ultimately, EF had to file an amended return.

*Failed to Disclose the E-File, Direct Deposit 8-15 Day Refund Option;*

The preparer completed EF's federal tax return, and two state returns for a total charge of \$85. After completing his calculations, the preparer told EF that he was due a refund of \$1,146 for his federal income tax and \$155 from my state taxes. He was then told that he had three options:

1. If he paid an additional \$48 he would receive my refund tomorrow.
2. He could pay \$42 and receive his refund in two weeks.
3. He could pay nothing, other than the tax preparation charges, and receive the refund in six weeks.

As EF explained:

At no time did he refer to this as a loan. One could easily have thought he was just charging an extra fee for expedited service. At this point I asked what the total cost would be, including preparation. While he was rattling off the numbers he listed a \$53.46 fee to Chase. I then asked what Chase had to do with anything. He finally said that they were the bank that would be backing my Refund Anticipation Loan. I asked if the \$48 was pre-paid interest and he said "yes." He made no mention of the interest rates for these two refund loans, nor did he present me with the terms. To his credit, he did not push the 24 hour refund. Instead, he told me that unless I was really in a bind for money I would be better off to wait.

The tax preparer never informed EF that he could pay his tax preparation fees up front, and then electronically file her taxes and receive her refund in her own bank account within 8-15 days.

*Misquoted RAL Fee and RAL Terms*

EF chose to apply for the refund anticipation loan. The preparer proceeded to print all of the tax forms and had EF sign his 1040 and state filings. EF explained:

The last thing I signed was the loan agreement. I began to read it over and he seemed anxious for me to just sign it and several times made comments to the effect that it was just paperwork laying out what we'd already discussed. The "contract" I signed is titled "Bank Product Information," is extremely vague, and does not explicitly list the terms of the contract being entered into. I thought I remembered signing a contract with at least some more boilerplate language in it, but if I did it was not included in the packet he handed over to me. Furthermore, as opposed to the \$48 figure I had been quoted, the actual bank fee was \$63—with no explanation from [the preparer] as to the disparity between the two figures. Of course, only \$11 of this consisted of pre-paid interest with the rest consisting of various processing charges.

EF then asked if he would be responsible for any additional fees if the refund fell short of what he had projected. The preparer assured EF that he wouldn't be responsible for any fees because, "We deal with the government for you." The preparer's statement is false, as RAL borrowers are required to pay back the lender regardless of the amount of refund that the borrower ultimately receives from the IRS. EF was never provided with a copy of his loan application and agreement that would have disclosed those terms.

**Summary of "Mystery Shopper" Visit to Jackson Hewitt  
February 6, 2008**

**Mystery Shoppers:** A&VS  
North Philadelphia Residents  
2 Children  
Total Income: \$24,763  
Qualifies for: EITC, Add'l Child Tax Credit

**Store:** Jackson Hewitt at Broad and Allegheny in Philadelphia  
Bank Partner: Santa Barbara Bank and Trust (SBBT)

**Total Charges:** \$ 433.95 in fees  
16%: Percentage of EITC lost due to fees: (433.95/3898)  
8%: Percentage of refund lost due to fees: (433.95/5669)

*Breakdown of Charges:*

\$298.00 tax preparation fees  
\$ 95.00 refund anticipation loan fee (disclosed as **56.5% APR**)  
\$ 30.95 "dummy bank account" fee for federal return  
\$ 10.00 "dummy bank account" fee for state return

**Summary of Visit:**

A&VS visited the Jackson Hewitt tax preparation site at 1818 E. Allegheny (Kensington and Allegheny) in Philadelphia on February 6, 2008.

*Failure to Disclose Price*

Upon entering the store, A&VS noticed that there were no prices posted regarding the cost of tax preparation services. Once they were assigned a tax preparer, they asked how much Jackson Hewitt would charge them for preparing their taxes. The preparer explained that she would not know the total cost until she had completed the interview and forms. A&VS agreed to go forward, and the preparer began reviewing their W-2s and other tax documents.

*Poor Quality Tax Preparation Services*

As the preparer began completing their tax forms, it became increasingly clear that she was inexperienced. She often would have to stop and ask her colleagues in the store how to handle certain issues. For example, the preparer had never before seen a Mortgage

Interest Statement, Form 1098, and her colleagues had to inform her that it would be relevant if A&VS chose to itemize their tax deductions.

Unfortunately, her inexperience appears to have caused her to make mistakes on the tax forms she prepared and filed for A&VS. Mr. S. had received approximately \$3500 in unemployment compensation during the year, which should have been included with A&VS' other earned income when calculating their total income for the year. The preparer, however, failed to include the unemployment compensation as income, and instead erroneously categorized it as "repaid benefits." In addition, she failed to include the \$25 in interest income A&VS had earned even though A&VS had provided her with the 1099 tax form from their bank regarding the interest income. A&VS did not catch these errors while they were in the store and prior to the preparer filing their return. The preparer's mistakes caused the A&VS's return to understate their income for the year, and overstate their refund by \$600! As a result, they had to file an amended return.

*Failed to Explain Refund Options and Failed to Explain that a RAL is a Loan*

The tax preparer also failed to fully and adequately explain their options for receiving their refund and for obtaining a loan based on their refund.

After she finished filling out their tax forms and calculating their refund, the preparer told A&VS that they had four options for receiving their refund:

1. They could receive their refund directly from the IRS in the form of a check, which would take about 21-28 days, but A&VS would have to pay an up-front tax preparation fee;
2. They could get their refund in about 8-15 days for approximately \$338;
3. They could get a "RAL" and get their money the next day for approximately \$433; or
4. They could get a Money Now Loan and receive money in about an hour.

A&VS noticed that the preparer was reading these options from a chart that appeared on her computer screen, but they had difficulty reading the screen from the other side of the desk. The preparer did not provide them with any written materials about their refund options, and her oral presentation of the options included several omissions.

First, she failed to tell A&VS that they could receive their refund directly from the IRS in 8-15 days by paying an up-front fee for tax preparation, filing electronically and having their refund deposited directly into their bank account. Instead, the preparer lead A&VS to believe that they would have to wait 21-28 days to receive a paper check directly from the IRS. The only 8-15 day option that the preparer presented would have required A&VS to pay an additional \$40.95 for a "dummy" bank account at Santa Barbara Bank & Trust (SBBT).

Second, the preparer did not explain that the "RAL"/one day option was a loan. The preparer always referred to the option of taking out a refund anticipation loan by using its



acronym, "RAL," and never once used the word "loan" to describe it. This omission is troubling because the fact that a RAL is a loan, and not simply a rapid refund, poses a risk to low-income individuals who use RALs for their immediate financial needs. If the IRS denies part of the refund, seizes it to pay a student loan obligation or child support obligation, or temporarily holds it for an audit, the consumer is still responsible for the full amount of the loan at an extremely high interest rate. In the case of A&VS, the interest rate for the RAL was 56.6% APR. While the documents presented to A&VS for their signature at the end of the tax preparation session do indicate that a RAL is a loan, the preparer failed to explain this important fact.

## Summary of "Mystery Shopper" Visit to Jackson Hewitt February 27, 2008

**Mystery Shoppers:** TM  
3 Children  
Total Income: \$29,538  
Qualifies for: EITC, Child Tax Credit, Add'l Child Tax Credit

**Store:** Jackson Hewitt at 5137 Chestnut Street in Philadelphia  
Bank Partner: Santa Barbara Bank and Trust (SBBT)

**Total Charges:** \$ 433.95 in fees  
25%: Percentage of EITC lost due to fees: (433.95/1739)  
8%: Percentage of refund lost due to fees (433.95/5476)

### *Breakdown of Charges:*

\$298.00 tax preparation fees  
\$ 95.00 refund anticipation loan fee (disclosed as **58.582% APR**)  
\$ 30.95 "dummy bank account" fee for federal return  
\$ 10.00 "dummy bank account" fee for state return

### **Summary of Visit:**

TM visited the Jackson Hewitt tax preparation site at 5137 Chestnut Street in West Philadelphia on February 27, 2008.

#### *Failure to Disclose Price*

When she arrived at the store, TM was greeted by a receptionist who asked her to fill out a form with information regarding her income and expenses. Brochures were displayed at the sign-in table regarding the Jackson Hewitt debit card and the company's "Gold Guarantee" product, but there were no prices posted regarding the cost of tax preparation services.

After she was assigned to a tax preparer, TM inquired about the cost. The representative told TM that she would not know the total cost until the taxes were completed.

The preparer told TM that she did not want to keep her at Jackson Hewitt for too long, and she'd work to get her out of the office quickly. TM asked if she was being charged by the minute. The preparer cryptically answered, "Yes and no." She stated that there

was not a per-minute charge, but the system tracks how long it takes to complete the taxes and she indicated that the fees were "time-based."

The preparer then began asking her questions to prepare the return.

#### *Failed to Explain Refund Options*

Once the preparer finished the return, the tax preparer failed to clearly and accurately explain the options for receiving the refund and for obtaining a loan based on the refund. Instead of providing TM with an explanation of her filing options, the tax preparer asked her how quickly she wanted to receive her tax refund. When TM responded by asking about the different options, the preparer said she could choose between getting her refund now or in 8-15 days. Initially, the preparer did not explain that by getting money now, TM actually would be getting a loan based on her refund, and not the actual refund.

On the desk, next to the preparer, was a color-coded, laminated chart that appeared to outline various refund, bank and loan product options. The preparer, however, never referred to this chart to help TM understand her options.

TM asked the preparer what the fees would be for the two options presented. The preparer then made a series of mistakes in disclosing the prices, which made it difficult for TM to understand the cost associated with the various options.

At first, the preparer said that it would cost \$897 just for tax preparation fees. TM was surprised by the cost. The preparer turned her computer screen toward TM to display the options. She never explained to TM precisely what she was looking at, but the screen appeared to be displaying a chart that identified TM's expected state and federal refunds as well as the various refund options and bank products including their costs. After examining the screen, TM pointed out that the preparer was looking at the wrong figure on the screen for the tax preparation fees. The preparer agreed and corrected herself, noting that the tax preparation fees would be \$298, not \$897.

At that point, the preparer began to explain more of the refund options to TM. She quickly noted that TM could get a check from the IRS directly, but disparaged that option because TM would have to pay the tax preparation fees up front. She said other options included getting a Money Now loan for money within an hour, a RAL for money the next day, or she could wait 8-15 days. She told TM that she did not recommend the Money Now loan because she would not be able to get any money until the next day because it was after 5 p.m. TM asked about the difference in price between the other options. The preparer erroneously told her that the fees for getting a RAL the next day or for waiting 8-15 days for the refund were the same. Based on the documents provided to TM when the session was completed, it is clear that the RAL would cost at least an additional \$95 from Jackson Hewitt's 8-15 day "Assisted Refund."

TM agreed to the RAL option. She asked the preparer if she could have the RAL put on the Jackson Hewitt *I Power* card, but the preparer told her the card was no longer available and that she would have to pick up her RAL check the next day.

TM also inquired about having her state refund deposited directly into her bank account. The preparer told her that because she had agreed to a RAL, the state tax return also had to be sent via the bank that made the refund anticipation loan. She would be charged another \$10 for that process and would have to pick up the proceeds in a check at Jackson Hewitt.

## Summary of "Mystery Shopper" Visit to H&R Block March 18, 2008

**Mystery Shoppers:** AR  
Student  
Total Income: \$7,770  
Qualifies for: EITC

**Store:** H&R Block 1517 Chestnut Street in Philadelphia  
Bank Partner: HSBC Bank USA, N.A.

**Total Charges:** \$ 242.93 in fees  
66%: Percentage of EITC lost due to fees: (242.93/368)  
29%: Percentage of refund lost due to fees (242.93/837)

### *Breakdown of Charges:*

- \$184.00 tax preparation fees
- \$ 8.98 refund anticipation loan fee (disclosed as **35.986% APR**)
- \$ 29.95 "dummy bank account" fee for federal return
- \$ 20.00 check fee for refund anticipation loan check

### **Summary of Visit:**

AR visited the H&R Block tax preparation site at 1517 Chestnut Street in Philadelphia on March 18, 2008.

#### *Failure to Disclose Price Up Front; High Fees for EITC Forms*

AR arrived at the store around 12:30 p.m. She asked the receptionist how much it would cost for her to get taxes done. The receptionist explained that there is a flat rate of \$87 and then the price could go up from there, depending on how much paperwork was completed. AR asked how high the price could go. The receptionist then asked AR if she was single and/or had any dependents. Upon hearing AR's response that she is single without dependents, the receptionist told her that it would not be too high.

Once AR was assigned to a tax preparer, she asked the preparer how much H&R Block would charge her for services. The preparer said that the rate for filing federal taxes was about \$87 and then it goes up with state return. She assured AR that because she was single and without dependents, it would not be too high.

The preparer had her sign a lot of paperwork about its services. The preparer offered, but did not specifically recommend, a \$30 service for the extra "Peace of Mind," a product which would provide her with some liability protection if the preparer were to make an error that was discovered in an audit.

The preparer then reviewed all of AR's tax documents and entered her information into a computer program. Her refund was calculated to be: \$837 on her federal return (\$469 for withholding and \$368 for the earned income credit) and \$87 on her state return.

The preparer then calculated the H&R Block fees, which totaled \$184. She showed AR the breakdown of how the fees accumulated. AR asked her if she would be receiving a copy of the breakdown. The preparer told her that she would not get this breakdown, just a total bill for \$184, but she did allow AR to write down the charges which were as follows:

Filing Fee for 1040	\$74.50
W-2	\$3.25
Earned Income Eligibility	\$34.75
Earned Income Worksheet	\$16.25
Interest/Dividends	\$7.25
PA-40	\$37.25
Forgiveness	\$11.50
Total	\$184.75, rounded down to \$184

The fees associated with the Earned Income Tax Credit forms made up 38% of the cost of the charges for preparing AR's federal return.

*Failed to Disclose the E-File, Direct Deposit 8-15 Day Refund Option*

After calculating AR's refund, the preparer told AR that she had four options for obtaining her refund:

1. She could pay \$184 for tax preparation up front and wait approximately 6 weeks for a refund check directly from the IRS.
2. She could have \$623 direct deposited into her checking account from H&R Block in 8-15 days for an additional \$30 fee (\$837 refund - \$184 tax preparation fees - \$30 account fee = \$623).
3. She could get a \$603 check in 8-15 days from H&R Block for an additional \$50. \$30 + \$20 check fee (\$837 - \$184 tax preparation fees - \$30 account fee - \$20 check fee = \$603).
4. She could get a \$594 check the next day (\$837 - \$184 tax preparation fees - \$30 account fee - \$20 check fee - \$9 RAL Fee = \$594).
5. Or, she could receive \$493 immediately through a Mastercard.

The preparer discussed with AR the pros and cons of each option. However, she never informed AR that she could pay her tax preparation fees up front, and then electronically file her taxes and receive her refund in her own bank account within 8-15 days. AR also could have avoided paying a \$20 check fee if she took out a refund anticipation loan and put the loan proceeds on an H&R Block debit card, but the preparer did not encourage her to use the debit card option.

Ultimately, AR told the preparer that she would prefer not to pay any amount up front. The preparer encouraged AR to take out refund anticipation loan, since it would only cost an additional \$9 to receive money the next day instead of waiting 8-15 days. AR agreed to the loan. The interest rate of the loan was disclosed as 35.986% APR. After reviewing that figure, AR reports, "I asked her if that was high, and she said that I wouldn't need to worry about it, that's just if the refund doesn't come through from the IRS and if it turns out that I owe money." Of course, that is simply not true, as AR paid that 36% APR in prepaid interest even though her refund came through without any problems from the IRS.

**ATTACHMENT 2**  
**SUMMARY OF TEST RESULTS**



Tester	EITC	Preparer	Bank	Refund amount	Tax Prep fee	RAL Fee (incl. account fee)	APR (incl. account fee)	RAC Fee	Doc/App	E-file Fee	Transmi	Other Fee	Description	Total Fee	Disclosed RAL as loan
<b>Durham</b>															
SH	Y	H&R Block	HSBC	\$1,921.00	\$189.00	\$50.56	98%					\$20.00	Check Fee	\$259.56	Y - but felt confused re fees
MA	Y	H&R Block	HSBC	\$503.00	\$185.00	\$35.34	276%					\$20.00	Check Fee	\$240.34	Y
BK	Y	Liberty Tax	SBBT	\$2,846.00	\$173.00	\$102.10	136%							\$275.10	N
OH	Y	Liberty Tax	SBBT	\$5,300.00	\$281.00	NA	NA	\$30.95					State RAC	\$321.95	Y
DL	N	Jackson Hewitt	SBBT	\$3,103.00	\$355.00	\$108.53	132%						Gold Guar	\$501.53	Y
BM	N	Independent	Republic	\$1,682.00	\$180.00	NA		NA						\$180.00	NA
RH	Y	Independent	Chase	\$2,026.00	\$75.00	\$52.26	176%		\$25.00		\$6.00		Technology	\$168.26	Y
								Unclear if received							
GC	Y	Independent	Chase	\$3,592.00	\$75.00	NA	NA	RAC						\$75?	Y
TR	Y	Jackson Hewitt	SBBT	\$1,999.00	\$194.00	\$80.93	154%							\$274.93	N-but saw watermark
DC	N	Jackson Hewitt	SBBT	\$268.00	\$208.00	NA	NA	\$30.95						\$238.95	N
JS	NA	Independent	Republic	NA	\$135.00	NA	NA			\$35				\$170-if had filed	NA
JC	Y	Independent	Chase	\$1,070.00	\$93.00	NA	NA	\$47.00	\$40.00			\$5.00	State Efile	\$185.00	Y
<b>Philadelphia</b>															
		Instant Tax Service													
KH	Y		SBBT	\$1,392.00	\$87.00	\$65.75	300% (inc doc prep) 268% (incl. doc prep and tech fee)	\$10 (for state )	\$40.00	\$149.00	\$15.00	\$120.00	Service Bu	\$486.75	N
EF	Y	Quick Refund Income Tax	Chase	\$1,146.00	\$60.00	\$43.46			\$25.00		\$10.00		Technology	\$148.46	Y - only after questioning
A&VS	Y	Jackson Hewitt	SBBT	\$5,669.00	\$298.00	\$125.95	83%	\$10 (for state )						\$433.95	N
TM	Y	Jackson Hewitt	SBBT	\$5,476.00	\$298.00	\$125.95	86%	\$10 (for state )						\$433.95	Y - only after questioning
															Y - but misinformed about nature of interest
AR	Y	H&R Block	HSBC	\$837.00	\$184.00	\$38.93	178%					\$20.00	Check Fee	\$242.93	rate



**APPENDIX 4 –**  
**CONSUMER GROUPS' COMMENTS TO IRS ON**  
**REFUND ANTICIPATION LOAN RULEMAKING**



**Comments of the**

**National Consumer Law Center  
(On behalf of its Low-Income Clients)  
Consumer Federation of America  
and  
Consumer Action  
Consumers Union  
U.S. Public Interest Research Group**

**Regarding**

**Advance Notice of Proposed Rulemaking  
Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain  
Other Products in Connection With the Preparation of a Tax Return**

**26 CFR Part 301**

**[REG-136596-07]  
RIN-1545-BH12**

**I. INTRODUCTION**

These comments are submitted by the National Consumer Law Center (NCLC) (on behalf of its low-income clients),<sup>1</sup> Consumer Federation of America (CFA),<sup>2</sup> Consumer Action,<sup>3</sup> Consumers Union,<sup>4</sup> and U.S. Public Interest Research Group.<sup>5</sup> These

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<sup>1</sup> The **National Consumer Law Center, Inc. (NCLC)** is a nonprofit organization specializing in consumer law issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys around the country, representing low-income and elderly individuals, including low-income taxpayers who have been harmed by RAL practices. NCLC has extensive expertise on consumer issues such as credit practices, debt collection abuses, and unfair trade practices. NCLC and CFA have been focused on the abuses of the RAL industry for many years, issuing annual reports and engaging in public outreach. These comments were written by Chi Chi Wu, Staff Attorney, and are submitted on behalf of the NCLC's low-income clients.

<sup>2</sup> The **Consumer Federation of America** is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education. These comments were co-authored by Jean Ann Fox, Director of Financial Services at CFA.

<sup>3</sup> **Consumer Action (www.consumer-action.org)** is a national non-profit consumer education and advocacy organization founded in San Francisco in 1971. The organization's hallmark is its free multilingual consumer education materials distributed through a national network of 9,000-plus non-profit and community-based agencies. In addition, Consumer Action serves consumers and its members nationwide by advancing consumer rights, referring consumers to complaint-handling agencies and training community group staff on the effective use of its educational materials. Consumer Action also advocates for consumers in the media and before lawmakers and compares prices on credit cards, bank accounts and long distance services.

<sup>4</sup> **Consumers Union of U.S., Inc.** is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health and personal finance; and to initiate and cooperate with individual and group efforts to

comments respond to the IRS notice that it is considering issuing a proposal to prohibit tax preparers from sharing tax return information to make refund anticipation loans (RALs), refund anticipation checks (RACs), and similar products. We strongly support this proposal, and we urge the IRS to issue its notice of proposed rulemaking.

A. Summary of Comment<sup>6</sup>

Currently, IRS rules at 301 C.F.R. § 301.7216-3 permit tax preparers to use confidential taxpayer return information to sell products, such as RALs, RACs and similar products, to consumers. All that the tax preparer needs to obtain for this marketing is the taxpayer's signature on a piece of paper, which is easily obtained. The preparer is then free to use the information in the taxpayer's return to promote RALs, and to share the taxpayer's return with the RAL lender in order to make the loan.

It is this consent exception that has enabled the nearly \$1 billion RAL industry. Without this exception, preparers could not offer RALs to taxpayers. As discussed in Part V, without this exception, only taxpayers who actively sought a RAL and were willing to physically themselves hand over their tax returns would receive a loan.

In general, we believe that the IRS should close this consent loophole to the strict privacy protections of Section 7216. This is especially true with respect to RALs for the reasons raised in its Advanced Notice of Proposed Rulemaking (ANPR) and discussed in this Comment, *i.e.*, that RALs exploit low- income taxpayers and encourage or abet tax fraud.

Part II of this Comment discusses how RALs exploit taxpayers.

**Cost.** Because a RAL is made for such a short period of time, their \$32 to \$130 loan fees can translate into high Annual Percentage Rates (APRs), sometimes in the triple digits. RALs drained \$900 million from the refunds of American taxpayers in 2006, plus \$90 million in other fees.

**Impact on the EITC.** RALs skim off hundreds of millions in EITC benefits. Nearly two thirds of RAL borrowers are EITC recipients, despite the fact they

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maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and services, and from noncommercial contributions, grants, and fees. Consumers Union's publications and services carry no outside advertising and receive no commercial support. Consumers Union's Financial Services Campaign team has been deeply engaged in the development of consumer protections to prevent identity theft and to enhance data security, as well as other problems consumers face in the financial services marketplace, including the consequences for consumers of errors in consumer credit reports.

<sup>5</sup> **U.S. PIRG** serves as the federation of state Public Interest Research Groups, which are non-profit, non-partisan public interest advocacy organizations.

<sup>6</sup> The factual research in support of these comments was conducted by NCLC. The Mystery Shopper Report attached at Appendix A was conducted by the Community Reinvestment Association of North Carolina, Community Legal Services of Philadelphia, and the Philadelphia Campaign for Working Families.

make up only about 17% of returns filed. RALs drained \$570 million from EITC benefits in 2006, plus \$57 million in other fees.

**Deception and Lack of Consumer Awareness.** Many RAL consumers are still not aware that the product is a loan or the risks of this loan. RAL providers have a history of misleading advertisement. While some providers now make better disclosures, others still continue to obfuscate the nature and risks of the RALs, as evidenced by enforcement actions and mystery shopper tests conducted as recently as this year and 2006, which found deceptive promotion and failure to inform taxpayers that RALs are loans.

**Risks and Abusive Terms.** RALs present significant risks to taxpayers. A RAL is a loan, and must be repaid. If the taxpayer's refund is not issued, he still must repay that loan, or he will be subject to debt collection tactics and a ruined credit history. Future refunds might be seized by RAL lenders using the practice of cross-lender debt collection.

**RALs Enable Confusion over Tax Prep Fees.** RALs and other products enable commercial preparers to withhold information on the price of tax preparation. One reason that low-income taxpayers use RALs is to pay tax preparation fees. RALs and RACs make taxpayers less sensitive to the price of preparation. It also enables preparers to refuse disclosure of the fee, and to pad the price with ancillary RAL-related fees such as "e-filing," "service bureau," and other fees.

Part III discusses how RALs encourage tax fraud.

**Examples of Tax Fraud Aided By RALs.** RALs have been involved in several cases where tax preparers inflated refunds, including:

- the Department of Justice's lawsuits against five Jackson Hewitt franchisees that operated 125 offices for their role in preparing fraudulent tax returns falsely claiming \$70 million in tax refunds.
- at least 57 enforcement actions by various federal and state law enforcement agencies against criminals who committed tax fraud involving RALs.
- testing in 2006 by the Government Accountability Office of commercial preparers, which found errors that led to overinflated refunds exceeding \$1,000 in 6 out of the 19 test cases.
- "mystery shopper" tests conducted this year in Philadelphia and Durham, in which at least two preparers omitted or advised the tester to omit significant sources of income from the testers' returns.

**Experts Find Connections Between RALs and Tax Fraud.** There have been a number of studies and reports documenting the link between RALs and tax fraud. These include:

- In 1993, Dr. Malcolm Sparrow, an expert on fraud at Harvard's Kennedy School of Government, issued a report to the IRS in which he explained that "the existence of RALs has acted as an attractor for fraud."
- In 2004, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued a warning to banks about the fraud potential of RALs.
- In 2004, the IRS's own Criminal Investigations Division noted the connection between RALs and fraud. Gary Bell, then Director of the IRS Criminal Investigation Division's Refund Crimes Unit, reported that 80% of fraudulent e-filed returns are tied to a RAL or other bank product.
- The National Taxpayer Advocate noted in her 2007 Report to Congress, that audits of tax returns with RALs had a 14% higher error rate than returns without RALs.

**Lenders Give Preparers Incentives to Sell RALs Which May Influence Return Preparation.** RALs provide a significant financial reward for preparers, which encourage preparers to sell RALs and take measures that promote loans. These measures may result in preparers sometimes inflating a taxpayer's refund.

- RAL incentives to preparers include a per RAL payment for some preparers and profit sharing for preparer corporations. H&R Block buys a 49.9% "participation share" from its RAL bank partner in each RAL facilitated by Block, while Hewitt receives a lump sum plus some form of profit or risk sharing arrangement.
- A bigger refund means the taxpayer is more likely to get a RAL. A bigger refund also means the preparer can charge a higher fee, because the size of the refund and the RAL makes the consumer less sensitive to such fees.
- For retailers who offer tax preparation and RALs, such as used car dealers and furniture stores, the bigger refund means the retailer can sell a more expensive product.

**Tax Fraud Fluctuates with RAL Volume.** The IRS experience with the Debt Indicator shows the connection between RALs and tax fraud. When the IRS terminated the Debt Indicator, RAL volume declined, and so did fraud. When the IRS reinstated the Debt Indicator, RAL volume went back up, and fraud went up by 1,400 percent.

**Banks' Failure to Prevent Fraud.** RAL banks have no incentive to prevent tax fraud beyond making sure they can mimic what the IRS does for fraud control. As long as the IRS pays the refund, the RAL bank makes money. For banks to screen for fraud beyond IRS controls, they would reduce their RAL approval rates, loan volume, and profits from loan fees. One bank even admitted it left fraud controls off when it thought IRS wasn't screening.

Part IV of this Comment documents the relationship between fringe preparers and RALs.



**Fringe Preparers.** Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. A review of the IRS website's list of authorized e-file providers for five states documents several hundred payday lenders, pawn shops, rent-to-own stores, and auto title lenders. The list also includes used car dealers, travel agents, beauty salons, furniture stores, grocery stores, jewelry stores, liquor stores, and a "therapy" office.

**The Problem with Fringe Preparers.** A major problem with fringe preparers is the questionable quality of tax preparation. While software providers do offer software and back office support, often the retail salesperson at the fringe preparer is actively engaged in the preparation.

**Fringe Preparers Aggressively Promote RALs.** Fringe preparers aggressively promote fast tax "refunds," and some fail to even make pro forma disclosures that RALs are loans. Some fringe preparers use names such as ASAP Rapid Refund Tax Service or Next Day Tax Cash that themselves deceptively promote RALs as refunds. Fringe preparers engage in other questionable practices, such as continuing to make "pay stub RALs" despite the fact that the major RAL banks no longer make such loans.

**RALs Encourage Fringe Preparers.** RALs and other bank products provide the incentive for fringe players to enter the field of tax preparation. Without bank products, there would be much less incentive for used car dealers, furniture stores, and payday lenders to be involved in tax preparation, because they could not extract as many fees or obtain control over the RAL proceeds to apply to the item they are selling.

Part V of this Comment responds to the specific questions posed by the IRS in its ANPR.

#### B. Additional Information

The Annual Reports by NCLC and CFA document in further detail the problems and abuses of RALs. These Annual Reports are submitted with this Comment as Appendix M. In addition, NCLC and CFA submitted an extensive response to IRS in May 2006 answering its Questions for Advocates as part of the study Congress required it to undertake under H.R. 3058 (2006). This May 2006 response is submitted as Appendix O along with selected Attachments.

This tax season, NCLC worked with Community Legal Services in Philadelphia (CLS), the Philadelphia Campaign for Working Families, and the Community Reinvestment Association of North Carolina (CRA-NC) on a "mystery shopper" project which sent testers to apply for RALs at a variety of commercial preparer storefronts. These testers actually had their returns prepared and sought RALs from commercial preparers. The testers documented a range of problems, abuses and misrepresentations involving RALs. A report on the test results, entitled "Tax Preparers Take a Bite out of

Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia,” is attached as Appendix A to this Comment.

### C. Considerations for IRS

Before discussing the substance of why IRS should restrict RALs, we wish to address the fact that the IRS has received several thousand pro-RAL comments on this matter. These comments were the result of lobbying by the RAL industry.

On March 18, 2008, H&R Block sent an email to potentially millions of its customers urging them to oppose the IRS proposal. The email warned that the proposal would mean that taxpayers “would no longer control the use or disclosure of your personal information through your tax preparer, even if you wish to do so.” A copy of this email is included in Appendix H.

We believe this email contains some questionable statements, and that Block’s clients may have responded in part due to these representations. First, the email frames the proposal as a sinister scheme by the IRS, which would result in taxpayers losing control over their personal information. As discussed below in Part V, that is simply not true - taxpayers would be entirely free to share their own information; the proposal restricts only what *commercial preparers* could do with information. Second, the email states “information to apply for a RAL or RAC – including your name, address, tax refund amount, and Social Security number – is only shared with the bank with your advance consent.” This sentence implies that only basic identifying information and refund amount is shared to make a RAL, which is not true. The entire tax return is shared with the RAL bank for underwriting purposes; for example, we know that RAL applicants have been rejected because their EITC amount was too high or they had Schedule C income.

We also believe that Block’s use of its clients’ information to send this email may have violated the privacy protections of Section 7216 of the Internal Revenue Code. Block used its clients’ tax return information – *i.e.*, their identifying information, the fact they used Block as a tax preparer, and maybe even the fact they received a RAL - to engage in administrative lobbying. Yet Block’s consent forms under Section 7216 do not include permission to use client information for lobbying purposes.

Block was not the only RAL provider who engaged in lobbying its customers. Pacific Capital Bank, the parent of RAL lender Santa Barbara Bank & Trust, had publicly stated its intention to do so as well. SBBT’s CEO told investment analysts: “I think the thing, again, that is so important for us is in this sort of 90 days that the IRS has opened up a window for comments is for us to ensure that the IRS hears from the 6.8 million people that we serve in the RAL business, and that’s something that we’re going to be really aggressive in pursuing.”<sup>7</sup>

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<sup>7</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, January 31, 2008, at 14. A copy of this transcription is included in Appendix J.

Finally, we urge the IRS not to make its decision on the basis of the volume of comments. First, we understand that about 4,500 comments were filed. Given that Block has nearly 4 million RAL customers, this is a response rate of about 0.1%. Second, the unfortunate fact is that some taxpayers will object to the elimination of RALs, just like some payday loan borrowers have objected to decisions to limit their access to dangerous and predatory credit (and other consumers have objected to their inability to access other dangerous products such as unsafe cars or drugs). Also, we think the responses of Block clients may have been different if the proposal had involved another proposal, such as capping RAL fees.

Finally, it is important to remember that part of the reason the IRS has expressed concerns over RALs is their role in aiding tax fraud. Given that this product contributes to money being cheated from the public fisc, the fact that a portion of taxpayers still want the product should not be relevant to this consideration.

## **II. RALS EXPLOIT LOW INCOME TAXPAYERS**

There is no question that RALs harm low-income taxpayers in a number of ways. In our Annual Reports and prior submissions, we have described in detail the problems with RALs, including costs, risks of the loan to borrowers, drain on the EITC, and lack of consumer awareness of the nature and terms of these loans. All of these issues are discussed more fully below and in our series of annual RAL reports.

### **A. Costs**

As the IRS is aware, RALs are bank loans secured by the taxpayer's expected refund. The loan is repaid by a direct deposit of the taxpayer's refund into a special temporary "dummy" account. Since the IRS direct deposits refunds in 8 to 15 days after filing, and the loan itself takes a day or two to make, the RAL loan term last about 7-14 days.

The price of a RAL includes several components –

- A loan fee ranging from \$32 to \$130, which is usually broken down into a "Refund Account" fee and a "Bank Fee."
- In some cases, an additional fee of \$25 to \$85 for an "instant" same day RAL.
- A separate fee charged by the tax preparer, often called an "application" or "document processing" fee, of about \$40. This fee is not charged by the major chains, with the possible exception of some Jackson Hewitt franchisees. It is charged by many non-chain independent preparers.
- In addition, we have seen other RAL-associated fees from independent preparers such as "e-filing," "service bureau," or "transmission/software" fees. These fees

can be very high, as much as \$185. (Sample RAL documents are provided in Appendix E of this comment).

Based on an average loan term of 10 days, the effective annual percentage rate (APR) for a RAL can range from about 50% to nearly 500% (this includes the “Refund Account” fee because we believe it represents a cost of the credit). If application fees are charged and included in the calculation, the effective APRs range from about 80% to nearly 1,200%.

Using the IRS SPEC data, we calculate that approximately 9 million taxpayers received RALs in the 2006 tax filing season (for tax year 2005), representing \$900 million in loan fees, plus over \$90 million in other fees. In addition, another 10.8 million taxpayers spent \$324 million on RACs.

The following are amounts paid by some of the CLS and CRA-NC testers for RALs this year:

Preparer	RAL Bank	Tax Prep Fee	RAL Fee (incl. account fee)	RAC Fee	Doc/APP Fee	E-file Fee	Transmission Fee	Other Fee	Description of Other Fee	Total Fee
H&R Block	HSBC	\$189.00	\$50.56					\$20.00	Check Fee	\$259.56
H&R Block	HSBC	\$185.00	\$35.34					\$20.00	Check Fee	\$240.34
Liberty Tax	SBBT	\$173.00	\$102.10							\$275.10
Liberty Tax	SBBT	\$281.00		\$30.95				\$10.00	State RAC	\$321.95
J.Hewitt	SBBT	\$355.00	\$108.53					\$38.00	Gold Guarantee	\$501.53
Independent	Chase	\$75.00	\$52.26		\$25.00		\$6.00	\$10.00	Tech. Access Fee	\$168.26
J.Hewitt	SBBT	\$194.00	\$80.93							\$274.93
J.Hewitt	SBBT	\$208.00		\$30.95						\$238.95
Independent	Chase	\$93.00	NA	\$47.00	\$40.00			\$5.00	State Efile fee	\$185.00
Instant Tax Service	SBBT	\$87.00	\$65.75	\$10 (state)	\$40.00	\$149.00	\$15.00	\$120.00	Service Bureau Fee	\$486.75
Quick Refund Income Tax	Chase	\$60.00	\$43.46		\$25.00		\$10.00	\$10.00	Technology Access Fee	\$148.46
J.Hewitt	SBBT	\$298.00	\$125.95	\$10 (state)						\$433.95
J.Hewitt	SBBT	\$298.00	\$125.95	\$10 (state)						\$433.95
H&R Block	HSBC	\$184.00	\$38.93					\$20.00	Check Fee	\$242.93

Other examples included in Appendix E show the following fees:

Preparer	RAL Bank	Tax Preparation Fee	RAL fee (inc account fee)	Document /Application Fee	E-file Fee	Transmission Fee	Other Fee	Description of Other Fee	Total
Independent	River City Bank	\$65	\$102	\$49	\$15		\$22.54	Sales Tax and unnamed fee	\$253.54
Independent	Chase	\$41	\$64		\$185	\$10			\$300

### B. Impact on Low Income Taxpayers and the EITC Program

RALs are mostly marketed to low-income taxpayers. According to IRS's own data, 85% of taxpayers who applied for a RAL in 2006 had adjusted gross incomes of \$37,300 or less.<sup>8</sup> This is consistent with statistics that:

- 57% of H & R Block's customers make less than \$30,000 annually.<sup>9</sup>
- 73% of Jackson Hewitt customers make less than \$30,000 adjusted gross income.<sup>10</sup>
- The majority of HBSC's RAL customers have an average household income of \$17,800.<sup>11</sup>
- A 2005 survey by CFA found that the majority of RAL borrowers (58.7%) earned below \$40,000.<sup>12</sup>

The IRS data shows that in 2006 nearly two-thirds (63%) of RAL consumers were EITC recipients. Yet EITC recipients made up only 17% of individual taxpayers in 2006. Thus, EITC recipients are vastly overrepresented among the ranks of RAL consumers. In addition, IRS SPEC data shows that 28.5% of EITC recipients applied for a RAL in 2006.<sup>13</sup>

We estimate that about \$570 million was drained out of the EITC program in 2006 by RAL loan fees. Administrative/application fees added another \$57 million to the drain. Each of these fees undermines the effectiveness of the EITC in supporting low-wage workers. These fees transfer hundreds of millions in wealth, paid out of the U.S.

<sup>8</sup> Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

<sup>9</sup> Peter Tufano and Daniel Schneider, *H&R Block and "Everyday Financial Services,"* Harvard Business School, October 2004, at 7.

<sup>10</sup> Jackson Hewitt, *Final Prospectus*, June 22, 2004, at 46.

<sup>11</sup> Household International, *2003 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 7.

<sup>12</sup> NCLC/CFA 2006 RAL Report at 9.

<sup>13</sup> Data from IRS SPEC, Return Information Database for Tax Year 2005 (Returns Filed in 2006), May 2007.

Treasury, from working poor families to multi-million dollar corporations. The IRS should not aid and abet this diversion of federally-funded anti-poverty funds by enabling the sale of RALs.

C. Lack of Consumer Aware and Deceptive Advertising of RALs

1. *Many Consumers Do Not Understand the Nature of RALs*

Many RAL borrowers do not understand that a RAL is a loan. Some preparers still refer to them as “instant” or “rapid” refunds. Others call them a “RAL,” but do not explain that the acronym stands for “refund anticipation *loan*.” For example, one consumer who complained about RALs on the website [consumeraffairs.com](http://consumeraffairs.com) stated:

I went to my local Jackson Hewitt office to file my taxes and to use the RAL which I was sure that I would get since I was getting \$7000.00 back from the IRS. They never once explained to me that it was a loan, and they never once advised me before beginning that I might be denied the loan.<sup>14</sup>

Several of the mystery shopper testers sent by CLS also observed that preparers consistently referred to RALs using the acronym alone, never mentioning the word “loan.” Five of 15 preparers did not verbally explain to their clients that a RAL is a loan. In addition, two other preparers only admitted the RAL was a loan after testers asked questions about the product.

The lack of understanding that RALs are loans has been demonstrated over the years. In late 2004, NCLC hired a professional polling firm to conduct a telephone survey to test consumer understanding of RALs. The survey found that 18% of respondents had taken out a RAL at some point in their lives. Of those receiving a RAL, a startling 70% didn't realize they'd received a loan.<sup>15</sup>

During recent years, some preparers have improved their disclosures, and nonprofit groups have undertaken public awareness efforts. While these efforts may have improved consumer understanding, we believe it remains uneven at best, for reasons discussed in the next section. Most troubling, even if a taxpayer is told that a RAL is a loan, they often do not understand the risks they face by borrowing against their tax refund, a topic discussed further below.

Other evidence that consumers remain unaware of the nature of RALs includes:

- (1) Mystery shopper tests conducted in 2006 by CLS found Block preparers continuing to refer to RALs as “rapid refunds,” not loans. Even worse, at a Jackson Hewitt office, preparers automatically prepared returns with RALs included, ensuring that taxpayers did not understand what they are getting. Copies of letters to H&R

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<sup>14</sup> [http://www.consumeraffairs.com/finance/jackson\\_hewitt.html](http://www.consumeraffairs.com/finance/jackson_hewitt.html), included in Appendix H.

<sup>15</sup> NCLC/CFA 2005 RAL report at 7-8.

Block and Jackson Hewitt documenting this testing are included as an attachment to the NCLC/CFA Response to IRS Questions in Appendix O.

(3) NCLC's client in the RAL cross-lender debt collection case did not realize she was applying for a loan when she signed the RAL application. *See* Complaint, Hood v. Santa Barbara Bank & Trust, a copy of which is included an attachment to the NCLC/CFA Response to IRS Questions in Appendix O.

(4) An internal H&R Block study finds that many consumers would decline to participate in the "Rapid Refund" service if they knew it was a loan. A copy of this study is submitted as Appendix K, and discussed below.

The major industry-sided study was conducted by the Credit Research Center at Georgetown University.<sup>16</sup> As expected, the Credit Research Center study asserts that RAL borrowers make a deliberate and informed choice to select a RAL. However, this finding is challengeable, because the Credit Research Center poll specifically asked consumers if they had taken out a "refund anticipation loan" and described a RAL as "a loan or advance of money against a tax refund, typically provided by a bank." Thus, the Credit Research Center study missed any RAL borrower who did not understand that a RAL is a loan, because those borrowers would not answer "yes" to such a question.

Indeed, the Credit Research Center data even appears to bear out that it missed many RAL borrowers. The poll interviewed 15,177 respondents; of those, only 330 of these respondents - or 2.17% - reported they had used a RAL. This is a gross underestimate of the percentage of RAL borrowers. As discussed above, the latest IRS data on RALs show that about 7% of taxpayers take out a RAL (even more apply for one). Thus, there is a three-fold disparity in the data. Finally, even the Credit Research Center study found that about 43% of the RAL borrowers who did know they received a loan did not know the amount of the RAL fee. Nearly three-quarters did not recall getting an APR disclosure.

## *2. History of Deceptive Advertising by RAL Providers*

There is a reason why many taxpayers don't realize that a RAL is a loan. RAL providers have a history of misleading advertisement that obfuscates the fact that a RAL is a loan. While some major tax preparation chains have improved disclosures and practices, there are still those that use deceptive advertising. Furthermore, implementation of these improved disclosures and practices seems uneven at best.

Many paid preparers continue to use deceptive advertising of RALs. These preparers may disclose in fine print that the product is a loan, but what they aggressively emphasize is the "fast refund" or "instant money" aspect. Some examples are:

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<sup>16</sup> Gregory Elliehausen, *Consumer Use of Tax Refund Anticipation Loans*, Monograph #37, Credit Research Center (April 2005).

(1) Independent preparers whose very name deceptively promotes “fast refunds.” A review of authorized e-file providers in five states from the IRS website<sup>17</sup> reveals names such as:

- AA Next Day Tax Cash (4 locations, AZ; 4 locations, FL; SD)
- Home of Next Day Tax Cash (AZ; 4 locations, FL; SD)
- Rapido Express Income Tax Services (AZ)
- ASAP Rapid Refund Tax Service (FL)
- Instant Refund (3 locations, FL)
- Instant Tax Service (49 locations, AZ; 34 locations, IL)
- Magic Tax Refund (4 locations, FL)
- Quick & Easy Rapid Refund (FL)
- Quick Refunds (FL; 13 locations, IL)
- Quick Cash Tax Services (FL)
- Quick & Easy Rapid Refund (FL)
- Rapid Tax Refund (FL)
- Refunds Express (FL)
- Super Fast Express Refunds (FL)
- Kai’s Rapid Tax Refund Service (IL)
- Next Day Tax Cash (4 locations, IL; 2 locations, SD)
- Xpress Refunds Tax Service (IL)
- Williams Rapid Refund (IL)
- Fast Tax Back (MA)
- Tax Man Refund Express (MA)

(2) Internet websites whose URL is deceptive, such as 24hourtaxrefund.com, fastcashrefundexpress.com, rapidrefund.net, rapidtax.com, and rapidtaxrefund.com. These websites will display prominently “Fast Tax Refund Options” and “Super Fast 1 to 2 business day option by direct deposit or overnight check,” then only disclose in tiny print that the product is a loan.<sup>18</sup>

The website TaxBrain.com had worked with the Internet payday lending website PRLDirect.com, to make RALs, sending an email advertising “Would you like your tax refund within 48 hours? TaxBrain.com can have your Income Tax Refund directly deposited in to your account.”<sup>19</sup>

(3) In 2006, the Government Accountability Office (GAO) issued a report on its own mystery shopper project involving tests of 19 commercial preparers (GAO 2006 Preparer Testing Report).<sup>20</sup> In the report, the GAO noted that many of the commercial preparers offered RALs and that:

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<sup>17</sup> <http://www.irs.gov/efile/page/0,,id=10162,00.html>.

<sup>18</sup> [www.rapidtax.com/rapidrefund.htm](http://www.rapidtax.com/rapidrefund.htm), copy included in Appendix F.

<sup>19</sup> Email from PRLDirect.com and TaxBrain.com, April 11, 2006, included in Appendix F.

<sup>20</sup> Government Accountability Office, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T, April 4, 2006, available at <http://www.gao.gov/new.items/d06563t.pdf>.



In some cases, what were clearly RALs were not described as loans but as “options” or “bank products.” One preparer gave us a RAL application to sign at the start of the visit without explaining what it was we were being asked to sign. Another preparer told us the size of the refund we could receive in 12 to 48 hours but did not give us the amount we would receive if we were willing to wait for a check from IRS, did not identify the faster refund as a loan, and did not explain that the amount we would receive was reduced by the amount of the fee associated with the option.<sup>21</sup>

(3) In 2003, the GAO issued a report on an investigation of the tax preparation industry and RALs.<sup>22</sup> In this report, the GAO noted that some commercial preparers fail to disclose the costs and risks of RALs and the availability of lower cost alternatives.

Other examples of deceptive advertising by RAL providers are the lawsuits and enforcement actions brought by government agencies challenging RAL promotion. These include:

(1) Just this year, the New York City Department of Consumer Affairs (DCA) announced it had conducted a six-week investigation of 300 tax preparation firms over RAL advertising. As a result, DCA issued 500 citations to preparers for violations including misleading or illegal advertisements in newspapers, misrepresenting RALs to their clients, and other violations. DCA’s citations represented a 75 percent increase from the previous tax year. DCA noted that preparers often market RALs as “instant” refunds or “24-hour” refunds, and fail to disclose that they are actually loans.<sup>23</sup>

In 2002, DCA filed a lawsuit against H&R Block over the company’s alleged misrepresentation of its “Rapid Refunds” program,<sup>24</sup> after an investigation finding that 86% of Block’s branches in the city failed to differentiate between true refunds and RALs.<sup>25</sup> DCA’s lawsuit resulted in a \$4 million settlement.

(2) The California Attorney General filed a lawsuit against Jackson Hewitt in January 2007, alleging that Hewitt made misleading statements in its promotion of its RAL

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<sup>21</sup> *Id* at 24.

<sup>22</sup> Government Accountability Office, *Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS is a Challenge*, GAO-04-70, October 2003, available at <http://www.gao.gov/new.items/d0470.pdf>.

<sup>23</sup> Press Release, *New York City Department of Consumer Affairs Announces Citywide Enforcement Sweep of Income Tax Preparers*, NYC Department of Consumer Affairs, Feb. 21, 2008, included in Appendix C.

<sup>24</sup> Complaint, *Dykstra v. H&R Block*, Index No. 02401201 (Supreme Court of New York March 12, 2002).

<sup>25</sup> Press Release, *Investigators Find That H&R Block Violates Agreement with Department by Misrepresenting Its Rapid Refund Program—Consumer Affairs Issues More than 2,200 Violations and Over One Million Dollars in Potential Fines*, New York City Department of Consumer Affairs, April 5, 2001.

and RAC program.<sup>26</sup> Hewitt agreed to enter into a settlement with the Attorney General, promising reforms of its practices and paying \$4 million in consumer refunds plus \$1 million in penalties and costs. The California Attorney General brought similar lawsuits against H&R Block in February 2006 and Liberty Tax Service in July 2007.<sup>27</sup>

On March 14, 2008, the California Attorney General requested an injunction against Block for continuing to make misleading RAL misrepresentations. Investigators called H&R Block offices throughout California, requesting information about how long it would take to get tax refunds. According to the California Attorney General, two-thirds of the H&R Block representatives told investigators that refunds can be sent to taxpayers within two days, without disclosing the fact that it was actually a loan.<sup>28</sup>

(3) The New Jersey Attorney General's Office sued a local tax preparation chain for deceptive advertisement of RALs. The lawsuit alleged that Malqui Corporation misrepresented RALs as tax refunds and did not disclose that they were loans. The lawsuit also alleged that Malqui failed to clearly tell consumers about the high interest and fees of these loans.<sup>29</sup>

(5) The RAL industry has had a long history of deception. For example, in September 2001, the IRS informed H&R Block that the use of the phrase "your money" in reference to RALs would violate IRS rules.<sup>30</sup> During the 1990s, several state consumer protection agencies and attorneys general instituted proceedings against H&R Block for failing to clearly distinguish between its RAL and "Rapid Refund" products.<sup>31</sup> In the mid 1970s, the Federal Trade Commission issued an order forbidding Beneficial from advertising its RAL product as an "instant tax refund."<sup>32</sup>

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<sup>26</sup> Judgment, *People of the State of California v. Jackson Hewitt*, Case No. 070304558 (Cal. Sup. Ct. Alameda Cty Jan. 3, 2007).

<sup>27</sup> Complaint, *People of California v. H&R Block, Inc.* (Cal. Sup. Ct. San Francisco Feb. 15, 2006); Complaint, *California v. JTH Tax, Inc.*, Case No. CGC-07-460778 (Cal. Super. Ct. Feb. 26, 2007).

<sup>28</sup> Press Release, *Brown Requests Injunction against H&R Block*, California Attorney General's Office, March 14, 2008, included in Appendix C.

<sup>29</sup> Press Release, *State Sues Tax Preparation Firm Over Deceptive "Fast Refund" Offers*, New Jersey Attorney General's Office, March 5, 2007, included in Appendix C.

<sup>30</sup> Letter from Director Jo Ann N. Blank, IRS Individual Electronic Filing Division, to H&R Block Tax Services, September 30, 2001, included in Appendix C.

<sup>31</sup> See, e.g., National Association of Attorneys General, *Texas – H&R Block, Inc., H&R Block of South Texas, Inc., 150 Percent Interest Charges*, NAAG Consumer Protection Report, September 1993, at 28. Several of the state enforcement actions are discussed in *JTH Tax v. H&R Block*, 128 F. Supp. 2d at 938 (citing *In re: H&R Block Eastern Tax Services*, No. 93-410039 (Fla. Office Attorney Gen. Jan. 6, 1994) (assurance of voluntary compliance); *Cerullo v. H&R Block*, No. 95-409497 (N.Y. Gen. Term) (consent order); *In re H&R Block*, No. 93-198 (Conn. Comm'r Consumer Prot. July 27, 1993)).

<sup>32</sup> *Beneficial Corporation v. Federal Trade Commission*, 542 F.2d 611 (3<sup>rd</sup> Cir. 1976) (upholding part of FTC order, but overturning in part).

(6) Private litigants have uncovered similar deceptive practices. In *JTH Tax v. H&R Block Eastern Tax Services*,<sup>33</sup> Liberty Tax Service sued Block over its use of the word “advance” in advertisements, since company research indicated that most consumers would not associate an “advance” with a loan. The District Court noted the many prior legal actions against H&R Block over similar misleading advertising. In *Basile v. H&R Block*,<sup>34</sup> a Pennsylvania judge concluded that many of Block’s customers had no significant understanding of the “Rapid Refund” service. The judge based her ruling in part on Block’s own internal research documents, including a study finding that many consumers would decline to participate in the “Rapid Refund” service if they knew it was a loan. (This study is submitted as Appendix K to these comments.)

### 3. *RAL Disclosures Will Not Solve the Lack of Consumer Understanding*

Two of the major tax preparation chains (H&R Block and Jackson Hewitt) have revised their disclosures in recent years, to emphasize that a RAL is a loan and explain less expensive options. However, better RAL disclosures have not and will not solve the problem of consumers failing to understand the nature of RALs.

First, any disclosures must be implemented by the individual Block or Hewitt storefront offices. As discussed above, mystery shopper tests conducted by consumer groups and the GAO have found that implementation by individual stores is spotty.

Furthermore, the key disclosure for many low-income taxpayers is whatever is verbally explained by the tax preparer, especially if the preparer makes a recommendation. Taxpayers rely heavily on paid preparers, and this itself creates an enormous potential for exploitation. As one tax preparer described: “Throughout my tax preparation career, I have found that there is an extremely strong trust relationship between the preparer and his or her client . . . . However, this preparer – client trust relationship can present opportunities for abuse.”<sup>35</sup>

It is this trust relationship that makes RAL marketing so successful, and it is the information sharing permitted by the IRS that allows such marketing. If preparers could not use tax return information to offer RALs, only consumers who actively sought the loans would obtain them.

Written disclosures are also less than effective because of the nature of the tax preparation process. Any written document is just another piece of paper in the stack of papers thrust upon taxpayers during the tax preparation process. Furthermore, receiving a disclosure is a far different thing than having the chance to actually read, digest and understand it.

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<sup>33</sup> 128 F. Supp. 2d 926, 938 (E.D. Va. 2001), *aff’d in part, vacated in part, and remanded in part*, 2002 U.S. App. LEXIS 477 (4<sup>th</sup> Cir. January 10, 2002).

<sup>34</sup> 777 A.2d 95 (Pa. Super. Ct. 2001).

<sup>35</sup> Statement of Pat Eckelberry before the U.S. Senate Permanent Subcommittee on Investigations, Hearing On Tax Related Financial Products Can Be Costly, April 15, 2005.

The consumer may not be given the chance to review the disclosure and consider her refund options. For instance, the lead plaintiff in one RAL case, *Hood v. SBBT*, recounts how she was rushed through the process and told to “sign here and here” so that her paperwork could go in the next “batch.”<sup>36</sup>

Some of the CLS and CRA-NC testers experienced the same rushing by preparers. One tester reported: “The last thing I signed was the loan agreement. I began to read it over and he seemed anxious for me to just sign it and several times made comments to the effect that it was just paperwork laying out what we'd already discussed.”

Even without such overt rushing, very few consumers are willing to make a tax preparer wait so that she can read every page in a stack of documents. Tax preparers get paid by the return. Every minute the preparer is waiting for a consumer to read the paperwork is a minute the preparer is not spending working on the next customer's return. The social and psychological pressure is for the customer to display trust of the preparer by signing quickly.

Furthermore, even if she wanted to read the disclosure, the taxpayer may not be able to do so. Many taxpayers, especially the low wage workers who receive the EITC, may have limited education and literacy skills.<sup>37</sup> They may also be limited English proficient. About 1 in 20 adults in the U.S. are non-literate in English, or about 11 million people. Overall, 14% of adults have below basic literacy skills.<sup>38</sup> As one CRA-NC tester who was actually offered the opportunity to review a written document admitted: “[s]incerely, there was so much info. I just scanned through it.”

The situation is even worse with respect to any disclosures in the RAL application and agreement. These documents are very difficult for taxpayers to read and understand. The language used by these documents is technical, often in small print, and lengthy. Taxpayers have little motivation to read long documents in fine print.

#### D. RALs Create Significant Risks to Taxpayers

A RAL is a loan, and must be repaid. If the taxpayer's refund is not issued by IRS, for example because of a refund freeze, he or she is still responsible for repayment of that loan. Few taxpayers can afford to repay the \$2,000 to \$4,000 debt incurred when a RAL is not repaid. These RAL borrowers are subject to debt collection tactics and their credit histories are ruined.

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<sup>36</sup> Complaint, *Hood v. Santa Barbara Bank & Trust*, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara March 18, 2003), included in Appendix O.

<sup>37</sup> For example, an estimated 46 to 51% of the general population and 76% of food stamp recipients do not have adequate literacy skills to complete the multiple tax forms necessary to claim the EITC itself. Michael O'Connor, *Tax Preparation Services for Low Income Filers*, 90 Tax Notes 231, January 8, 2001.

<sup>38</sup> National Center for Education Statistics, *National Assessment of Adult Literacy: A First Look at the Literacy of America's Adults in the 21st Century*, Dec. 15, 2005, available at <http://nces.ed.gov/NAAL/PDF/2006470.PDF>.

More importantly, taxpayers with unpaid RAL debt face a significant risk of future refunds being seized by lenders using the practice of cross-lender debt collection. Most of the RAL lenders (the exception is Chase) have included a provision in their RAL agreements allowing them to take a consumer's tax refund and use it to pay back any prior RAL debts *for any RAL lender*. Thus, if a taxpayer owes money to one RAL lender from a prior year and applies for a RAL from a different lender, her RAL will be denied and her refund will be gone. The second lender will take her refund and use it to repay the prior RAL debt to the first lender. There have been several lawsuits filed against RAL lenders and tax preparers over this cross-lender debt collection practice, including one by NCLC.

We have provided a collection of 17 stories of consumers harmed by the risks of RALs, including cross-lender debt collection, at Appendix D.

#### E. RALs Enable Preparers to Obfuscate the Price of Tax Preparation

Finally, one effect of both RALs and other tax-related financial products is that they enable commercial preparers to obfuscate the price of tax preparation. One of the reasons that low-income taxpayers use RALs and RACs is to pay for the price of tax preparation:

- Several CRA-NC and CLS testers noted that preparers emphasized the ability for them to have preparation fees deducted from the proceeds of a RAL or RAC.
- A survey of about 1000 low- and moderate-income households in the Detroit metropolitan area found that nearly half of RAL borrowers reported that an important reason for taking out the loan was to pay for preparation and filing.<sup>39</sup>
- The GAO 2006 Preparer Testing Report noted that preparers sometimes sold RALs or RACs by stressing that taking the product would mean that the cost of preparation would be deducted from the refund and the taxpayer would not have to pay any money on the day of the visit.<sup>40</sup>

The price of tax preparation averages \$163 (Block) or \$178 (Hewitt) at the commercial chains, and can be even higher - one CRA-NC tester was charged \$355.<sup>41</sup> Because low-income taxpayers may not have this amount of cash at hand, preparers offer RALs and RACs to allow the price of preparation to be deducted from the proceeds of the loan or refund.

However, this practice makes taxpayers less sensitive to the price of preparation. It also enables preparers to engage in questionable practices, such as:

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<sup>39</sup> Michael S. Barr and Jane K. Dokko, *Tax Filing Experiences and Withholding Preferences of Low- and Moderate-Income Households: Preliminary Evidence from a New Survey*, 2006, available at <http://www.irs.gov/pub/irs-soi/06barr.pdf>.

<sup>40</sup> GAO 2006 Preparer Testing Report at 24.

<sup>41</sup> NCLC/CFA 2008 RAL Report at 12.

(1) Failing to disclose the price of preparation services to consumers. Examples include:

- At least three CLS mystery shopper testers reported that commercial preparers refused to give them a quote on preparation services
- GAO's testing in 2006 involved asking for an estimate of fees at the start of every commercial preparer transaction. The testers found that 8 out of 19 preparers either did not provide an estimate or gave an estimate with the qualifier that the fee would depend on the forms required. Furthermore, the GAO found: "The fees charged in our 19 visits varied widely, sometimes between offices affiliated with the same chain, and were sometimes significantly larger or smaller than the original estimate we were given."<sup>42</sup>

(2) Padding the price of preparation with ancillary RAL-related fees such as "e-filing," "service bureau," and other fees, sometimes in conjunction with deceptive advertising of low prices for tax preparation. Examples include:

- Four of the six CRA-NC and CLS testers who went to non-chain independent preparers this year were charged some sort of ancillary fee. One CLS tester was charged \$40 for document preparation, \$148 for e-filing, \$15 for "transmission" and \$120 as a "service bureau fee" – a total of \$324 in ancillary fees.
- A tax preparer in Baltimore advertised a \$36 tax preparation fee and "Faster and Cheaper than H&R Block/Jackson Hewitt" but then charged a consumer \$185 for an "electronic filing fee" and \$10 for a "transmission/software" fee – a total of \$195 in ancillary fees.
- A tax preparer in Florida charged \$65 for tax preparation, and then charged \$49 for a "RAL Processing Fee," \$15 for a "Federal Electronic Filing Fee," and \$10 for mysterious "Other charges" – a total of \$74 in ancillary fees.
- The GAO testing in 2006 included examples of testers charged between \$479 to \$570 for a RAL of \$5,000, after subtracting the amount charged to prepare the return.<sup>43</sup> Since the RAL banks charged loan fees of about \$110 that year for a RAL of \$5,000, the preparers had added ancillary charges of \$370 to \$460 on top of the loan fee.<sup>44</sup>

Finally, commercial preparers use the "quick cash" of RALs to market preparation services, thus enabling them to charge several hundreds dollars for sometimes fairly simple forms. RALs provide a lure not available from most free tax preparation sites (with the exception of a few that make low-cost alternative RALs) or by preparing taxes at home.

#### F. Privacy and Security Issues in Tax Preparation

The IRS raised two concerns in its ANPR over RALs and other financial products - the role of RALs in inflating tax refunds and harm to consumers from the products sold - but surprisingly did not raise the issue of privacy and security risks inherent in the use of tax return information to sell these products. By permitting tax preparers to share, use,

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<sup>42</sup> GAO 2006 Preparer Testing Report at 24.

<sup>43</sup> GAO 2006 Preparer Testing Report at 24.

<sup>44</sup> NCLC/CFA 2006 RAL Report at 15.

or sell tax return information to facilitate the sale of financial products, the IRS has enabled the dissemination of tax returns to commercial entities over which it has no control, including banks that make RALs and RACs, or sell other products at tax time.

As discussed in Part IV, the lure of RALs attracts fringe preparers, such as check cashers, rent-to-own stores, payday lenders, used car dealers, furniture stores, and others, into the tax preparation business. These fringe preparers are handling and retaining tax return and other sensitive financial information from taxpayers. We are alarmed at the privacy and security risks to taxpayers exacerbated by exposure of tax returns to unsupervised fringe preparers.

In issuing its final revised rule in January 2008 permitting preparers to use return information to sell products or for any other use as long as the taxpayer signs a consent form, the IRS relied on its oft-repeated argument that taxpayers should be able to control the use and disclosure of their own tax information. Yet when the IRS permits tax return information to be shared or used for commercial purposes by entities not subject to Section 7216, the result is that taxpayers lose control of their tax return information. As consumer groups noted in comments filed in 2006, the idea that consumers exercise control of information at tax preparation time is naïve. Taxpayers get a piece of paper stuck in a stack of papers they are instructed to sign. The informational and power disparities between a preparer and a taxpayer make the idea of the taxpayer directing the preparer on information sharing ludicrous. The only way for the IRS to meet its announced goal of taxpayer control of returns is to close the 7216 “consent loophole” and prohibit tax preparers from trafficking in tax returns for commercial purposes.

Tax returns include some of the most sensitive personal financial information that a consumer has, such as the number of minor children, income, employer, homeownership, child support, mutual fund investments, charitable contribution totals, bank account routing numbers provided for direct deposit of refunds, and even the name of the taxpayer’s day care provider. This is a goldmine of information for database marketers. Moreover, it is ideal for identity theft, which is the fastest growing crime in this nation.

Although taxpayers must sign consent forms before return information can be sold, shared or used for other purposes, once tax return information is in the hands of the RAL lending banks, they can then share tax return information with affiliates without needing to get prior consent. Under the much weaker Gramm-Leach-Bliley Financial Services Modernization Act (GLB), financial institutions only need provide an opportunity to opt out of information sharing with unrelated third parties. Taxpayers getting RALs are given a confusing assortment of tax preparer and bank privacy consent forms and policies. The banks’ privacy policies permit widespread use of tax return information. For example, HSBC’s privacy policy states:

How We Share Information with Companies Affiliated with Us....These affiliated companies all provide financial services, such as banking, consumer finance, insurance, mortgage, and brokerage services. Some examples include companies

doing business under the names HSBC, HFC, or Beneficial. We may also share certain information with non-financial service providers that become affiliated with us in the future, such as travel, auto, or shopping clubs, except as prohibited by applicable law.<sup>45</sup>

A few years ago, PennPIRG wrote to the Federal Trade Commission (FTC), which is responsible for compliance by tax preparers with GLB, to request an investigation of unsafe data handling at tax preparation kiosks in stores but got no reply or indication that any investigation had been conducted.<sup>46</sup> PIRG surveyors found lax privacy and security exposure for taxpayers who used Jackson Hewitt and H&R Block kiosks at Wal-Mart stores in a survey conducted at 14 locations in nine states in 2004. The surveys found glaring holes in privacy practices that could lead to instances of identity theft. “Shoulder surfing” is one of the techniques identified by the FTC as a key method of stealing personal information. In all but one case, the PIRG survey noted that tax preparer’s desks were positioned such that passersby or shoppers could easily gain access to valuable sensitive information. In one case, a PIRG surveyor could have easily stolen a consumer’s completed tax forms.<sup>47</sup>

In the CLS mystery shopper test conducted this year, one tester noticed that Instant Tax Service compromised the security of its clients’ sensitive information. Preparers kept file folders with the name and Social Security number of each client who was scheduled to return to pick up a refund or RAL check. These files were prominently displayed behind the desk of each associate. The names and Social Security numbers could be easily read by anyone in the office.

### **III. RALS CONTRIBUTE TO TAX FRAUD**

One of the key questions in the IRS ANPR is whether RALs and other products provide an incentive to inflate tax refunds. We believe that RALs cause more harm than just inflated refunds. According to fraud experts, including IRS criminal enforcers, RALs aid thieves in their commission of tax fraud.

#### **A. RALs Provide Preparers With Financial Incentives to Push the Loans, Which May Lead to Inflated Refunds**

The IRS is right in its suspicion that RALs may provide incentives for tax preparers to take inappropriate tax positions that improperly increase refunds. RALs have been involved in several situations where tax preparers inflated refunds. The most prominent recent example, of course, comes from Department of Justice’s lawsuits against five Jackson Hewitt franchisees that operated 125 offices for their role in

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<sup>45</sup> HSBC, *Privacy Statement*, undated, included in Appendix E.

<sup>46</sup> Letter from Beth McConnell, PennPIRG Education Fund to the Federal Trade Commission, March 15, 2004.

<sup>47</sup> State Public Interest Research Groups, *A Survey of Consumer Privacy Safeguards at Tax Preparation Booths*, March 5, 2004, available at <http://static.pennpirg.org/reports/TaxPrepPrivacySurveys.pdf>.



preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. As discussed further in the following section, RALs were involved in that case of massive fraud.

Other examples in which RALs were involved in cases of inflated refunds include:

(1) The GAO 2006 Preparer Testing Report found errors that led to inflated refunds exceeding \$1,000 in 6 out of the 19 test cases. These inflated refunds resulted from preparers not reporting business income in 10 of 19 cases and claiming an ineligible child for the EITC in 5 out of the 10 applicable cases. The GAO report specifically noted that RALs were often offered by these paid preparers.

(2) A CRA-NC tester had to withdraw from this year's mystery shopper testing because of preparer incompetence in the treatment of income from dividends. The preparer was confused about how to handle dividend income and needed to consult her "tax people" for advice. After a consultation, she advised the tester that it was not necessary to report the dividend income, essentially instructing the tester to commit tax fraud. Furthermore, this tester had both dividend income and profits from the sale of stock shares. The preparer also completely missed the stock sale.

(3) A Jackson Hewitt preparer failed to include unemployment insurance income in the return of a married couple who served as CLS testers. This omission substantially understated the couple's income. This couple was required to file an amended return in order to correct this omission.

(3) The National Taxpayer Advocate's 2007 Report to Congress noted that when IRS audited EITC tax returns associated with RALs, they found errors in 87% of cases, versus 73% of the cases without RALs – a 14% difference. Furthermore, returns with RALs resulted in adjustments of tax liability that averaged 10% more than non-RAL returns.<sup>48</sup>

We also note that a study for the Casey Foundation that compared error rates in returns from both free tax preparation sites and commercial preparers found much higher error rates in the latter – 41% in free sites versus 73% in commercial sites.<sup>49</sup> The errors in commercial sites were also larger in dollar amount and more likely to overestimate the refund than underestimate (40% of the commercial preparer returns overestimated the refund, but only 8% of the free site returns overestimated). Part of the reason for these higher error rates, tilted toward inflated refund amounts, may be the financial incentives provided by RALs and RACs, since the nonprofit free sites have no similar financial incentive.

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<sup>48</sup> National Taxpayer Advocate, *FY 2007 Annual Report to Congress*, December 31, 2007, at 88.

<sup>49</sup> Amy Brown, *Quality in Free and Commercial Tax Preparation: Results from the 2006 Tax Season*, Annie E. Casey Foundation, June 2006, included as Appendix L.

RALs provide significant financial incentives to preparers. These incentives encourage preparers to sell RALs, and to take measures that promote loans. In turn, those measures may result in preparers sometimes inflating a taxpayer's refund. These incentives include:

- Some preparers receive a kickback per RAL. For example, Republic Bank & Trust advertises on its website a kickback “incentive” payment of \$7 per RAL plus an additional payment of \$2 to \$7 depending on the loan performance of the RALs facilitated by the preparer.<sup>50</sup> At one point, all of the major RAL lending banks offered these kickbacks and Santa Barbara Bank & Trust still does.<sup>51</sup>
- Previously, Block employees had been compensated per RAL or RAC. Individual Block employees no longer receive compensation for these products, but the company does. Block buys a 49.9% “participation share” from HSBC in each RAL facilitated by Block.<sup>52</sup>
- It is unclear whether Jackson Hewitt preparers receive compensation, but since that company primarily operates on a franchise model, it may differ by franchisee. The corporation does receive compensation for each RAL, and even shares in the risk of loan defaults. Currently, Hewitt receives a lump sum from RAL lenders plus “a variable payment upon the attainment of certain contractual growth thresholds.”<sup>53</sup> In prior years, Hewitt's share of loan profits was even more explicit. Hewitt's 2004 Securities and Exchange Commission prospectus describes how the company received \$16 plus a potential additional \$2 plus 50% of any profit over 1% of the aggregate loan volume of RALs--in other words, Hewitt received a significant percentage if not the majority of profits from RALs, but shared in a 50% risk if loan defaults resulted in a net loss to the bank.<sup>54</sup>

IRS Publication 1345, which governs e-file providers, specifically prohibits preparers from basing their fees on the refund amount. However, the above compensation structures undermine this protection by compensating preparers for generating loans. On a corporate level, both Block and Hewitt are compensated not only on a per loan basis, but also share in the profits or risks of the loans, which are dependent on the loan amounts (and thus refund amounts). Furthermore, preparers have incentives to inflate refunds when RALs are involved because:

- While a larger RAL does not mean more compensation for the preparer on an individual basis, a bigger refund and RAL means the independent preparer can

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<sup>50</sup> <https://www.republicrefund.com/ERO-Support/ERO-Incentives.aspx>, included in Appendix F.

<sup>51</sup> Santa Barbara Bank & Trust, *Bank Product Program 2008*, October 2007, included in Appendix F.

<sup>52</sup> H&R Block Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 6, available at <http://www.sec.gov/Archives/edgar/data/12659/000095013707009521/c16312e10vk.htm>.

<sup>53</sup> Jackson Hewitt Tax Service Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 22, available at <http://www.sec.gov/Archives/edgar/data/1283552/000119312507147353/d10k.htm>.

<sup>54</sup> Jackson Hewitt, Final Prospectus, June 22, 2004, at 39, available at <http://ccbn.10kwizard.com/cgi/convert/rtf/JACKSONHEWITTTA424B1.rtf?rtf=1&repo=tenk&ipage=2856162&num=-3&rtf=3&xml=1&dn=2&dn=3>.

charge a higher fee in that the taxpayer becomes less sensitive to the amount of tax preparation fees.

- A larger refund also means a taxpayer is more likely to get a RAL. Taxpayers are more likely to get a RAL for a \$3,000 refund (costing \$62 to \$112) than a \$500 refund (costing \$33 to \$38).
- For retailers who offer tax preparation and RALs, such as used car dealers and furniture stores, the bigger refund means the retailer can sell a more expensive product. A bigger refund also means a bigger check cashing fee for the check casher who prepares taxes, or more money to pay off a loan for payday lenders and pawn shop operators.

Finally, RALs and other financial products, such as RACs, often permit preparers to handle the payment mechanism (check or prepaid card). This provides another opportunity for malfeasance on the part of the preparer. In at least three of the RAL fraud cases listed in Attachment B of CRA-NC's comments, the preparer illegally endorsed a RAL check and deposited it into their own bank accounts. This is especially easy because the tax preparer is the one who prints a RAL check or issues a prepaid card – indeed, the preparers often are provided blank check stock to print out RAL checks. In contrast, if a taxpayer receives a paper check from the government or a direct deposit, s/he has direct control over the funds when first issued.

Finally, RALs may provide incentives to inflate refunds simply because they draw fringe preparers into the field, as discussed in Section IV.E below. The quality of preparation services by fringe preparers is questionable, and may result in inflated refunds.

#### B. RALs Are Often Involved in Tax Fraud Cases

There is no question that RALs are often involved in cases of tax fraud. A review of published legal cases, materials posted on the websites of the U.S. Department of Justice and IRS, and media reports finds at least 46 cases of tax fraud in which the defendants used RALs as a method of receiving their ill-gotten gains. These cases are listed in Attachment B to the comments submitted by CRA-NC, which we incorporate by reference. Appendix B of this Comment contains an additional list of 12 media articles and other sources describing tax fraud involving RALs.

These 58 cases alone would be a strong indicator that RALs assist criminals in committing tax fraud. However, the IRS itself has long known about the role of RALs in fraud, because IRS personnel that work on criminal investigations have noted the strong connection. In 2004, Gary Bell, then Director of the IRS Criminal Investigation Division's Refund Crimes Unit, reported that 80% of fraudulent e-filed returns are tied to a RAL or other refund financial product. Mr. Bell even explained the reasons why RALs enable tax fraud, noting that RALs offered fraudsters "an opportunity to get their cash and make a quick getaway."<sup>55</sup>

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<sup>55</sup> Allen Kenney, *IRS Official Shines Spotlight on E-Filing Fraud*, 2004 Tax Notes Today 130-4, July 6, 2004, included in Appendix G.

Nancy Jardini, Chief of the Criminal Investigations Division, reported similar data with respect to cases of tax fraud committed by prisoners. In testifying before Congress, Ms. Jardini noted that over 50% of false prisoner returns requested either RALs or direct deposit refunds.<sup>56</sup>

RALs are the tool of choice for fraudsters who commit tax identity theft. Just last month, a Wall Street Journal article about the growing problem of tax ID theft featured several cases in which RALs were used to perpetrate that crime.<sup>57</sup> Appendix D includes several stories about taxpayers who were victimized by tax ID theft perpetrated using RALs.

Last year, a Senate Finance Committee hearing on tax fraud and ID theft featured the testimony of Evangelos Dimitros Soukas, who netted over \$40,000 by stealing the identities of other taxpayers as well as making up false returns. Mr. Soukas was initially attracted to the crime of tax identity theft and tax fraud because of a RAL advertisement on a website, and used RALs in his criminal schemes.<sup>58</sup>

Of course, the most prominent tax fraud case brought recently by the U.S. Department of Justice (DOJ) was the civil enforcement action filed April 2, 2007, against 5 Jackson Hewitt franchisees that operated 125 offices for their role in preparing fraudulent tax returns falsely claiming \$70 million in tax refunds. DOJ alleged that the owners and managers of these franchisees “created and fostered a business environment . . . in which fraudulent tax return preparation is encouraged and flourishes.” Examples of fraud alleged by DOJ include filing false returns claiming refunds based on phony W-2 forms; using fabricated businesses and business expenses on returns to claim bogus deductions; claiming fuel tax credits in absurd amounts for customers clearly not entitled to any credits; and massive fraud related to EITC claims.<sup>59</sup>

According to the complaints filed in these lawsuits, RALs were heavily involved in the fraud committed by these Jackson Hewitt franchisees. The lawsuits against all of the franchisees alleged:

“Many of [franchisees’] stores cater to prospective customers who are not entitled to tax refunds but who seek to obtain fast money in the form of Jackson Hewitt

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<sup>56</sup> Statement of Nancy J. Jardini, Chief, Criminal Investigation, Internal Revenue Service, *Testimony before the Subcommittee on Oversight of the House Committee on Ways and Means*, June 29, 2005, available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=2875>.

<sup>57</sup> Tom Herman, *Identity Thieves Target Tax Refunds*, Wall Street Journal, March 12, 2008, included in Appendix B.

<sup>58</sup> Statement of Evangelos Dimitros Soukas, *Testimony before the Senate Finance Committee*, April 12, 2007, included in Appendix B.

<sup>59</sup> Complaint, *United States v. Smart Tax of Georgia, Inc.*, 1:07CV-0747 (N.D. Ga. Apr. 2, 2007); Complaint, *United States v. Smart Tax Inc.*, 07C-1802 (N.D. Ill. Apr. 2, 2007); Complaint, *United States v. Sofar, Inc.*, Civ. No. 2:07-cv-11460 (E.D. Mich. Apr. 2, 2007); Complaint, *United States v. Smart Tax of North Carolina, Inc.*, Civ. No. 5:07-cv-00125-FL (E.D.N.C. Apr. 2, 2007). All of the complaints are available at <http://www.usdoj.gov/tax/txdv07215.htm>.

"Holiday Express Loan Program" (HELP) loans, "Money Now" loans, or Refund Anticipation loans (RALs) secured by fabricated tax refunds fraudulently claimed on Jackson Hewitt prepared and filed tax returns."<sup>60</sup>

In addition, one of the lawsuits alleged: "In 2007, a Smart Tax/Jackson Hewitt return preparer offered to fraudulently manipulate a customer's 2006 return information so the customer would qualify for a RAL."<sup>61</sup>

The complaints also suggested that RALs contributed to an atmosphere which encouraged fraudulent tax preparation, in part due to a sense that it was not the preparer's responsibility to look out for or stop fraud. For example, one complaint noted that the franchise owner told an employee not to reject returns with false Form W-2s, stating "fraud detection is the job of the police and Santa Barbara Bank & Trust" (Jackson Hewitt's RAL lender).<sup>62</sup>

The Jackson Hewitt case is by no means an isolated incident, as shown by Appendix B to this comment and Attachment B to the CRA-NC's comments. With the 58 cases listed in these Appendices, the IRS cannot claim instances of RAL-enabled tax fraud are isolated incidents.

### C. The Speed of RALs Makes Tax Fraud Easier for Criminals

One reason that RALs encourage tax fraud is the speed by which the fraudster receives loan proceeds. Such reasoning is not only intuitive and logical, it was pointed out to the IRS nearly 15 years ago. In 1993, the IRS commissioned a report on electronic filing fraud by Dr. Malcolm Sparrow, an expert on fraud at Harvard's Kennedy School of Government. In his report, Dr. Sparrow informed the IRS:

Most importantly, the existence of RALs has acted as an attractor for fraud by shortening the "exposure period" for the perpetrators. The exposure period -- the time that elapses between the carrying out of a dishonest act and the receipt of the financial payoff from that act -- is one of the most powerful deterrents for fraud available. It is a very uncomfortable period for the criminal as they have to, in some sense, stay contactable or available to the authorities in order to receive their reward. In the paper system the processing delays, although never designed explicitly as fraud controls, acted as such.

The existence of RALs has brought the exposure period right down to 48 hours, which, for a simple to execute fraud with a \$ 3,000 reward, is incredibly fast and therefore extremely attractive when compared with other fraud opportunities.

"Easy money fast" is a much more attractive proposition for fraud perpetrators than "easy money . . . which you should get in six weeks."<sup>63</sup>

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<sup>60</sup> *Id.*

<sup>61</sup> Complaint, *United States v. Smart Tax Inc.*, 07C-1802 (N.D. Ill. Apr. 2, 2007).

<sup>62</sup> Complaint, *United States v. Smart Tax of Georgia, Inc.*, 1:07CV-0747 (N.D. Ga. Apr. 2, 2007).

<sup>63</sup> Malcolm Sparrow, *Fraud In The Electronic Filing Program: A Vulnerability Assessment Prepared for the Internal Revenue Service*, Sept. 1, 1993, at 10.

A copy of Dr. Sparrow's report is included in Appendix I.

Thus, the role of RALs in fraud is something the IRS has been aware of since 1993, and indeed was the reason that the agency terminated the Debt Indicator in the following year. Unfortunately, the IRS chose to reinstate the Debt Indicator in 1999, and as discussed in Section III.D, both the number of RALs and tax fraud skyrocketed.

The federal government's own financial crimes experts came to the same conclusion as Dr. Sparrow. The Treasury Department's Financial Crimes Enforcement Network (FinCEN) raised concerns about the role of RALs in promoting fraud in August 2004. FinCEN issued a warning to banks that month, noting the fraud potential of RALs: "To make this type of loan appealing to the public, funds are made immediately available, leaving little time for the lender to perform due diligence to prevent fraud."<sup>64</sup>

Other commentators have made similar observations. For example,

- As noted above, Gary Bell of the IRS Criminal Investigations Division noted that the speed of RALs enables fraudsters to make a quick getaway. Mr. Bell further explained "it may take the IRS three or more weeks to process the return [using fraud detection measures], especially in the peak of the spring filing season. Meanwhile, the RAL lenders have processed the loan within a couple of days of the return being filed, the money is in the hands of the bad guys, and they can disappear without a trace,..."<sup>65</sup>
- Steven Saltzburg, a Georgetown University law professor who was the director of a Treasury Department task force on tax fraud, stated that "the refund anticipation loan system made it easy for criminals with false papers to steal up to \$3,300, the maximum refund anticipation loan amount, but because the I.R.S. pays the banks within two weeks and rarely pursues recovery, the taxpayers often end up as the losers."<sup>66</sup>
- Unnamed tax officials quoted in the New York Times observed that RALs "allow them [fraudsters] to get the money for their fraudulent returns before the fraud can be detected by the I.R.S."<sup>67</sup>

#### D. Experience with the Debt Indicator

The IRS experience with the Debt Indicator also provides an indication of how RALs promote fraud. In 1994, the IRS terminated the Debt Indicator due to concerns

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<sup>64</sup> FinCEN, SAR Activity Review, Issue 7, August 2004, at 15-17, relevant portion included in Appendix G.

<sup>65</sup> Gail Perry, *Electronic Filing Fraud: Latest Tax Scam's Got Legs*, Accounting Today, August 9, 2004, at 3, included in Appendix G.

<sup>66</sup> David Cay Johnston, *Bank Challenges I.R.S. on Refunds for Borrowers*, New York Times, Feb. 22, 1995, included in Appendix G.

<sup>67</sup> Robert D. Hershey Jr., *Administration Moves Against Tax Credit*, New York Times, Oct. 27, 1994, included in Appendix G.

over mounting fraud in refund claims.<sup>68</sup> IRS data during that time period had indicated that 92% of fraudulent returns filed electronically involved RALs.<sup>69</sup>

After the Debt Indicator was terminated, the number of RALs dropped – at H&R Block, RAL volume was cut in half from 5.5 million to 2.35 million. The elimination of the Debt Indicator and corresponding decrease in RALs appeared to have had its intended effect of cutting down fraud. According to the Assistant Attorney General in charge of the Tax Division at the Department of Justice, eliminating the Debt Indicator, along with other fraud prevention measures, successfully reduced the number of fraudulent claims.<sup>70</sup>

When IRS reinstated the Debt Indicator in 1999, the number of RALs increased as a result. In reinstating the Debt Indicator, the IRS attempted to address fraud by requiring tax preparers to institute fraud prevention measures. Despite these new measures, fraud increased when the Debt Indicator was reinstated as the number of RALs went up. Gary Bell of IRS's Criminal Investigations Division noted in 2004 that e-file fraud increased by more than 1,400 percent since 1999 (when the Debt Indicator was reinstated), and that approximately 1 in every 1,200 e-filed returns was phony, compared with a rate of about 1 in every 5,000 four years earlier. The FinCEN report also noted that RAL fraud had multiplied between 2000 and 2003.<sup>71</sup>

#### E. Banks Have Little Incentive to Institute Fraud Control Beyond IRS's Controls

Another reason that RALs contribute to tax fraud is that banks have little incentive to reduce fraud beyond reliance on IRS's own measures. As Dr. Sparrow described in his report to the IRS:<sup>72</sup>

This raises an interesting point with respect to the banks' incentives. Their profit motive provides no incentive at all for them to detect fraud; they have a financial incentive only to predict IRS behavior. The [Debt Indicator] has been, this year, an excellent predictor of IRS behavior, so they had a very profitable year. Note that they decline 6% or 7% of applications because the [Debt Indicator] comes back negative, whereas they decline only 0.5% of applications on the basis of their own fraud detection systems. So the [Debt Indicator] is doing nearly all of their selection work for them.

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<sup>68</sup> A history of the Debt Indicator, its termination and subsequent reinstatement, and its impact on the RAL industry is set forth in Chi Chi Wu, *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud*, National Consumer Law Center (July 2005). A copy of this paper is included in Appendix N.

<sup>69</sup> George Guttman, *Improper Refunds Sapping Billions*, 66 Tax Notes 19, October 3, 1994, at 23, included in Appendix G.

<sup>70</sup> John Tigue & Linda Lacewell, *Tax Litigation – Interview with Loretta C. Argrett – Part II*, New York Law Journal, July 17, 1997, included in Appendix G.

<sup>71</sup> FinCEN, SAR Activity Review, Issue 7, August 2004, at 15-17.

<sup>72</sup> Malcolm Sparrow, *Fraud In The Electronic Filing Program: A Vulnerability Assessment Prepared for the Internal Revenue Service*, Sept. 1, 1993, at 23.

The banks argue that they behave as good citizens, care deeply about fraud control, and are not solely guided by the profit margins. They do, however, monitor each [tax preparer] BY THEIR LOSS RATE, and cut off those [tax preparers] that become unprofitable for the banks. (emphasis in original).

Despite the banks' protestations that they deeply care about fraud, some RAL banks up until last year continued to do nothing more than mimic the IRS's controls. As long as the IRS paid the refund, these banks treated their fraud controls as sufficient. One bank even admitted it left fraud controls off when they thought IRS wasn't screening. The CEO of Santa Barbara Bank & Trust admitted:

The reason why we didn't have it [fraud control] on all the time before is because we had a history with the IRS over their own fraud control and we mimicked, or tried to mimic the IRS' fraud control. So we would turn on when we thought the IRS would turn on its fraud control, and for many years, 10 or 15 years, that served this bank very, very well. It allowed the bank to balance revenue growth with loss control.<sup>73</sup>

Indeed, SBBT did not even employ a bank officer in its RAL division who was responsible for credit quality. As one investment analyst noted: "risk management was a little sparse."<sup>74</sup>

This sparse risk management and piggybacking on IRS fraud controls continued until last year, when SBBT suffered significant losses from RAL fraud. While SBBT instituted new measures this year, there is nothing to prevent SBBT from reverting back to mimicking IRS fraud controls once the bank can be assured that it has "gamed" the controls and can determine whether the IRS will pay the refund. After all, during the years prior to IRS's institution of better fraud controls, SBBT knew it would be making loans against some fraudulent returns but accepted it so long as the bank knew it would get repaid from the U.S. Treasury.

A reversion to mimicry once the RAL banks figure out the new IRS fraud controls would be expected given the financial incentives for the banks. RAL banks have a significant incentive NOT to run fraud controls that exceed or are different from IRS fraud controls, because that lowers the bank's approval rate and results in a decrease in profit. For example, SBBT predicted that its RAL volume would decrease by 5% due to its new fraud controls that are different from the IRS fraud controls.<sup>75</sup> That translates into about 90,000 RALs. Given that SBBT charges \$111 for a RAL of the average refund amount, these stronger fraud measures will cost SBBT \$10 million in foregone RAL fees. As SBBT's CEO put it:

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<sup>73</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, October 29, 2007, at 14, included in Appendix J.

<sup>74</sup> *Id.* at 10.

<sup>75</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, Nov. 1, 2007, at 5, included in Appendix J.



“I think the fact of the matter is this is a volume driven business, and the guys in San Diego worked very hard to sort of balance the risk requirements with the revenue generating issues of that business; and we patterned the fraud control, in particular, on behaviors that the IRS had done for many, many years.”<sup>76</sup>

#### IV. RALS AND FRINGE PLAYERS

RALs cause harm to low-income taxpayers and promote shady tax preparation another way: by attracting fringe preparers into the business. This next section explores how RALs promote fringe tax preparation.

##### A. The Independent Sector

Independent preparers have a large share of the commercial tax preparation market. According to data from IRS SPEC, there were 77.2 million returns prepared by paid tax preparers in 2006. In 2006, Block prepared 15.7 million returns, Jackson Hewitt prepared 3.7 million returns, and third largest chain Liberty Tax prepared about 1 million returns.<sup>77</sup> This adds up to slightly more than 20 million returns. Thus, independent preparers prepared nearly 57 million tax returns, or almost three-quarters of all paid preparer returns, in 2006.

There is little data as to how many RALs were sold through these independent preparers. We know that at one point, HBSC/Household had a relationship with approximately 5,600 tax preparers, most of whom we assume were independent.<sup>78</sup> We also know that H&R Block and Jackson Hewitt only accounted for about 5.3 million of the 9 million RALs made in 2006.<sup>79</sup>

Independent preparers can range from licensed professionals, such as attorneys and certified public accountants, to any person who wishes to hang a “shingle” and make money preparing taxes. The federal government regulates return preparers very minimally, and only two states (California and Oregon) license preparers. While there are many independent preparers who are just as experienced and well trained, if not more so than the commercial chains, there is a sector of independent preparers that is extremely problematic – the fringe preparers.

Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. Some retailers, such as jewelry and furniture stores, are fringe tax preparers. In

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<sup>76</sup> Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, October 29, 2007, at 10.

<sup>77</sup> NCLC/CFA 2008 RAL Report at 22-26.

<sup>78</sup> Household International, *2003 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 7, available at <http://www.sec.gov/Archives/edgar/data/354964/000095013703001680/c75016e10vk.txt>.

<sup>79</sup> NCLC/CFA 2008 RAL Report at 22-24.

immigrant communities, businesses that offer travel services, “notario” services, and quickie divorces also often offer tax preparation of varying quality.

Fringe preparers are able to exist because of the software and back office support of certain companies called “transmitters,” “service bureaus,” or “software developers.” Examples include NTS Service Corp., Universal Tax Systems, Petz Enterprises, OrrTax and Refunds Today. These companies sometimes serve as the “electronic return originator” for the fringe preparer, *i.e.*, these companies are the ones authorized by the IRS to electronically file tax returns.

For example, Petz Enterprises advertises its Tax Software and Financial Products or “QuickAccess” to check cashers, noting that “you get to keep a percentage of every transaction.”<sup>80</sup> There is a transmitter that specifically caters to used car dealers – Tax Refund Services, which operates as TaxMax. TaxMax advertises that it is “the leading tax consultant in the industry with a portfolio of over 3000 car dealerships nationwide.”<sup>81</sup> One of TaxMax’s services is to provide car dealers with advertising copy that states: “Free Tax Preparation! FILE YOUR TAXES HERE. DRIVE HOME TODAY!” Of course, the ad fails to mention that the dealer is permitted to take a dealership incentive fee of up to \$99.<sup>82</sup> TaxMax also appears to have a pay stub RAL program, called its 4<sup>th</sup> Quarter Sales Program, despite the fact that the major RAL banks have ceased making those loans.<sup>83</sup>

Software providers are also recruiting tax offices to become payday lenders. OrrTax Software Solutions is marketing Xpress Cash as an opportunity for “year-round revenue!” for tax preparers, by offering payday loans to their tax clients. The sample financial estimate claims \$32.50 in profits out of the \$45 charged for a \$300 two-week loan, which translates into an APR of 390%. Xpress Cash notes that the average payday loan customer receives 7 to 9 loans per year for average annual profit per customer of \$248.<sup>84</sup>

## B. Check Cashers and Payday Lenders

Tax refunds have a significant impact on high cost lenders such as payday loan outlets and pawn shops. Typically, loan volume trends downward early in the year as consumers with payday or pawn loans use RAL and refund proceeds to take a break from the payday loan debt treadmill. Some payday lenders and other high cost lenders have responded by setting up tax preparation services. Major payday lenders that offer tax preparation include Dollar Financial Group’s MoneyMart, ACE Cash Express, and Advance America.

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<sup>80</sup> Quick Access ad, *Cheklis*, Winter 2007, at 31.

<sup>81</sup> <https://www.taxrefundsolutions.com/Site/TRSTaxMax/AboutUs.aspx>, included in Appendix F.

<sup>82</sup> <https://www.taxrefundsolutions.com/Site/TRSTaxMax/FAQ.aspx>, included in Appendix F.

<sup>83</sup> <https://www.taxrefundsolutions.com/Site/TRSTaxMax/FourthQuarterSalesProgram.aspx>, included in Appendix F.

<sup>84</sup> [http://www.orttax.com/pdfs/ERO\\_Flyer\\_Orrtax%20-%20FINAL.pdf](http://www.orttax.com/pdfs/ERO_Flyer_Orrtax%20-%20FINAL.pdf), included in Appendix F.

Advance America actually uses a new H&R Block service called TaxOne, which provides preparation by a Block office and RALs from SBBT. While the RALs may be less expensive and the quality of tax preparation better than at other payday lenders, the downside is that TaxOne allows payday loan chains to keep their customers coming through the doors during a time of year when typically the demand for payday loans drops.

In order to get a sense of the magnitude of high cost lenders involved in tax preparation, we reviewed the IRS website's lists of entities that are authorized e-file providers for five states.<sup>85</sup> We uncovered a significant number of payday lenders, rent-to-own stores, auto title lenders and other high cost lenders engaged in tax preparation. The following chart summarizes our review of the e-file provider list for these 5 states:

<b>State</b>	<b>Fringe Lenders/Providers</b>	<b>Percent of Authorized e-file Providers</b>
Arizona	213	5.0 %
Florida	351	2.5
Illinois	240	2.7
Massachusetts	19	0.4
South Dakota	17	3.7

Some of the high cost lenders listed on the IRS website include:

- Ace Cash Advance (11 locations, AZ)
- Check Advance (20 locations, AZ)
- Loan Mart (31 locations, AZ)
- Money Mart (32 locations, AZ)
- Cash AdvantEdge (10 locations, AZ)
- A Florida's Cash Express (FL)
- Bay Auto Loan Cash Advance (FL)
- Cash 4 U (FL)
- Check Man (6 locations, FL)
- Fast Money Inc (2 locations, FL)
- Flash Cash Services (FL)
- Instant Cash Advance (2 locations, FL)
- Mr. Cash & Assoc. (FL)
- Melrose Jewelry & Pawn (FL)
- Calumet City Currency Exchange (IL)
- Colortyme (rent-to-own store) (2 locations, IL)
- Dupage Currency Exchange (IL)
- Peoples Choice Cash & Pawn (IL)
- Security Finance (55 locations, IL)
- Quick Pay (MA)

<sup>85</sup> <http://www.irs.gov/efile/page/0,,id=10162,00.html>.

EZ Money Check Cashing (SD)  
Money Lenders (3 locations, SD)

Washington State requires outlets that facilitate the sale of RALs to register with the Department of Financial Institutions. Included on the list of 611 registered RAL facilitators in Washington are 101 Advance America outlets and 60 MoneyTree stores that offer tax preparation and RALs through TaxOne's remote service. Other Washington fringe financial service providers that market RALs include 18 Rent-a-Center's CashAdvantEdge services, and two offices of payday lender Til Payday Inc.

Small installment lenders also offer tax preparation services during tax season. Sun Loan Company, with outlets in several western states, offers tax preparation, e-filing and RALs<sup>86</sup>

Fringe preparers also continue to make "pay stub RALs" despite the fact that the major RAL banks no longer make such loans. American Cash Center offers "HOLIDAY LOANS For a limited time bring in your last pay stub and we will loan you up to \$1000." (Copy included in Appendix F). Rent-a-Center urged customers to bring their latest pay stub, starting on December 15 to get the "earliest estimate of your tax refund available," and to come back January 2 or later with a W-2 to file "your simple tax refund quickly and easily, and you could walk out with your refund loan in minutes, if you qualify."<sup>87</sup> As noted above, TaxMax offers a pay stub RAL program to used car dealers.

### C. Other Questionable Preparers

The review of the IRS list of authorized e-file providers for five states uncovered additional questionable fringe preparers, such as:

Arizona Auto Title Co. (AZ)  
Statons Home Furnishings (AZ)  
U Haul International (AZ)  
4 J'S Auto Sale & Services, LLC (FL)  
A D Used Cars (FL)  
Babcock Home Furniture (FL)  
Buddy's Home Furnishings (54 locations, FL)  
Cherilus Driving School (FL)  
Delilah Ephraim Beauty Salon (FL)  
Jays Stucco & Plastering (FL)  
Jolinda Beauty Supply and Service (FL)  
Lithos Jewelry (FL)  
Lundys Liquor (FL)  
Rent a Wheel (9 locations, FL)  
Aloha Travel & Tax Services (IL)  
Benton Super Lube (IL)

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<sup>86</sup> [www.sunloan.com/taxreturns.asp](http://www.sunloan.com/taxreturns.asp), included in Appendix F.

<sup>87</sup> [www.cashadvantedge.com/site/page/pg3092.html](http://www.cashadvantedge.com/site/page/pg3092.html), included in Appendix F.

Paradise Super Market (IL)  
Belmar Travel & Tour (MA)  
New Age Oriental Therapy (MA)  
Union Travel & Tours (MA)<sup>88</sup>  
A to Z Language Interpreters (SD)  
Appliance & Furniture Rent All Inc (5 locations, SD)

Thus, businesses engaged in tax preparation and potentially offering RALs include used car dealers, travel agents, beauty salons, furniture stores, grocery stores, jewelry stores, liquor stores, and a “therapy” office. Needless to say, we wonder about the quality of preparation at these businesses. We question why the IRS has been permitting these businesses to become authorized e-file providers. The Treasury Inspector General for Tax Administration has noted the deficiencies in IRS oversight of the e-file provider program.<sup>89</sup>

#### D. The Problem with Fringe Tax Preparers

A fundamental problem with fringe preparers is the questionable quality of tax preparation. While software providers do offer software and back office support, often the retail salesperson at the fringe preparer is actively engaged in the preparation. The fringe preparer often asks the taxpayer the important questions, gathers the documentation, and enters it. For example, TaxMax provides used car dealers with a tax questionnaire that asks detailed questions about qualifications for the EITC such as “Was EIC Denied Last Year or Did You Receive an IRS Request to Qualify Your Childs Residency. If Yes Was Form 8862 or 8836 Completed to Qualify.” (Copy included in Appendix E.)

The testing conducted by CLA and CRA-NC found several instances of incompetent tax preparation, including by one fringe preparer who essentially advised the tester to commit tax fraud. This tester dropped out of the project because of the potential problems if he proceeded with filing the erroneous return. Even some independent and chain preparers that specialize in taxes provide questionable quality. An article on a small independent chain called “Mo’ Money Taxes” notes that about 10 to 15% of their customers end up with a RAL but no refund from IRS.<sup>90</sup> That 10-15% “loss” rate is extremely high – much higher than the 1.5% loss rate reported by the RAL banks in general.

Fringe tax preparers also have been known to file tax returns without a W-2. An IRS spokesperson in Georgia recently noted that “[o]ffering to file a tax return with

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<sup>88</sup> Union Travel & Tours was sued by the Massachusetts Attorney General’s Office for offering quickie Dominican divorces that were not valid in the United States. Kathy McCabe, *Fee Refunds Ordered For Invalid Divorces*, Boston Globe, July 23, 2000, included in Appendix G.

<sup>89</sup> Treasury Inspector General For Tax Administration, *Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program*, Reference No. 2007-40-176, September 19, 2007.

<sup>90</sup> Wendi C. Thomas, *Your Super-Fast Refund Comes with Strings That Pull Back*, Tennessee Commercial Appeal, Jan. 28, 2007, included in Appendix G.

merely a pay stub, for example, may be a gimmick used ‘primarily to entice taxpayers to pay extra fees for extra services that they may or may not need.’”<sup>91</sup>

Another problem with some fringe preparers is that, while the commercial chains at least claim to make disclosures that RALs are loans, fringe preparers sometimes don’t even bother trying. Fringe preparers aggressively promote fast tax “refunds.” Some of the examples of fringe preparers and their advertisements include:

(1) Buddy’s Home Furnishings in Bradenton, Florida, which the manager described as issuing an “instant check” for tax returns, but refused to disclose the fee structure.<sup>92</sup>

(2) Serpentine Chevy in Cleveland advertised: “We’ll Do Your Taxes For Free And Double Your Refund,” then used tiny type to disclose that the “tax refund bonus” was limited to \$500, and had no mention that a loan was involved. A copy of this advertisement is included in Appendix F.

(3) Car Credit City advertised: “Take \$20 Off Your tax service. File your taxes at Car Credit City and driver away in a quality vehicle. All you need is – Your 2007 W-2 – Driver’s License – Social Security Card – 2 most recent pay stubs – Proof of Residency (utility bill or piece of mail).” A copy of this advertisement is included in Appendix F.

(4) Dollar Financial Group’s advertisements for its Money Mart stores promise to “Turn your refund into fast cash! With a RAL for \$200 to \$9,500 by check in one to three days or an instant RAL for up to \$1,700 with the balance of funds payable with a RAL in one to three days.”<sup>93</sup>

(4) Preparers who use names that imply the taxpayer can receive a refund quickly, listed in Section II.C.2.

(5) TaxStar Online advertises “The Tax Refund Program brings customers to your location when you advertise a FREE Instant Tax Refund Estimate. Most people are anxious to find out how much money they will get back and you provide that useful service. You simply enter a few items from the customers W-2 into the Online Estimator, or onto the paper form and fax to us, and we instantly estimate the amount of tax refund they should receive. You will know in minutes how many refund dollars you have available.

Larger Down Payments. Close more deals with the extra \$3,000 to \$5,000 available for a down payment from your customer’s tax refund. It makes financing easier and qualifies the customer for a wider selection of your inventory. And there is no long wait for the cash; we can have the refund deposited directly into your bank account,

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<sup>91</sup> Susan McCord, *W2 or no W2?*, Albany Herald, Feb. 18, 2008, included in Appendix G.

<sup>92</sup> Brian Neill, *Fast-Cash Tax Returns Come with Price*, Bradenton Herald, Feb. 1, 2008, included in Appendix G.

<sup>93</sup> [www.moneymart.com/MM/tax.asp](http://www.moneymart.com/MM/tax.asp), included in Appendix F.

or you can print a Refund Anticipation Loan check, directly from your computer, in as little as 12 hours.

(6) Now defunct transmitter FastFile advertised in 2006 to car dealers: “Top Ten Reasons to use FastFile This Tax Season

10. Potential customers without a source of down payment can use their anticipated tax refund to use as a payment toward their big ticket purchase. They can spend their money before they get it!
9. Customer doesn't have to wait to find out what his tax refund will be or wait for the actual funds in hand to complete a deal with you.
8. All tax refund monies are sent directly to the designated retailer, NEVER to the end consumer.
7. Once a deal is signed and submitted, the customer cannot change the refund to go to his home or another location. He cannot file another tax return anywhere else in the country, nor can he do a similar deal with your competitor.  
\* \* \* \*
4. You don't have to waste time or money with special training.”

Sample ads from fringe tax preparers are included as Appendix F.

#### E. RALs Encourage Fringe Players to Become Tax Preparers

It is RALs and RACs that encourage fringe players to enter the field of tax preparation. There would be much less incentive for used car dealers, furniture stores, and payday lenders to be involved in tax preparation without RALs and RACs, because:

- (1) the fringe preparer would not be the arranger of the financial product used to pay for goods & services, and the transaction would lack the “seamless” nature that encourages taxpayers to spend their refunds with the fringe preparer.
- (2) the fringe preparer could not obtain control of the financial product proceeds, *i.e.*, if there were no RALs and RACs, tax refund monies would always be paid directly to the taxpayer by mail or direct deposit. The RAL or RAC allows the fringe preparer/retailer to physically hold the funds or check, especially since the preparer is the one that issues the check or cards.
- (3) the fringe preparer could not extract tax preparation, document processing, e-filing or other fees from the proceeds of a RAL or RAC.
- (4) the fringe preparer would not receive the per RAL fees that RAL lenders pay to preparers in making a RAL.

Thus, the elimination or restriction of RALs would have the added advantage of reducing the number of questionable fringe preparers in the commercial tax preparation field.

## V. RESPONSE TO IRS QUESTIONS AND RECOMMENDATIONS

We answer the specific questions posed by IRS in its ANPR:

1. *If RALs and certain other products create a direct financial incentive for preparers to inflate tax refunds, are there alternative approaches that would eliminate or reduce this incentive?*

As stated above, we strongly support a rule that would prohibit tax preparers from using tax return information to offer RALs. We believe that the IRS should do everything in its power to ban, eliminate, or reduce RALs. We also believe that the IRS has the authority to ban or reduce RALs in other ways such as:<sup>94</sup>

- Prohibiting tax preparers who are electronic return originators from arranging for RALs under Publication 1345 under the theory that it presents a conflict of interest for a tax preparer to sell a risky, high rate loan to the taxpayer.
- Prohibiting tax preparers and their employees from receiving any compensation, individually or as a corporation, for facilitating a RAL.
- Prohibiting tax preparers from handling RAL proceeds, such as printing the check or issuing stored value cards in the preparer's office.
- Eliminating the Debt Indicator.

In addition, the National Taxpayer Advocate has proposed an innovative idea which we support. In her 2007 Objectives Report to Congress, she proposed that the IRS provide a "Revenue Protection Indicator," which would delay release of the acknowledgement file (indicating acceptance of an e-filed return) until the IRS had run the taxpayer's return through several compliance screens in order to ensure that the refund would not be delayed or reduced by compliance actions.<sup>95</sup> This would delay issuance of RALs, thus reducing or eliminating their advantage in speed over an e-filed, direct deposit refund.

Another way to reform RALs is to limit direct deposit of tax refunds to bank accounts or other accounts that are held in the consumer's name that the consumer has control over. Currently, the IRS does not require that a refund be direct deposited into a bank account in the consumer's name.<sup>96</sup> RALs are repaid by direct deposit to a "dummy" account held by the RAL lending bank. If the IRS were to require that direct deposits be only made to an account in the consumer's name that the consumer could access, it would force RAL lenders to provide real bank accounts to borrowers, bringing more of them into the financial mainstream. For the \$30 "refund account fee" charged by RAL banks, taxpayers should get a real bank account they can use all year long.

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<sup>94</sup> Additional suggestions are included in a letter from about 70 consumer, civil rights, free tax preparation, and advocacy groups that was sent to every member of Congress. A copy of this letter is included in Appendix P.

<sup>95</sup> National Taxpayer Advocate, *2007 Objectives Report to Congress: Volume II – The Role of the IRS in the Refund Anticipation Loan Industry*, June 30, 2006, at 12.

<sup>96</sup> National Taxpayer Advocate, *FY 2007 Annual Report to Congress*, December 31, 2007, at 114.



Finally, we would support an exception for free tax preparation sites offering low-cost “alternative RALs” to any rule prohibiting tax preparers from offering RALs.

*2. If the marketing of RALs and certain other products exploit or have the potential to exploit certain taxpayers, is the approach described in this ANPRM better viewed as protecting taxpayers from exploitation or as restricting taxpayers’ ability to control their tax return information? If the latter, is there an alternative approach that would address the concerns described above?*

We believe that a rule prohibiting tax preparers from using tax return information to offer RALs will certainly better protect taxpayers from the exploitative aspects of RALs. We also believe such a rule gives taxpayers more – not less - control over their tax return information.

A rule prohibiting tax preparers from using tax return information to offer RALs does not restrict the ability of taxpayers to control the use of their own returns. If a taxpayer really wants to take out a RAL, she can take a copy of her tax return and go to the lender’s office to apply for one. There is nothing preventing the taxpayer from sharing her own return information herself.

What the proposed rule does do is ensure that the taxpayer shares her information actively and knowingly. As we stated in our March 2006 comments to IRS on its earlier proposal to revise 26 C.F.R. § 301.7216-3, allowing taxpayers to sign a consent form permitting preparers to use tax returns for marketing purposes does not adequately protect consumers. Taxpayers often do not give their consent as an affirmative, conscious and deliberate act. Any consent form stuck in front of a taxpayer becomes just another piece of paper to be signed, especially since it is stuck in a big stack of papers including the actual tax return that is given to the taxpayer at the end of the preparation process.

In contrast, if the taxpayer must take her return to the lender herself, she explicitly knows she is sharing her information with the RAL lender. This scenario eliminates the “seamless” nature of the current RAL transaction, in which the preparer merely asks “how fast do you want your money,” clicks a box on the computer, prints the RAL agreement plus consent, and instructs the taxpayer to sign. By making the transaction less seamless, the proposed rule reduces the ability of the preparer to mislead the taxpayer or omit critical information about the nature of a RAL and its costs.

Thus, the proposed rule ensures real understanding and active participation by the taxpayer in applying for a RAL. The taxpayer knows she is meeting with a bank employee, not a tax preparer, and is completing a different transaction separate from tax preparation. The taxpayer knows she is sharing her tax return with the bank employee. This gives the taxpayer a much better ability to control her information than she has currently.

3. *Should RACs be treated the same way as RALs and audit insurance, or do RACs present lesser concerns?*

It is true that RACs present different issues than RALs. They do not present the risk of a defaulted loan and unmanageable debt, since a RAC represents the proceeds of the actual refund, not a loan. They are less expensive than a RAL. However, RACs are still very pricey for what is essentially a one-time use bank account. Instead of a RAC, taxpayers should be encouraged to open real bank accounts. They can receive refunds in the same time frame as a RAC by having their refunds direct deposited into their account.

In addition to the RAC fee itself, many independent preparers who charge fees for “document processing” or e-filing will charge these fees for RACs as well. This can significantly add to the expense of a RAC, sometimes three or four times the cost. In one of the examples in Section E, a preparer noted in RAL paperwork that a \$185 electronic filing fee would be charged for either a RAL or a RAC.

RACs are also offered to taxpayers as a way to avoid paying tax preparation fees up front. If the taxpayer simply has her refund direct deposited into her own bank account, she must pay preparation charges out of pocket. Thus, RACs may in some cases be disguised loans to pay the tax preparation fee. If a RAC fee of \$30 were to be treated as a finance charge for the loan of a tax preparation fee, based on the typical tax preparation fee of \$165, the APR for this loan would 577%.

Finally, there have been a few cases of consumer problems with RACs. Intuit and SBBT offered a RAC on Turbo Tax preparation software that was marketed as a way to avoid using a credit card to pay for a \$16.95 e-file fee. Unfortunately, the RAC cost \$29.95, and consumers complained that the fee was not made clear to them when they used the product.<sup>97</sup>

4. *Are there other products that present significant concerns for tax compliance or taxpayer exploitation that should be addressed by regulation?*

We believe that audit insurance is a product that is also subject to abuse. For example, in 2003, the Attorneys General of 42 states obtained a \$3.3 million settlement with H&R Block over that company’s practices regarding its “Peace of Mind” guarantee.<sup>98</sup> Block agreed in the settlement to obtain the taxpayer’s authorization before charging for the Peace of Mind product and to refrain from “recommending” its purchase.

Testing by CLS and CRA-NC appears to show that Block preparers are in compliance with the settlement. On the other hand, one of the CRA-NC testers was automatically charged for the Jackson Hewitt “Gold Guarantee.” Not only did the Hewitt

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<sup>97</sup> Teresa Dixon Murray, *The Scuzzy Award Goes to TurboTax*, Cleveland Plain Dealer, Apr. 9, 2007, included in Appendix G.

<sup>98</sup> Gene Meyer, *H&R Block Pays \$3.3 Million to Settle “Peace of Mind” Dispute*, Kansas City Star, April 25, 2003, included in Appendix G.

preparer fail to obtain the tester's agreement to buy the product, the tester specifically declined the product yet was charged for it.

Finally, there have been two lawsuits filed against Jackson Hewitt stemming from the Department of Justice enforcement actions discussed above in Section III.B. One of the claims in these lawsuits alleged that the customers were sold "Gold Guarantee" products, but their claims were denied in violation of their contracts.

## **VI. CONCLUSION**

We strongly support the IRS proposal to adopt a rule prohibiting tax preparers from using tax return information to arrange for RALs or similar products. Given the history of abuse of taxpayers and the fraud involved with RALs, such a rule is long overdue.

## List of Appendices

- A. Report: *Tax Preparers Take a Bite out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia*
- B. Tax Fraud Cases Involving RALs and Selected Articles Documenting Cases
- C. Selected Government Enforcement Actions against Tax Preparers
- D. Stories of Consumers Harmed by RALs
- E. Sample RAL Truth in Lending Disclosures and Other Documents
- F. Sample Advertisements
- G. Selected News Articles
- H. Web Materials
- I. Report: Dr. Malcolm K. Sparrow, *Fraud in the Electronic Filing Program: A Vulnerability Assessment prepared for the Internal Revenue Service*
- J. Pacific Capital Bancorp – Investor Conference Calls (October 29, 2007; Nov. 1, 2007; and January 31, 2008)
- K. H&R Block Marketing Study
- L. Report: Amy Brown, *Quality in Free and Commercial Tax Preparation: Results from the 2006 Tax Season*
- M. Annual Reports on Refund Anticipation Loans issued by National Consumer Law Center and Consumer Federation of America
- N. Report: *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud*
- O. National Consumer Law Center and Consumer Federation of America Response to IRS Questions for Advocates, May 2006.
- P. RAL Reform Agenda Letter from Consumer, Civil Rights, Free Tax Preparation, and Advocacy Groups