



Consumer Federation of America

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STILL A BAD DEAL: BEWARE QUICK TAX REFUND LOANS

Survey Shows Many Consumers Don't Realize "Quick Tax Refunds" Are Actually High-Cost Loans; Over 12 Million Sold To American Taxpayers in 2003

BOSTON – Some of America's most cash-strapped taxpayers – those from low- and moderate-income families – spent an unnecessary \$1.4 billion in the latest year recorded for what is almost always an unnecessary product: the so-called "refund anticipation loan" at income tax time.

With another tax season gearing up, the National Consumer Law Center (NCLC) and Consumer Federation of America (CFA) are warning taxpayers to steer clear of refund anticipation loans (RALs), one of the most avoidable tax-time expenses. New figures reveal that RALs drained over \$1 billion in loan fees, plus \$389 million in other fees, from the wallets of more than 12 million American taxpayers in 2003.

"Taxpayers can save themselves over a billion dollars by just saying 'no' to quick tax refund loans," says NCLC staff attorney Chi Chi Wu. Advice for consumers on better alternatives to RALs is available in the NCLC brochure "Don't Pay to Borrow Your Own Money," attached and also on-line at www.consumerlaw.org/initiatives/refund_anticipation/content/RALBrochure.pdf.

A new NCLC survey finds that most consumers who've taken out RALs don't understand what they're getting into. More than two-thirds (70%) of RALs borrowers didn't realize that a RAL is actually a loan. And a breath-taking *eighteen percent of all those surveyed* had taken out a RAL at some point, bringing home the problem's impact on millions of American families.

RALs Examined

RALs are extremely high-cost bank loans secured by the taxpayer's expected refund -- loans that last about 7-14 days until the actual IRS refund repays the loan. That's the first indicator of just how unnecessary most RALs are: Most taxpayers could have their refund in two weeks or less even without the costly loan.

"Taxpayers who want quick refunds can get them in two weeks or less by using electronic filing and having refunds directly deposited into their own bank accounts," says Jean Ann Fox, director of consumer protection for CFA, "That's a quick refund, and it's also free."

RALs cost from \$30 to \$115 in loan fees. Some tax preparers also charge a separate fee, often called an “administrative” or “application” fee, ranging from \$28 to \$59 and averaging \$32. The nation’s largest tax preparation chain H&R Block will be eliminating its administrative fee.

The effective annual interest rate (APR) for a RAL can range from about 40% to over 700%. If administrative fees are charged and included in the calculation, RALs cost about 70% to over 1,700% APR.

Consumer use of RALs may be leveling off, but at disturbingly high levels. Using the most recent data available from the IRS, NCLC and CFA calculate that approximately 12.15 million taxpayers received RALs in the 2003 tax filing season (for tax year 2002). For that year alone, more than 1 in 10 tax returns (or just under 11%) involved a RAL. Although high, these 12.15 million RALs represent a small decline from the 12.7 million RALs taken in 2002.

This year, a RAL for the average refund of around \$2,050 will cost about \$100. This loan fee is in addition to tax preparation fees averaging \$120 and, in some cases, an administrative fee of about \$30. A loan under those terms bears an effective APR of about 187% (247% if administrative fees are charged and included in the APR). Tax preparers and their bank partners also offer an “instant” same day RAL for an extra \$20 to \$39.

Who Gets RALs

RALs disproportionately impact low- and moderate-income consumers. About a quarter of respondents with incomes under \$50,000 had taken out RALs, as compared to only 10% of those who made over \$75,000. And a new survey commissioned by NCLC found that 18% of all consumers, or more than 1 in 6, have taken a RAL at some point in their lives.

IRS data confirms that RALs are mostly used by low- and moderate-income consumers. According to the IRS, 79% of RAL recipients in 2003 had adjusted gross incomes of \$35,000 or less. An SEC filing for tax preparation chain Jackson Hewitt reported similar data, noting that 73% of the company’s customers make less than \$30,000 adjusted gross income annually.

The survey also found racial disparities in RAL usage. Twenty-eight percent (28%) of African-American and 21% of Latino taxpayers responded that they’d received RALs, compared with 17% of white consumers. And educational background also correlated with RAL usage. RALs were used more often by consumers with a high school education (23%) or less (30%) than by college graduates (12%).

RALs Target Working Families

The NCLC survey found that families with children are twice as likely as childless taxpayers to borrow against expected tax refunds. Over a quarter (26%) of consumers with children get RALs, while only 13% of childless taxpayers do.

RALs particularly target low-income working families claiming the Earned Income Tax Credit (EITC), draining hundreds of millions of dollars from EITC anti-poverty benefits. Nearly 57% of all RAL borrowers are EITC recipients according to IRS data, despite the fact that EITC recipients only make up 17% of taxpayers. One out of every three EITC recipients gets a RAL.

“RAL fees drain wealth from the families that can least afford it,” says NCLC’s Chi Chi Wu. “They transfer billions of dollars of public monies, meant to support working families, into the pockets of big corporations.”

Based on IRS data for 2003, NCLC and CFA estimate that 6.92 million working poor families spent \$1.74 billion on RAL fees, commercial tax preparation, and (for some of them) check cashing fees, all in order to get their tax refund monies less than two weeks sooner than they otherwise could. These families paid about \$519 million in RAL loan fees, \$221 million in administrative fees, and \$830 million in tax preparation fees. About 45% of them spent approximately \$168 million to cash their RAL checks with check cashers.

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL loan fee	\$75	\$519 million
Application/ Admin. Fee	\$32	\$221 million
Tax preparation fee	\$120	\$830 million
Total	\$227	\$1.57 billion
Check cashing fee (for 45% of EITC recipients)	\$54	\$168 million
<i>Total with check cashing</i>	\$ 281	\$1.74 billion

Survey Reveals Consumer Confusion About RALs

The NCLC survey revealed that few consumers who had gotten RALs understood exactly what they were getting. Of those receiving RALs a startling 70% didn’t realize they’d received a loan.¹ Younger consumers (ages 18 to 24) were the least likely to know a RAL was a loan -- only 14% as compared to slightly older consumers (ages 25 to 24), 40% of whom knew a RAL was a loan.

“These results are very disturbing,” says CFA Director of Consumer Protection Jean Ann Fox. “The vast majority of consumers who get RALs still do not understand what they’re actually getting, or the risks they run because the RAL is a loan.” Ms. Fox noted that because the RAL is a loan, it has to be paid back whether or not the IRS sends the expected refund. If the taxpayer’s refund is denied or less than expected, failure to pay back the full loan amount could result in debt collection and a black mark on the taxpayer’s credit report.

The survey also showed that consumers are interested in saving money while getting tax refunds quickly. When survey participants who had previously gotten RALs were informed about the ability to receive their tax refund in 7 to 14 days if they filed electronically and used direct deposit, 79% of prior RAL users stated they would rather use this free method instead of getting a RAL.

The survey was conducted by the firm Opinion Research Corporation International from December 9th through 13th, 2004, and involved a representative sample of 2,044 adult

¹ Survey participants were asked whether they had ever gotten a “rapid or speedy refund,” which was described as “services that allow you to get your federal income tax refund in one to three days.” These services are invariably RALs since only a RAL delivers funds to consumers in one to three days. If consumers answered that they had gotten RAL, they were then asked “Was your rapid or speedy refund the kind that involved a loan?”

Americans. The survey's overall margin of error is plus or minus 2 percentage points. The margin of error for questions asked only of the sample of consumers who had gotten RALs is plus or minus 6 percentage points. All of the differences cited are statistically significant at the 0.05 level.

Upcoming Report

NCLC and CFA will be publishing their annual comprehensive report on the RAL industry, regulation, and litigation later this month. The report will be available on NCLC's website at www.consumerlaw.org or on CFA's website at www.consumerfed.org

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NCLC is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as organizations, who represent low-income and elderly individuals on consumer issues.

CFA is a nonprofit association of some 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

Ways to Save At Tax Time

Here are ways to take a pass on that RAL – most folks don’t need one – and save money at tax time:

E-File with Direct Deposit. File your tax return electronically (E-file) to speed up your refund. Tell the IRS to deposit the refund directly into your bank account – you provide your account number right on your tax return. You can get a refund in about 10 days this way – without paying one cent extra for a loan. Some of the free tax preparation programs (called “VITA” sites) can file taxes electronically. If you have internet access, you may be able to get free tax preparation and electronic filing at “www.icanefile.org”.

Get a bank account. If you don’t have a bank account, open one up to take advantage of direct deposit. You can use a savings account to receive your tax refund, and maybe save some of it for a down payment on a house or a car, or to build a nest egg.

Wait just a bit longer. Do you really have to get cash from your tax refund today? Can you wait a few weeks to save almost \$100? If you have an urgent bill to pay, ask for more time until the tax refund check comes from the IRS. Don’t take on a new expensive debt to pay an old bill.

Avoid check cashers. Check cashers charge an extra fee to cash RAL and tax refund checks. Some check cashers charge up to 7% to cash a RAL check – the average is about 3%. So if you receive a \$2,000 refund, it would cost you an av-

erage of \$60 to cash the RAL check — on top of the RAL and tax preparation fees. A smarter move is to use a bank account.

Save \$ and Avoid RALs – Use a VITA Site

A great way to save money at tax time is to go to a Volunteer Income Tax Assistance (VITA) site. VITA sites provide free tax preparation to low- and moderate-income taxpayers. VITA sites are sponsored by the IRS and can be found in libraries, community centers, and other locations during tax time.

For the nearest VITA site, call the IRS general help line at 1-800-TAX-1040 or go to www.tax-coalition.org.

The following is a VITA site serving your community:

77 Summer Street • 10th Floor
Boston, MA 02110
(617) 542-8010
Fax: (617) 542-8028
www.consumerlaw.org



Don't Pay to Borrow Your Own Money

The Risks and
Costs of **Tax
Refund
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Don't Pay to Borrow Your Own Money

The Risks and Costs of Tax Refund Anticipation Loans

The "Tax Refund" That Really Isn't One: It's a Refund Anticipation Loan

How would you like to pay a super-high price to borrow money that already belongs to you? Sounds ridiculous, right? But that's pretty much what happens to many folks at tax time in the crazy world of RALs, or refund anticipation loans.

You may be tempted by tax-time advertisements for "Fast Cash Refunds," "Express Money," or "Instant Refunds." These ads will offer to get you your refund in just a day or two, or even on the spot. Beware! Many of these "fast refunds" are really LOANS, refund anticipation loans.

When you get a RAL, you're borrowing against your own tax refund money. And RALs are often marketed to people who need money the most — low- and moderate-income workers who receive the Earned Income Tax Credit.

Don't Pay Triple-Digit Interest Rates to Borrow Your Own Refund

RALs are extremely expensive. Loan fees typically range from \$30 to \$90, which translates into Annual Percentage Rates (APRs) of about 60% to over 700%. If you paid those rates on all your borrowing you'd probably go broke! And all to get your tax refund just a few days earlier than you can

for free from the IRS. You're lining someone else's pockets with YOUR hard-earned money!

RAL fees, combined with tax preparation, electronic filing, and other fees, can end up eating away a big chunk of your refund.

RALs Can Be Hazardous to Your Financial Health

In addition to their high costs, RALs can be risky. Since a RAL is a loan from a bank in

partnership with a tax preparer, it must be repaid *even if the IRS denies or delays your refund, or your refund is smaller than expected*. If you don't pay back the RAL, the lender will take actions to hurt your credit rating and may send your account to a debt collector. In addition, when you apply for a RAL, you are giving the lender the right to grab your tax refund to pay for old tax loan debts that the lender claims you owe.

Example:

For a tax refund of \$2000, you might pay to get a RAL:

RAL loan fee:	\$75
Electronic filing fee:	\$40
Combine that with the fee you will need to pay to the tax preparer:	\$100
Total:	\$215

This is **over 10%** of your refund!

This RAL has an APR (Annual Percentage Rate) of **142%** if it beats the IRS by 10 days.

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