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September 4, 2002

Mr. Paul J. Mamo
Internal Revenue Service
1111 Constitution Avenue, Room 2403
Washington, DC 20224

Re: "Electronic Tax Preparation and Filing; Intent to Enter Agreement"
Federal Register August 8, 2002

Dear Mr. Mamo:

Consumer Federation of America, Consumers Union, the National Consumer Law Center (on behalf of its low-income clients), and U. S. Public Interest Research Group file these comments concerning the Internal Revenue Services' proposed Agreement to provide free services for online tax preparation and filing services.¹ The IRS has proposed to enter into an agreement with a Consortium of commercial companies to provide free online tax filing for up to 60 percent of taxpayers through a link from the IRS.gov website to the Consortium companies, instead of providing free e-filing capability directly from the government to taxpayers.

We believe that the proposed Agreement is seriously deficient and does not protect the interests of taxpayers, especially low-income taxpayers. Instead of entering into this Agreement, which is of limited benefit and exposes taxpayers to the risks of usurious tax refund loans, we urge the IRS to provide e-filing on its own website. We also urge the IRS to provide more free tax preparation services to low-income taxpayers. In the alternative, the IRS should amend this proposed Agreement to remedy the gaps described in this letter and to widen the circle of groups involved to include representatives to low-income taxpayers and consumer organizations.

The IRS Should Provide On-Line Filing on Its Own Website

The Consortium project is offered as a substitute for the IRS providing free online tax preparation and filing capability directly to taxpayers. The IRS does not allow consumers to file

¹ 67 Fed. Reg. 51621 (August 8, 2002)

their taxes on-line in an age where some state tax agencies allow taxpayers to file online (e.g. Massachusetts). In addition, consumers can file applications on-line with a number of other federal and state government agencies, such as the Social Security Administration (Social Security benefits), the Department of Education (college financial aid), and some state Department of Motor Vehicles (for replacement for drivers license). And of course, there are literally hundreds if not thousands of private entities that permit on-line filing.

Instead of providing on-line filing like other government agencies, the IRS has chosen to provide free on-line filings to only a portion of those it is supposed to serve. Furthermore, the IRS has chosen to meet this need by exposing taxpayers to the risks of costly ancillary services, such as refunds anticipation loans, fees for personal assistance, or padded prices for state tax return preparation services.

The Proposed Agreement is Unlikely to Provide Substantial Benefit To Low-Income Taxpayers

This proposed Agreement is unlikely to benefit the working poor who now go to commercial tax preparers for help in filing for EITC benefits and other tax credits. The major obstacle for low-income taxpayers is not lack of free e-filing, but lack of free preparation for more complex EITC forms. The National Taxpayer Advocate's FY 2002 Report notes that only 113,000 of the 17 million low-income taxpayers eligible for the EITC in 1998 were served by free tax preparation services.² Furthermore, EITC-eligible taxpayers have the most need of tax preparation services, because of the complexity of the EITC forms and the limited education/literacy of this population.³ Because there are so few free community tax preparation services, many of these low-income taxpayers are forced to turn to the often-expensive services of paid preparers. It is also the lack of free tax preparation services, combined with the fact that many of these consumers do not have the cash up front to pay for paid services, that forces them to take out RALs to finance the services.

The proposed Agreement will not help alleviate this problem for several reasons. As a preliminary matter, it is unclear whether both online tax preparation and electronic filing will be free to consumers who use the proposed Consortium service. The Federal Register notice states as an objective: "Seeking to assure access to a free and secure electronic preparation and filing option for additional taxpayers, building upon free electronic tax preparation and filing provided in the commercial market today."⁴ This implies that both online tax preparation software and electronic filing will be free to consumers. However, the press release announcing this initiative from the Office of Management and Budget states "78 million will no longer have to pay to file their tax returns online. Currently, taxpayers who choose to file online can pay an average of \$12.50 in filing fees in addition to the cost of purchasing tax preparation software."⁵ This implies that only free on-line filing will be available.

² National Taxpayer Advocate, FY 2001 Annual Report to Congress, December 31, 2001, at 51.

³ Michael O'Connor, *Tax Preparation Services for Low Income Filers*, 90 Tax Notes 231, January 8, 2001.

⁴ 67 Fed. Reg. at 51,621.

⁵ Office of Management and Budget, Press release, July 31, 2002.

Even if the proposed Agreement does include free on-line tax preparation, there is no requirement that the Consortium serve the neediest of consumers. The proposed Agreement calls for each tax preparation company and software publisher in the Consortium to offer free services to at least 10 percent of the taxpayers each serves, but it does not specify which groups of taxpayers should receive free service. The proposed Agreement does not spell out who will be eligible for free online tax preparation versus only free electronic filing. There is no requirement that Earned Income Tax Credit recipients must be included in the 10% each company will serve or that EITC forms must be included in the online tax preparation service offered by all participating companies.

Moreover, the proposed Agreement will face the barrier of the digital divide for low-income taxpayers. Many taxpayers will be unable to take advantage of free online tax preparation or filing because of lack of Internet access. A recent report by the Electronic Tax Administration Advisory Committee acknowledges this fact.⁶ Thus, even if the Agreement does include online preparation, that will do little good for many taxpayers, since 49% of households do not have Internet access at home.⁷ Furthermore, approximately 46% of taxpayers do not use the Internet anywhere.⁸ The situation is even worse for low-income taxpayers. Only 25% of taxpayers who earn under \$15,000 use the Internet.⁹ Only 33% of the next income level, working poor taxpayers who make \$15,000 to \$25,000, use the Internet.¹⁰

Finally, the proposed Agreement does not address the lack of access to bank accounts needed to speed refunds. The ETAA Report notes that one of the incentives to encourage e-filing is expedited refunds.¹¹ To receive fast refunds when taxes are filed electronically, taxpayers must have a bank account into which refunds can be deposited. Yet, nowhere does the proposed Agreement or the ETAA Report consider the 10 million unbanked customers, many of whom are EITC recipients. Adding a Treasury-provided bank account to receive electronically delivered tax refunds would address this.

The Proposed Agreement Will Put More Taxpayers At Risk for Costly Services, such as Refund Anticipation Loans (RALs), Padded Fees for State Tax Return Preparation, and Fees for Personal Assistance.

This proposed Agreement is unlikely to assist consumers without exposing many customers to high-priced ancillary products and services, such as refund anticipation loans (RALs). These are triple-digit interest small loans made by banks and currently marketed to low-income consumers through commercial tax preparation companies. These are high risk, high cost loans that bleed hundreds of millions from low-income taxpayers and the EITC

⁶ Electronic Tax Administration Advisory Committee, 2002 Report to Congress (June 30, 2002) (“ETAA Report”), at 11.

⁷ U.S. Dep't of Commerce, Econ. & Statistics Admin. and Nat'l Telecomm. & Info. Admin., A Nation Online: How Americans are Expanding Their Use of the Internet (Feb. 2002) at 5, available at <http://www.ntia.doc.gov>.

⁸ Id. at 8.

⁹ Id. at 28.

¹⁰ Id.

¹¹ ETAA Report at 2.

program. The numerous problems with RALS have been documented by not only consumer groups, but the Brookings Institution.¹²

For those taxpayers who do have Internet access and use the proposed free services, they will become prime audiences for solicitations and advertisements for RALs. The IRS intends to provide a direct link on its website to commercial tax preparation companies, implying an endorsement of these companies, without sufficient safeguards to protect consumers. The IRS appears more interested in meeting the Congressional mandate for 80% electronic filing by 2007 than it is in serving the best interests of taxpayers who most need access to free tax preparation services and e-filing. Taxpayers need to be able receive their refunds and tax credits quickly without becoming trapped in usurious loans.

For years, IRS's e-filing program had the effect of encouraging the RAL industry. The proposed Agreement will drive even more taxpayers into the arms of paid preparers, where they will become a captive audience for refund anticipation loans. According to the ETAA Report, the IRS efforts are aimed at encouraging the 30 million taxpayers who now prepare their own returns by hand and file them on paper to file electronically using the proposed Consortium companies' "free" services.¹³ These are taxpayers who currently do not pay commercial tax preparers to complete their returns and are unlikely to now be RAL customers.

How will Consortium members recoup lost revenue from providing "free" electronic tax filing for millions of taxpayers? The ETAA Report notes that "tax preparation companies may realize significant client development benefits from providing free Internet access in their offices."¹⁴ Nothing in the proposed Agreement prevents commercial tax preparers from marking up or "padding" the price for preparing state tax returns. They are also free to charge fees for providing "personal" customer assistance to taxpayers who use the "free" service.

Some software companies already package RALs with their tax preparation programs.¹⁵ Even taxpayers without Internet access will be at risk of RALs. It would be all too easy for the paid preparers, who make tens of millions of dollars from RALs, to encourage these taxpayers to "come into our office for free e-filing if you don't have Internet access." At the paid preparer's office, the taxpayer will be subject to a high-pressure, face-to-face sales pitch for RALs.

The proposed Agreement does not provide adequate protection against cross-marketing of high priced services or predatory small loans to consumers. The Federal Register notice merely notes that "Consortium Participants shall also agree that provisions of Free Services shall not be conditioned on obtaining an eligible taxpayer's consent to solicitations of additional business."¹⁶ This provision simply prohibits tying of additional services to free tax filing. The

¹² Chi Chi Wu, Jean Ann Fox, and Elizabeth Renuart, "Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed from the Working Poor and the U. S. Treasury" Consumer Federation of America and National Consumer Law Center, January 31, 2002, available at www.consumerlaw.org; Alan Berube, et al., "The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC," Brookings Institution and Progressive Policy Institute, May 2002, available at www.brookings.org.

¹³ ETAA Report at 2.

¹⁴ *Id.* at 11.

¹⁵ NCLC/CFA Report at 15.

¹⁶ 67 Fed. Reg. at 51,622.

IRS should go further to explicitly prohibit Consortium members from offering or selling RALs to taxpayers receiving free service, padding fees for other services, or charging for personal assistance.

Recommendations:

1. The IRS should scuttle the proposed Agreement with the Consortium and offer free electronic tax filing capability at the IRS web site directly. In addition, the IRS should provide more free tax preparation assistance for low and moderate income consumers, especially those who receive the Earned Income Tax Credit and other credits.
2. If the IRS proceeds with the proposed Agreement with the Consortium, it should provide unequivocally that paid preparers are forbidden to make or facilitate RALs to taxpayers who are being provided benefits under this program. There should be no extra charges for personal assistance. The price of also preparing state tax returns must be clearly disclosed and must not be “padded”.
3. EITC-eligible taxpayers must be included in the 10% of customers served by all Consortium members.
4. The IRS must make provisions in the Agreement to require preparers to provide bank account options to taxpayers without bank accounts. The Department of Treasury, which the IRS is a part of, has spent much effort to encourage unbanked consumers to open bank accounts. The IRS should get on this bandwagon and use the proposed program to encourage the same.
5. The IRS should ensure that taxpayers who don’t have a computer or Internet access will not be forced to go through a paid preparer, and will be served by this program through free community tax preparation programs.
6. The Consortium that will oversee this program should include taxpayer representatives.

Sincerely,

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