



Consumer Federation of America

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MAJOR CHANGES FOR TAX REFUND LOANS: FEWER LOANS AVAILABLE, BUT MORE PRICEY

Consumer Advocates Recommend Cheaper Alternatives for Getting Refund Fast

Significant developments in the refund anticipation loan (RAL) landscape will mean fewer and more expensive RALs for this upcoming tax season. Consumer advocates suggest that taxpayers who are looking for quick refund cash should consider lower-cost or free alternatives:

- Taxpayers with a bank account can get their tax refunds in 8-15 days with e-filing and direct deposit.
- Taxpayers without a bank account can get a fast refund by e-filing and having their refund deposited to a prepaid card, including any existing payroll or prepaid card that the taxpayer already has.

“There are plenty of options for taxpayers to get quick refunds without paying for a costly RAL,” stated Chi Chi Wu, NCLC Staff Attorney. “Of course, taxpayers should compare costs and consumer protections when choosing among these options.”

Taxpayers without a bank account should also consider opening an account to receive their refund. “Getting a big refund is the perfect time to open a savings account and start a nest egg,” advised Jean Ann Fox, Director of Financial Services for Consumer Federation of America.

Prepaid card options specifically targeted for tax time will be offered by some tax preparers or tax software companies in 2011, such as the Get It Card from Advent Financial Services or the H&R Block Emerald Card. A few even permit taxpayers to

have the costs of tax preparation deducted from their refunds. More information on prepaid cards is below.

Low-income taxpayers have a number of options for free tax preparation, including Volunteer Income Tax Assistance (VITA) (1-800-906-9887 or www.irs.gov) and AARP Tax-Aide sites (https://locator.aarp.org/vmis/sites/tax_aide_locator.jsp). Choosing a VITA or AARP Tax-Aide site saves taxpayers both the cost of a RAL and the cost of a tax preparation fee. Many VITA sites also offer services to help open a bank account or get a low-cost prepaid card.

For taxpayers willing to do it themselves online, there are a number of websites that allow taxpayers to prepare and file their taxes for free, such as the IRS Free File program (www.irs.gov) and the I-CAN! E-file site (www.icanefile.org).

Background on RALs

RALs are bank loans secured by the taxpayer's expected refund -- loans that last about 7-14 days until the actual IRS refund repays the loan. Using the most recent data available from the IRS, NCLC and CFA calculate that about 7.2 million taxpayers received RALs in the 2009 tax filing season (for tax year 2008). This represented a 14% drop from the 8.4 million taxpayers who took out a RAL in the 2008 filing season.

In addition to RALs, refund anticipation checks (RACs) are another product offered by tax preparers and their partner banks. 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 or prepaid card and closes the temporary account. Consumers without a bank account may pay extra to then cash the RAC check.

RACs generally cost about \$30. In 2009, about 12.9 million taxpayers received a RAC.

"Consumers should considering opening a real bank account to get their refunds fast, instead of paying \$30 for a one-time use account," recommended Jean Ann Fox of CFA.

Changes in the RAL Industry

During the past year, there have been a number of major developments in the RAL industry. In April 2010, JPMorgan Chase exited the RAL market. JPMorgan Chase had been one of the three biggest RAL providers, serving about 13,000 independent preparers.

Concerns over RALs have prompted a number of regulators to take action against them. In August 2010, the IRS announced it would stop providing the Debt Indicator, a service that helped tax preparers and banks make RALs by acting as a form of credit

check. The Debt Indicator revealed whether a taxpayer's refund would be paid or would be intercepted for government debts. Consumer advocates had strongly urged termination of the Debt Indicator, and applauded the IRS's action (see http://www.nclc.org/images/pdf/high_cost_small_loans/ral/pr-ral-irs-debt-indicator-08-10.pdf). Without the Debt Indicator, RAL lending is expected to decline and be much riskier.

In October 2010, the Office of Thrift Supervision issued a supervisory directive to MetaBank, effectively prohibiting that bank from making RALs. Previously, MetaBank had announced its intent to make RALs, and was expected to be the RAL partner for Jackson Hewitt. MetaBank also had previously provided Jackson Hewitt with a "pay stub" RAL in the form of its iAdvance line of credit on a prepaid card. The OTS directive resulted in the termination of the iAdvance program, citing "unfair or deceptive acts or practices."

Finally, in December 2010, the Office of the Comptroller of the Currency issued a directive prohibiting HSBC from offering RALs. HSBC had been H&R Block's RAL-lending bank partner. This followed a similar OCC action in December 2009 that forced Santa Barbara Bank & Trust, which had been Jackson Hewitt's main RAL lending partner, out of the RAL market.

As a result of these actions, there are only three small banks making RALs – Republic Bank & Trust, River City Bank and Ohio Valley Bank, all based in Louisville, Kentucky. These banks have limited capacity, and cannot provide the same loan volume as JPMorgan Chase or HSBC.

Republic Bank has agreed to provide the bulk of RALs for Jackson Hewitt. Hewitt claims that Republic will provide coverage for approximately 80 or 90% of Hewitt's RAL needs for the 2011 tax season. However, Republic had also previously stated that its RAL lending is expected to decrease by two-thirds from last year.

RALs More Expensive; Will Still Drain Refunds

While there will be fewer RALs in this tax season, they will be more expensive. For example, Republic Bank states that it will charge \$61.22 for a RAL of \$1,500, which translates into an APR of 149%. If the refund exceeds \$1561.22, the taxpayer will be charged another \$29.95 when the remainder of the refund arrives in the form of a RAC, for a total of \$91.17 in fees. This compares to a fee of about \$65 for a \$3,300 RAL in 2010, with an APR of 72%.

Tax preparers may also charge their own fees in addition to a RAL or RAC fee charged by the bank. These add-on fees can range from \$25 to several hundred dollars.

"RALs will cost more and be even riskier this tax season," noted Chi Chi Wu. "There is even greater reason for taxpayers to avoid them this tax season."

Reports on RALs

NCLC and CFA will be publishing their annual comprehensive report on the RAL industry, regulation, and litigation later in February 2011. The report will be available on NCLC's website at www.nclc.org or on CFA's website at www.consumerfed.org.

Q&A ON PREPAID CARDS

What is a Prepaid Card?

Prepaid cards are debit cards that hold consumer funds but are not tied to an individual bank account. Often Visa- or MasterCard-branded, they work like bank debit cards but may not have the same consumer protections. For example, some cards do not offer statements or have protections against theft or unauthorized use that are as strong as cards linked to a regular bank account.

What should I look for in a Prepaid Card?

As with any financial product, you should consider the cost, especially any activation, monthly, ATM, balance inquiry and other fees. Also make sure the card protects you in case of loss or theft and that you can get statements or other forms of transaction information to monitor your balance, fees and charges. Avoid any prepaid card that allows you to overdraw the card and charges a hefty fee for doing so.

Where can I find more information about Prepaid Cards?

Resources on prepaid cards include:

National Consumer Law Center: <http://www.nclc.org/issues/prepaid-debit-cards.html>

Consumers Union: <http://www.defendyourdollars.org/pdf/2010PrepaidWP.pdf>

(Appendix A has a chart comparing different prepaid cards)

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National Consumer Law Center® 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.

The Consumer Federation of America is an association of nearly 300 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education.