NATIONAL CONSUMER LAW CENTER INC

CFA Consumer Federation of America

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CONSUMER ADVOCATES WARN TAXPAYERS AGAINST NEW "PAY STUB" REFUND ANTICIPATION LOANS

National Consumer Law Center and Consumer Federation of America Issue Report on New Abusive Loan Product

WASHINGTON, DC – Believe it or not, tax season has already begun, at least for companies that exploit low-income taxpayers desperate for cash. The tax preparation industry is offering a new breed of high cost, high risk loan products targeting the tax refunds of hard working Americans. Called "pay stub RALs" or "holiday RALs," these new loans are a variation on refund anticipation loans (RALs), but are made as early as November. Consumer advocates are warning taxpayers to stay away from pay stub and holiday RALs, noting that they drain even more precious dollars from tax refunds and can pose dangerous risks to consumers.

Refund anticipation loans (RALs) are high cost loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). About 12 million taxpayers took out RALs in 2004, costing them over $1 billion dollars in loan fees. Pay stub RALs differ from a traditional RAL because they are offered earlier, before a taxpayer receives her W-2. Since a taxpayer cannot file a tax return without a W-2, pay stub RALs are made before the tax season officially starts, from January 2 to mid-January, and are based on the consumer's most recent pay stub. Holiday RALs are made even earlier, during November and December. Both types of loans are offered by tax preparers, and are expected to be repaid from the proceeds of the consumer's tax refund.

NCLC Staff Attorney Chi Chi Wu stated, "Pay stub and holiday RALs represent one more step down the slippery slope of selling more products at more expense and more risk to American taxpayers. How much more do these companies want to take from the tax refunds of working poor families?"

Pay stub RAL fees can be as high as $102, translating into triple digit APRs. In addition, at least one tax preparation company, Jackson Hewitt, charges a $50 "deposit" for services when making the loan. Furthermore, Hewitt customers must pay for another RAL or a refund anticipation check to repay the pay stub RAL.

In contrast, H&R Block appears to be offering less expensive versions of pay stub and holiday loans. Block has committed to offering pay stub/holiday RALs at a 36% APR if the consumer chooses its debit card product. Consumers will be charged an additional $25 by Block if they opt to receive a paper check.

In addition to added costs, pay stub and holiday RALs pose significant risks to consumers, because they are made based on estimated tax returns before taxpayers receive their final tax information from a W-2. At the time that the pay stub RAL is made, for example, the tax preparer would not have any information if the IRS is planning to seize all or part of the taxpayer's refund to pay a child support or student loan debt. The taxpayer may have pre-tax deductions such as retirement contributions that are not accurately reflected on the taxpayer's final pay stub. A taxpayer might have other sources of income not reflected on his pay stub that reduce his refund, such as a second job, income from a 1099, or unemployment compensation.

"Consumers should stay away from expensive and risky pay stub RALs. These loans must be paid back by mid-February whether or not their tax refund is large enough to cover the loan and fees," warned Jean Ann Fox, director of consumer protection for Consumer Federation of America. "Borrowers run the risk of burdensome new debt or a ruined credit record."

Another problem with pay stub and holiday RALs is the fact that one tax preparation company, Jackson Hewitt, is apparently forcing pay stub RAL borrowers to return to the same tax preparer and same office for tax preparation. This prevents borrowers from seeking a less costly alternative for tax preparation, such as filing the return themselves through the IRS Free File program or obtaining free tax preparation services from a VITA site. Pay stub RAL borrowers cannot even comparison shop for a less expensive commercial tax preparer.

A significant threat posed by pay stub and holiday RALs is the fact that they enable the RAL industry to keep draining tax refunds and Earned Income Tax Credit (EITC) benefits. The IRS has been working on efforts to speed the delivery of refunds, which should help to reduce the use of traditional RALs that put cash in taxpayers' pockets within a day or two of filing the tax return.   Instead of phasing out controversial tax refund loans, the RAL industry appears to be responding to the potential of faster IRS refunds by introducing a loan product that can get the "jump" on tax filing season, allowing tax preparers and high rate lenders to continue exploiting the tax refunds of cash-strapped low-wage workers.

The National Consumer Law Center and Consumer Federation of America have issued a report on pay stub and holiday RALs entitled "Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom." The report will be available on NCLC's website at www.nclc.org/action_agenda/refund_anticipation/content/PaystubRALsReport.pdf. The new report calls upon the Comptroller of Currency to require the national banks that make pay stub and holiday RALs to exit this market.

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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.