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IT'S A WILD WORLD: Consumers at Risk from Tax-Time Financial Products and Unregulated Preparers

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By

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Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, to help financially stressed families build and retain wealth, and advance economic fairness. www.nclc.org



Consumer Federation of America

ABOUT CONSUMER FEDERATION OF AMERICA

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. www.consumerfed.org

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EXECUTIVE SUMMARY

Last year (2013) was the first year in which refund anticipation loans (RALs) were not available on a large-scale basis from banks. Most of the consumers who formerly received RALs now appear to be using refund anticipation checks (RACs). About 21 million consumers obtained RACS in both 2012 and 2013.

A few payday lenders and other non-bank businesses are making tax-time loans. These non-bank RALs may be even more expensive than bank RALs were. However, these non-bank RALs are not made on the same scale as bank RALs. In 2013, there were only 100,000 consumers who applied for a RAL – in contrast to the 12.7 million consumers who received bank RALs at their height in 2002

RACs, on the other hand, remain a product sold to tens of millions of taxpayers. With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund; after receiving the refund, the bank deducts the tax preparation fee and issues the rest of the funds to the consumer. RACs are not as expensive or risky as RALs, but they do not provide a speed advantage for many consumers, and often represent a high-cost loan of the tax preparation fee. Furthermore, some preparers also charge expensive “add-on” or junk fees for RACs, which can add significantly to their cost.

Other consumer issues plague taxpayers. Tax preparation fees are an area of abuse. These fees are often opaque and expensive, with taxpayers unable to obtain estimates of fees to comparison shop. Tax preparation fees should be subject to a standardized, easy-to-understand disclosure.

Perhaps the most critical issue facing taxpayers as consumers is the lack of regulation for tax preparers. Only four states regulate paid tax preparers (Maryland, Oregon, New York and California). The IRS attempted to regulate preparers, but a federal court struck down the agency’s regulations, a decision which was recently upheld by the D.C. Court of Appeals. As a result, taxpayers in 46 states are at risk of paid preparers who are incompetent or even commit fraud.

This report also includes historical data concerning RALs and RACs, such as:

- IRS data shows that RAL volume declined significantly during the last two years in which banks offered the loans, in 2011 and 2012. Tax preparers and their bank partners made approximately 630,000 RALs in 2012 and 750,000 RALs in 2011. This compares with 5 million RALs in 2010, and a high of 12.7 million RALs in 2002.
- Consumers paid an estimated \$630 million in RAC fees in 2012 and again in 2013. They paid an estimated \$38.6 million in RAL fees in 2012 as well.
- In addition to RAL and RAC fees, consumers in 2012 and 2013 paid another estimated \$195 million in add-on fees, such as “transmission,” “data and document storage,” and “technology” fees.

I. TAX-TIME FINANCIAL PRODUCTS UPDATE

A. Introduction to the Tax-Time Products Market

For many low- and moderate-income Americans, tax time is when they will receive the largest influx of money during the year. In general, nearly 80% of Americans receive a refund when they file their tax returns.¹ Some of these taxpayers, especially working families, will receive the Earned Income Tax Credit (EITC), a refundable credit intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, providing nearly \$62 billion to nearly 26 million families in 2013.²

These EITC recipients, and consumers receiving substantial refunds in general, present a lucrative target for many businesses. This includes retailers, such as car dealers and furniture stores, as well as purveyors of financial products such as check cashers and prepaid card issuers. More significantly, an entire industry evolved to profit off taxpayers and EITC recipients - the tax-time financial products industry.

For decades, the main product providing hefty profits to this industry was refund anticipation loans (RALs), which were loans made by banks, secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs were usually made for a duration of about seven to fourteen days (the difference between when the RAL was made and when it was repaid by deposit of the taxpayer's refund), fees for these loans could translate into triple digit annual percentage rates (APRs). Between 2009 and 2012, all of the banks left the RAL market either voluntarily or because they were forced out by federal regulators. Thus, 2013 was the first year in which no banks made any RALs.

A related product is the 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 or prepaid card, or makes a direct deposit, and closes the temporary account. A RAC is no faster than the direct deposit of a refund to the taxpayer's own bank account, but it allows the consumer to pay for tax preparation fees out of the refund. In the past, the IRS has stated that the direct deposit of a refund, if the return is filed electronically, generally took 8 to 15 days.³ This year, the IRS is advising that "more than 9 out

¹ Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Years 2013 (Returns Filed in 2013) (Jan. 2014).

² *Id.*

³ Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, Major Changes in the Quick Tax Refund Loan Industry 10, n. 41 (Feb. 2010) [hereinafter NCLC/CFA 2010 RAL Report].

of 10 refunds to taxpayers [would be issued] in less than 21 days”⁴ Apparently, the IRS provided these longer timeframes in part due to anti-fraud measures.⁵

With the demise of bank RALs, a handful of non-bank lenders began offering tax-time loans. These include everything from RAL replacement loans offered by major tax preparation chains to tax refund “buying” that is really a disguised loan. However, these non-bank loans are made at a much smaller scale than bank RALs: only in the tens of thousands, versus tens of millions.

Another form of tax-related lending is the pre-season loan. These are lines of credit offered prior to tax season, which are not secured by the tax refund. However, the loans are offered by tax preparers and are generally expected to be repaid in part out of the refund.

Consumers anxious for the cash infusion received annually from tax refunds may be more vulnerable to non-bank RALs and pre-season loans this year. In addition to the longer stated timeframes for refunds, the IRS was forced to delay the start of tax season until January 30, 2014. The delay is due to the partial government shutdown in October 2013.⁶ Thus, taxpayers had even longer waits for refunds this year, potentially making them susceptible to abuses.

For over a decade, the National Consumer Law Center (NCLC) and the Consumer Federation of America (CFA) have jointly issued annual reports on the tax-time financial products industry and the drain caused by RALs and RACs from tax refunds and EITC benefits.⁷ These reports have also included discussions of other consumer issues affecting taxpayers, such as high tax preparation fees and lack of regulation for tax preparers. In addition to our yearly reports, we have issued three reports regarding mystery shopper testing of RAL providers⁸ and most

⁴ IRS, Publication 2043, IRS Refund Information Guidelines for the Tax Preparation Community (Dec. 2012).

⁵ Jeff Stimpson, IRS: 21-Day Refunds Likely Again in 2013, *Accounting Today*, Dec. 15, 2012, *available at* <http://www.accountingtoday.com/news/IRS-21-Day-Refunds-Likely-Again-in-2013-65012-1.html>.

⁶ IRS, 2014 Tax Season to Start Later Following Government Closure; IRS Sees Heavy Demand As Operations Resume, IR-2013-82, Oct. 22, 2013, *available at* www.irs.gov/uac/Newsroom/2014-Tax-Season-to-Start-Later-Following-Government-Closure-IRS-Sees-Heavy-Demand-As-Operations-Resume (visited Feb. 18, 2014).

⁷ These reports are all available at www.nclc.org/issues/refund-anticipation-loans.html. The first of these reports was Chi Chi Wu, Jean Ann Fox, and Elizabeth Renuart, National Consumer Law Center and Consumer Federation of America, Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed from the Working Poor and the U. S. Treasury (Jan. 31, 2002), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/ral/2002-ral-report.pdf [hereinafter NCLC/CFA 2002 RAL Report].

⁸ Chi Chi Wu, Deyanira Del Rio, Alexis Iwanisziw, Peter Skillern, National Consumer Law Center, NEDAP, Community Reinvestment Association of North Carolina, Tax Time 2011: Mystery Shopper Testing In New York And North Carolina Finds Continuing Problems With Tax Preparers (Apr. 2011) [hereinafter 2011 RAL Mystery Shopper Report]; Chi Chi Wu, Michael Rowett, Peter Skillern, Deyanira Del Rio, Alexis Iwanisziw and Josh Zinner, National Consumer Law Center, Arkansas Against Abusive

recently, a report on how the lack of preparer regulation has led to widespread incompetence and fraud.⁹

B. Refund Anticipation Checks

With the demise of RALs, refund anticipation checks have become the dominant tax-time financial product on the market. According to the latest IRS data, about 21 million taxpayers obtained a RAC in 2012,¹⁰ and about the same number in 2013.¹¹ Since the fee for RACs was typically \$30 to \$35 in those years (see below), these taxpayers paid at least \$630 million each year for RACs.

The number of RACs increased by 14% from 2011, when 18.4 million consumers received these products at a cost of \$550 million,¹² and by a whopping 63% from 2009, when 12.9 million taxpayers received these products at a cost of \$387 million.¹³ The vast majority of RAC consumers – about 84% in 2013 – are low-income.¹⁴ About half of RAC consumers are EITC recipients.¹⁵

RACs present a number of issues for consumers. In the past, they have generally cost \$30 to \$35.¹⁶ This year, they cost \$30 to \$54.95 delivered via check (with discounts for delivery via

Payday Lending, NEDAP, Community Reinvestment Association of North Carolina, Tax Preparers Out of Compliance: Mystery Shopper Testing Exposes Violations of Refund Anticipation Loan Laws in Arkansas, New York and North Carolina (Apr. 2010) [hereinafter 2010 RAL Mystery Shopper Report]; Chi Chi Wu, Kerry Smith, Peter Skillern, Adam Rust, and Stella Adams, National Consumer Law Center, Community Reinvestment Association of North Carolina, Community Legal Services of Philadelphia, Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia (Apr. 2008) [hereinafter 2008 RAL Mystery Shopper Report].

⁹ Chi Chi Wu, National Consumer Law Center, Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do (November 2013), *available at* www.nclc.org/issues/riddled-returns.html [hereinafter Riddled Returns].

¹⁰ IRS, Daily E-File At A Glance, U.S. Totals For Individual Returns (Data Source: ELF1505), November 2013.

¹¹ *Id.*

¹² See Chi Chi Wu, Tom Feltner, and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, Something Old, Something New in Tax-Time Financial Products: Refund Anticipation Checks and Quickie Tax Loans 3 (Feb. 2013) [hereinafter NCLC/CFA 2013 Tax-Time Products Report].

¹³ See Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, End of the Rapid Rip-Off: An Epilogue for Quickie Tax Loans 13 (Feb. 2011) [hereinafter NCLC/CFA 2011 RAL Report].

¹⁴ See Section I.G.

¹⁵ *Id.*

¹⁶ See Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America, The Party's Over for Quickie Tax Loans: But Traps Remain for Unwary Taxpayers 11 (Feb. 2012) [hereinafter NCLC/CFA 2012 RAL Report]; NCLC/CFA 2011 RAL Report at 13; NCLC/CFA 2010 RAL Report at 8-9. See also U.S. Government Accountability Office, 2012 Tax Filing: IRS Faces Challenges

prepaid card or direct deposit). This is less expensive than a RAL, but still pricey for what is essentially a one-time use bank account. For 2014, sample RAC fees include:

- H&R Block charges \$34.95 for a RAC delivered on an Emerald Card or via direct deposit, or \$54.95 for a RAC delivered via paper check.¹⁷
- Both Jackson Hewitt¹⁸ and River City Bank¹⁹ charge \$32.95 for a RAC.
- Republic Bank & Trust charges \$9.95 for a RAC on a prepaid card; \$19.95 for a RAC delivered via direct deposit; and \$31.95 for a RAC delivered by check.²⁰
- EPS Financial provides a free RAC if it is deposited on the E1 Visa Prepaid Card; otherwise it charges \$20 for direct deposit (\$15 plus another \$5 for a state refund) or \$30 for a check (\$20 plus another \$10 for a state refund).²¹

In addition to the RAC fee itself, many tax preparers charge add-on fees, such as “document processing” or e-filing fees, discussed further in Section I.F. This can significantly add to the expense of a RAC. We estimate that RAC consumers paid about \$195 million in add-on fees, discussed in Section I.F. This adds to the total for RACs, bringing it to almost \$825 million.

RACs do not have a speed advantage over a refund that is direct deposited by the IRS into the consumer’s own bank account or onto a prepaid card. A taxpayer who does not have a bank account should be encouraged to open one. In addition to speeding refunds, bank accounts help taxpayers avoid paying check cashing fees.

RACs may also represent a disguised loan of the tax preparation fee. When taxpayers obtain a RAC simply because they cannot afford the price of tax preparation upfront, they are essentially paying to defer payment of the tax preparation fee—which is a loan. If a taxpayer pays \$30 to defer payment of a \$200 tax preparation fee for three weeks, the APR would be equivalent to 260%. At least two court decisions have now held that a RAC constitutes a loan of the tax

Providing Service to Taxpayers and Could Collect Balances Due More Effectively, GAO-13-156, Dec 2012, at 23, available at <http://www.gao.gov/products/GAO-13-156>.

¹⁷ H&R Block, Pay Nothing out-of-pocket with a Refund Anticipation Check, at <http://www.hrblock.com/financial-services/tax-refund-payment/> (visited Dec. 2, 2013).

¹⁸ Jackson Hewitt, Preparer Fee Disclosure, Chicago, IL (undated).

¹⁹ River City Bank, Product > Pricing, at www.rcbtaxdivision.com/pricing.aspx?mnu=3 (visited Feb. 12, 2014).

²⁰ Republic Bank & Trust, Refund Transfers (RTs), at <https://www.republicrefund.com/Products/Refund-Transfers.aspx> (visited Feb. 13, 2014).

²¹ E-Collect, EPS Financial, at <http://www2.epsfinancial.net/en/solutions/e-collect> (viewed Feb. 13, 2014). The E1 Prepaid Card is issued by Bancorp Bank. See <http://www2.epsfinancial.net/en/solutions/e-collect/card-connection/e1-card-fees> (viewed Feb. 10, 2013).

preparation fee, and thus RAC fees are finance charges under the Truth in Lending Act.²² In the most recent decision, *United States v. Instant Tax Service*, discussed further in Section IV.B, the court noted:

In terms of its economic substance, the RT [i.e., RAC] is a loan (or an extension of credit) because it involves an ITS franchisee allowing a customer to defer payment for services rendered by the franchisee's employees (namely, tax-return preparation and filing) until the time that the customer receives his or her tax refund. The amount of the loan (credit) is the fair market value of those services.²³

Furthermore, by permitting the taxpayer to have the price of tax preparation deducted from the refund, RACs make taxpayers less sensitive to the price of tax preparation. The problems with lack of transparency in tax preparation fees are discussed in Section II.B.

Finally, mystery shopper testing has revealed instances in which tax preparers have automatically sold RACs to consumers, without the consumers' knowledge, consent, or full understanding.²⁴

C. Non-bank RALs

With the end of RALs made by banks, a few high-cost non-bank lenders stepped into the fray. We have also seen the return of tax refund "buying," which is a disguised loan. However, the spread of non-bank RALs appears to be limited, and we have seen fewer examples in 2014 than in 2013. This year's examples are:

- AIT Financial Group offers the "Simple Cash Option," which it characterizes as "the opportunity presented to a taxpayer by a participating tax professional to sell a portion of the taxpayer's anticipation settlement at a discount price in exchange for receiving funds 24 – 48 hours after the IRS accepts the tax return."²⁵ The Simple Cash Option is offered through CrossLink Professional Tax Software.²⁶ It appears to be a form of tax refund "buying," which existed prior to the advent of bank RALs,

²² *United States v. ITS Fin., LLC*, 2013 WL 5947222 (S.D. Ohio Nov. 6, 2013); *People v. JTH Tax, Inc.*, 212 Cal. App. 4th 1219, 151 Cal. Rptr. 3d 728 (2013).

²³ *United States v. ITS Fin., LLC*, 2013 WL 5947222, ¶535.

²⁴ See 2011 RAL Mystery Shopper Report at 5; 2008 RAL Mystery Shopper Report at 5. See also Benjamin Marks, Sara Dewees and Shawn Spruce, First Nations Development Institute, *More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns*, 2012, at 10-12; Sara Dewees, First Nations Development Institute, *Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses*, Apr. 15, 2011, at 11-12.

²⁵ Brochure, AIT Financial Group, "Simple Cash Option from AIT Financial Group," on file with author.

²⁶ *Id.*

and is actually a disguised loan. A similar product was the subject of the Colorado Attorney General's lawsuit in *State ex rel Salazar v. The Cash Now Store*.²⁷

- iTax Advance is a lead generator marketing short-term consumer loans to taxpayers searching for RALs, RACs or refund installment loans. The company offers referrals to lenders providing short-term loans, installment loans, and lines of credit.²⁸ iTax Advance provides referrals for loans with APRs between 200% and 780%.²⁹ No tax preparation services are provided, and iTax Advance does not require a borrower to provide any tax return information as part of the loan application. Lenders who receive referrals from iTax Advance are licensed in the states where the borrower resides and loans made to borrowers in Texas are arranged through a Credit Services Organization (CSO).³⁰
- Liberty Tax Service is again partnering with a non-bank lender to make RALs called Instant Cash Advance (ICA) in about 21 states,³¹ discussed further in Section II.C. In 2013, Liberty offered non-bank RALs in 27 states in partnership with lenders who appear to have been linked with Texas payday lenders.³² The fees and interest charged by Liberty's lenders may vary depending on what is permitted by state small loan laws.

Some independent or small chain preparers appear to be offering RALs that they fund. For example:

- ATC Income Tax offers an Advance Cash Loan (ACL), which is marketed as an instant, interest-free advance based on the expected tax refund.³³ We do not know if ATC charges a flat fee for the advance. Loans of up to \$1,000 are available and must be repaid through the proceeds of the income tax refund or by other arrangements.³⁴ ATC's RAL is available through ATC Income Tax's 24 locations in Milwaukee, WI and Atlanta, GA. ATC's website does not disclose the identity of the lender for the RAL.
- Gateway Tax offers a "Refund Anticipation Advance" which it promotes as allowing taxpayers to "receive an advance of up to \$1,000 within 24 hours after filing." This

²⁷ 31 P.3d 161 (Colo. 2001).

²⁸ <http://www.itaxadvance.com/> (visited Feb. 13, 2014).

²⁹ http://www.itaxadvance.com/al_ratesandfees.php (visited Feb. 13, 2014).

³⁰ <http://www.itaxadvance.com/> (visited Feb. 13, 2014).

³¹ Bob Scott, Liberty Tax Loans Cut Back, Progressive Accountant, Dec. 10, 2013, available at <http://www.theprogressiveaccountant.com/index.php/tax-128/3485-liberty-tax-loans-cut-back> (visited Feb. 14, 2014).

³² NCLC/CFA 2013 Tax-Time Products Report at 23-24.

³³ <http://www.atcincometax.com/cash-loan/> (viewed Feb. 14, 2014).

³⁴ *Id.*

RAL is offered by “CMD Financial (a Gateway Tax Service company) or a third party lender.”³⁵ Gateway Tax’s RAL is available through its 30 locations in the Los Angeles area. The fees are not disclosed on Gateway’s website.³⁶

These non-bank RALs may be more expensive or riskier for consumers than bank RALs. However, they are not as widespread as bank RALs, at least for now. They are made on the scale of hundreds of thousands of loans at most, not millions of loans. Indeed, there appear to be fewer noteworthy non-bank RAL options this year than in 2012 and 2013.

There are several reasons why non-bank RALs are not as widespread as bank RALs. First, unlike banks, nonbank lenders do not have the legal ability to flout state laws that cap interest rates, *i.e.*, usury laws. Tax-time loans from non-bank lenders are subject to state loan laws, usury caps, or loan broker requirements in states that have them. Eighteen states (and the District of Columbia) do not permit payday lending at all.³⁷ This limits the amount of uniformity that a national tax chain can have when making RALs.

Second, nonbank lenders may also lack the funding necessary to make RALs on a broad scale. The lack of capital and smaller scale of non-bank RALs is evident in the number of RALs seen in 2013. In that year, only 100,000 consumers applied for a RAL.³⁸ This is in contrast to the 12.7 million consumers who received RALs from banks at their height in 2002. While a few non-bank RALs may have been made without reporting to the IRS,³⁹ there are no signs of massive non-compliance of the requirement for tax preparers to report RALs to the IRS.

In order to make those 100,000 RALs, non-bank lenders needed \$150 million in capital (assuming loans of \$1,500). Furthermore, these funds are necessary for a short period of time – a four to six week period – unlike payday loans, which are spread out over the year and for which roll-overs mean that less real funds are actually extended. It is much easier for a large bank like former RAL lenders HSBC and JPMorgan Chase to have such capital. Even smaller banks have had trouble with the amount of funds needed to make RALs; in December 2009, the Office of Comptroller of Currency ordered Santa Barbara Bank & Trust (which then was Jackson Hewitt’s RAL lender) out of the RAL market because of the strain that RALs put on the bank’s capital levels.⁴⁰

³⁵ Gateway Tax Services, Tax Services, at <http://gatewaytaxservice.com/tax-services> (viewed Feb. 13, 2014).

³⁶ *Id.*

³⁷ For a complete listing of state payday lending laws, see www.paydayloaninfo.org/state-information.

³⁸ IRS, Daily E-File At A Glance, U.S. Totals For Individual Returns (Data Source: ELF1505), November 2013.

³⁹ In addition, certain non-bank loans not directly tied to tax refund delivery, such as loans by payday lenders which are their usual products pitched as a tax-time offering, would probably not be reported to IRS.

⁴⁰ NCLC/CFA 2010 RAL Report at 14.

D. Pre-Season or “Paystub” Lending

Pre-Season or “pay stub” loans are loans made prior to the tax filing season, before taxpayers receive their IRS Form W-2s and can file their returns. Traditionally, H&R Block and Jackson Hewitt both offered these loans. This year, it appears only Block is offering them.

H&R Block’s version uses its Emerald Card, which offers the Emerald Advance Line of Credit, providing loans of up to \$1,000. The Emerald Advance carries an annual fee of \$45 for the first year plus an interest rate of 36%.⁴¹ Thus, for a \$500 advance repaid in one month, the total fee would be \$60. A one-month, closed-end loan with the same loan amount and fee would have an APR of 158%. If the customer secures the line of credit with a deposit in an Emerald savings account, the interest rate is reduced to either 9% or 18%.⁴² H&R Block earned about \$60 million in interest from Emerald Advances in both 2012 and 2013.⁴³

Pay stub loans are generally outstanding for a longer time than traditional RALs: a month or more versus 7-15 days. However, they present risks to taxpayers, because they are based on the expectation of a refund before the taxpayer receives final tax information from a W-2. For example, before filing the tax return, the preparer will not have any information about whether the IRS is planning to seize all or part of the taxpayer’s refund to pay a child support or student loan debt. Consumers run the risk of not being able to repay the loan in full from the tax refund. In the past, Block has stated that it conducts underwriting for its loans based on considerations other than the estimated refunds.⁴⁴

The Emerald Advance is significant because it appears to be the only major form of tax-time lending that remains. A few years ago, Block explicitly stated that it intended to use the product in place of traditional RALs.⁴⁵

NCLC and CFA issued a report on pay stub and holiday RALs in November 2008, entitled *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom*.⁴⁶

⁴¹ H&R Block, H&R Block Bank Emerald Line of Credit, at www.hrblock.com/financial-services/emerald-advanced-lending-credit/index.html (viewed Dec. 2, 2013).

⁴² *Id.*

⁴³ H&R Block 2013 Form 10-K 2.

⁴⁴ NCLC/CFA 2009 RAL Report 19.

⁴⁵ H&R Block, Inc. *F4Q09 (Qtr End 04/30/09) Earnings Call Transcript*, June 29, 2009, from Seeking Alpha at <http://seekingalpha.com/article/146073-h-amp-r-block-inc-f4q09-qtr-end-04-30-09-earnings-call-transcript> (quoting Block’s Chief Tax Network Officer as stating “This year was a successful year of seasoning for our Emerald Advance program which is part of the suite of financial products we could offer clients in place of the traditional RAL if the rules change.”).

⁴⁶ Available at

www.consumerlaw.org/action_agenda/refund_anticipation/content/PaystubRALsReport.pdf.

E. RAL and RAC Volume in 2012 and 2013

RAL volume was already decreasing dramatically prior to the exit of the last RAL-lending bank from the market after the 2012 tax season. RAL volume dropped by about 16% from 2011 to 2012. This followed a drop of about 85% from 2010 to 2011. Only 0.5% of taxpayers obtained a RAL in 2012.⁴⁷

Based on IRS data, we estimate there were approximately 630,000 RALs made in 2012. IRS data shows that there were 840,000 RAL applications in 2012.⁴⁸ However, not all RAL applications result in loans, as a certain percentage of applications are rejected.

During the prior decade, we had used approval rates of 90% and 85% to estimate the number of RALs made in relationship to the number of applications.⁴⁹ However, we have used a more conservative 75% approval rate for 2010 and 2011.⁵⁰ Thus, we assume a similar approval rate in 2012.

In 2013, IRS data shows that 100,000 taxpayers applied for a RAL.⁵¹ Since no banks were making RALs in 2013, we assume these were all non-bank RALs. We have no data on the approval rates for non-bank RALs.

Table 1 shows the trends in RALs since 2000, using a 25% rejection rate for 2010 to 2012, a 15% rejection rate for 2007 to 2009 and 10% for years earlier.⁵² To give a better indication of RAL trends, it also includes RAL applications in addition to total RALs made. Note that even a rejected RAL costs the taxpayer a fee, because the taxpayer is automatically given a refund anticipation check (RAC) at a cost of about \$30 to \$35.

⁴⁷ There were 132 million returns filed in the 2012 filing season, which was for Tax Year 2011. Data from IRS SPEC, Return Information Database for Tax Year 2011 (Returns Filed in 2012) (Jan. 2014).

⁴⁸ IRS, Daily E-File At A Glance, U.S. Totals For Individual Returns (Data Source: ELF1505), November 2012.

⁴⁹ See NCLC/CFA 2011 RAL Report 7-8.

⁵⁰ See NCLC/CFA 2013 Tax-Time Products Report 10; NCLC/CFA 2012 RAL Report 6.

⁵¹ IRS, Daily E-File At A Glance, U.S. Totals For Individual Returns (Data Source: ELF1505), November 2013.

⁵² This chart is based on data from the IRS and the annual RAL reports issued by NCLC and CFA.

Table 1: Trends in Refund Anticipation Loans (2000 – 2013)

Filing Year	No. of RAL Applications	Increase/Decrease from Prior Year	No. of RALs Made	RAL Loan Fees
2013	0.1 million	(-88%)	unknown	unknown
2012	0.84 million	(-16%)	0.63 million	\$38.6 million
2011	1 million	(-84.5%)	0.75 million	\$46 million
2010	6.85 million	(-18.5%)	5 million	\$338 million
2009	8.4 million	(-14%)	7.2 million	\$606 million
2008	9.9 million	(-3%)	8.4 million	\$738 million
2007	10.2 million	2%	8.67 million	\$833 million
2006	10 million	(-7%)	9 million	\$900 million
2005	10.7 million	(-22%)	9.6 million	\$960 million
2004	13.8 million	2%	12.38 million	\$1.24 billion
2003	13.5 million	(-4%)	12.15 million	\$1.1 billion
2002	14.1 million	5%	12.7 million	\$1.1 billion
2001	13.4 million	12%	12.1 million	\$907 million
2000	12 million	--	10.8 million	\$810 million

The only bank making RALs in 2012, Republic Bank & Trust (the lender for Jackson Hewitt and Liberty Tax), charged \$61.22 for a RAL of \$1,500. Thus, we estimate that consumers paid \$38.6 million for RALs in 2012. We also estimate that they paid \$10 million in add-on fees.

F. Add-on Fees

Add-on fees are fees separately charged by tax preparers. They are in addition to the RAL or RAC fees charged by the banks. Add-on fees for RALs and RACs appear to be a large source of profits for some preparers.

Of the three major tax preparation chains, only H&R Block does not charge add on fees.⁵³ Jackson Hewitt and Liberty Tax had promised to stop charging add-on fees several years ago,⁵⁴ but then began charging them again in 2010. Jackson Hewitt charges an add-on fee anywhere from \$5 to \$30.⁵⁵ Liberty charged a \$20 add-on fee in 2012, which it reduced to \$9 in 2013.⁵⁶ In addition, tax preparers not affiliated with one of the three big commercial tax preparation chains will often charge add-on fees.

⁵³ Chi Chi Wu and Jean Ann Fox, National Consumer Law Center and Consumer Federation of America *Coming Down: Fewer Refund Anticipation Loans, Lower Prices from Some Providers, But Quickie Tax Refund Loans Still Burden the Working Poor*, Mar. 2008, 7.

⁵⁴ *Id.*

⁵⁵ Jackson Hewitt, Preparer Fee Disclosure, Chicago, IL (undated); Visit to Jackson Hewitt office, Prescott Valley, AZ; 2011 RAL Mystery Shopper Report, Appendix A; 2010 RAL Mystery Shopper Report, Appendix B. *See also* JTH Holdings, Inc., Investor Day 2012 Presentation, at 74.

⁵⁶ *Id.* at 74-75.

There are multiple types of add-on fees. Some of the names for add-on fees that we have observed include:

- Application fees;
- Data and document storage fees;
- Document processing fees;
- E-filing fees;
- Service bureau fees;
- Transmission/software fees;
- Technology fees.

Some in the tax preparation industry have admitted that add-on fees represent nothing more than an opportunity for generating additional revenue. The decision in the Instant Tax Services case, discussed in Section IV.B below, documents how the owner of ITS, Fesum Ogbazion, called add-on fees “junk fees” and “revenue generators.”⁵⁷ A provider of RACs called Refundo has also characterized add-on fees as “junk fees.”⁵⁸

The decision in the Instant Tax case also documents how some of these fees have served no purpose since the early 2000s, and represent pure profit to tax preparers:

Service bureau fees were originally charged by tax preparation firms in the 1980s and 1990s to recover the costs of outsourcing computerized tasks like electronic return filing to third parties. After approximately 2000, there was no longer any reason to charge such fees to customers because the tax preparation companies handled such tasks with their own software. . . . ITS franchisees did not have to charge anything for Service Bureau, since there was in fact no Service Bureau. Instead they could have just increased the tax-preparation fees. . . . In an audio recording, Ogbazion told ITS franchisees on January 12, 2010, that the intent of the Service Bureau fee is to break up the tax prep fees, and make the tax prep fees look “lower.” . . . Ogbazion also admitted that having Instant Tax Service offices charge a Service Bureau fee allowed Instant Tax Service franchisees to tell customers that the Service Bureau fees were actually third-party fees. . . . At Corporate-owned stores, ITS Financial charged customers a Service Bureau fee of \$100. . . . Ogbazion instructed his employees at the Corporate-owned stores to misrepresent the “Service Bureau Fee” as a fee paid to securely transmit a tax return to the IRS.⁵⁹

As with many other preparers, Instant Tax Service actually charged several add-on fees. The cumulative impact of these add-on fees can be very expensive. Mystery shopper testing by

⁵⁷ United States v. ITS Fin., LLC, 2013 WL 5947222, ¶ 337.

⁵⁸ <https://www.refundo.com/home/taxpreparer> (viewed Feb. 18, 2014).

⁵⁹ United States v. ITS Fin., LLC, 2013 WL 5947222, ¶¶ 358 - 367 (citations to the record and paragraph numbers omitted).

consumer groups found add-on fee totals ranging from \$25 to \$324 in 2008;⁶⁰ \$19 to \$85 in 2010;⁶¹ and \$35 in 2011.⁶² Similar mystery shopper testing by First Nations Development Institute found significant add-on fees.⁶³

While Instant Tax was able to set its own Service Bureau Fee, in some cases add-on fees are not determined by the tax preparer, but by the software or transmitter company that the preparer uses.⁶⁴

Providers of RACs and other financial products build in the capability to charge add-on fees, as well as capping them. For example, EPS e-Collect (discussed in Section I.B) permits preparers to deduct a transmitter fee; a Service Bureau fee (capped at \$35); and up to \$999.99 in preparation fees (although EPS will “monitor” fees over \$400).⁶⁵

We estimate that 7.8 million RAC and RAL consumers paid about \$195 million in add-on fees in 2013. We assume that half of preparers other than H&R Block charged add-on fees (which is conservative).⁶⁶ We use an average add-on fee of \$25—a low estimate given the proliferation of multiple fees.

G. Impact on Low-Income Taxpayers and EITC Recipients

RACs and RALs are mostly marketed to low-income taxpayers, and they have the greatest impact on this population. According to IRS data, 84% who obtained a RAC in 2013 were low-income.⁶⁷ For RALs, in prior years, IRS data has indicated that 78%⁶⁸ to 94%⁶⁹ of consumers who obtained these loans were low-income.

The most likely RAC and RAL users are recipients of the Earned Income Tax Credit (EITC). IRS data shows that in 2013 about 50% of RAC consumers were EITC recipients.⁷⁰ Yet EITC recipients made up only about 20% of individual taxpayers in 2013.⁷¹ For RALs, in prior years,

⁶⁰ 2008 RAL Mystery Shopper Report, Attachment 2.

⁶¹ 2010 RAL Mystery Shopper Report, Appendix B.

⁶² 2011 RAL Mystery Shopper Report, Appendix B.

⁶³ Sara Dewees, First Nations Development Institute, *Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses*, Apr. 15, 2011, at 14.

⁶⁴ NCLC/CFA 2013 Tax-Time Products Report at 13.

⁶⁵ EPS Financial, *ERO e-Collect Program Handbook 2012*, on file with authors.

⁶⁶ There were 21 million RACs in 2011. See Section 1.B above. Block made 5.4 million RACs. See Section III.A below. Thus, other preparers made about 15.6 million RACs.

⁶⁷ Data from IRS SPEC, *Return Information Database for Tax Year 2012 (Returns Filed in 2013)* (Jan. 2014).

⁶⁸ See NCLC/CFA 2006 RAL Report at 9.

⁶⁹ See NCLC/CFA 2013 Tax-Time Products Report at 14.

⁷⁰ IRS reports that 10.2 million EITC returns were associated with a RAC in 2013. Data from IRS SPEC, *Return Information Database for Tax Year 2012 (Returns Filed in 2013)* (Jan. 2014).

⁷¹ There were 26.2 million EITC returns and 132 million individual tax returns in 2013. *Id.*

IRS data has indicated that 56%⁷² to 85%⁷³ of consumers who obtained these loans were EITC recipients. Thus, EITC recipients are vastly over-represented among the ranks of RAL and RAC consumers.

In addition, IRS data shows that about 40% of EITC recipients obtained a RAC in 2013.⁷⁴ In other words, a sizable portion of EITC recipients paid part of their publicly funded benefits to a bank to obtain a tax-related financial product. In contrast, only about 10% of taxpayers who do not receive the EITC got a RAC in 2013.⁷⁵

Based on this IRS data, we estimate that about \$315 million was drained out of the EITC program in 2013 by RAC fees.⁷⁶ Add-on fees contributed another \$97.5 million to the drain.⁷⁷

Non-financial product fees also significantly drain EITC benefits. The EITC is the nation's largest anti-poverty program. One criticism has been that no other anti-poverty program requires its beneficiaries to pay for the cost of accessing the benefit, which includes the drain created by both tax-time financial products and by preparation fees. Including tax preparation fees provides a fuller picture of how EITC benefits are chipped away. The average tax preparation fee last reported by H&R Block was \$183⁷⁸ and could be higher for other preparers.⁷⁹

Thus, EITC recipients who got RACs paid an estimated \$1.9 billion in tax preparation fees.⁸⁰ Including tax preparation fees, RACs drained \$2.3 billion from EITC recipients who were sold these products in 2013.

⁷² See NCLC/CFA 2006 RAL Report at 9.

⁷³ See NCLC/CFA 2013 Tax-Time Products Report at 14.

⁷⁴ Data from IRS SPEC, Return Information Database for Tax Year 2012 (Returns Filed in 2013) (Jan. 2014).

⁷⁵ *Id.*

⁷⁶ This is 50% of the \$630 million total paid for RACs in 2013. See Section I.D, above.

⁷⁷ This is 50% of the \$195 million in add-on fees paid for RALs in 2013. See *id.*

⁷⁸ H&R Block Inc., 2011 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 19.

⁷⁹ Tax preparation fees were as high as \$540 in mystery shopping conducted in New York and North Carolina. 2011 RAL Mystery Shopper Report, Appendix A.

⁸⁰ In general, nearly 15 million EITC recipients used a paid tax preparer in 2013. Data from IRS SPEC, Return Information Database for Tax Year 2012 (Returns Filed in 2013) (Jan. 2014). Thus, about \$2.75 billion in federal tax credits meant to support working families was paid to tax preparers to access this benefit.

II. TAX PREPARER CONSUMER PROTECTION ISSUES

A. Preparer Regulation

The single most important consumer protection issue for taxpayers is the desperate need for regulation of paid tax preparers. The lack of regulation for most preparers – *i.e.* the fact that in 46 states, paid preparers are not required to meet any minimum educational, training, competency, or other standards – is one of the most surprising aspects of paying taxes in this country. In November 2013, NCLC released a report documenting how lack of regulation has allowed incompetence and abuses by tax preparers to flourish. The report, [*Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do*](#), analyzes years of mystery shopper testing by government agencies, consumer groups, and advocacy organizations, all of which found disturbingly high levels of incompetency and outright fraud, such as:

- Intentional omission of income;
- Falsifying information to make the taxpayer eligible for various credits and deductions, such as charitable deductions, job-related or business expenses, and the Earned Income Tax Credit (EITC); and
- Inability to accurately handle education-related items, such as grants and tuition credits.

This incompetency and fraud could expose consumers to the risk of audit by the IRS, or even criminal sanctions. The latest example of preparer fraud is the decision in the Instant Tax Service case, discussed below in Section IV.B. One mind-blowing statistic from this case is that:

Based on the random customer interviews (*i.e.*, excluding any non-random interviews of customers conducted during United States' investigations), there was a 50–70% error rate for tax returns prepared by Instant Tax Service franchisees in Chicago, Indianapolis, Kansas City/St. Louis, and Las Vegas.⁸¹

Thus, *over half of returns prepared by Instant Tax* in these cities were incorrect.

The IRS attempted to address the problem by developing a system to regulate tax return preparers, which would have required them to register with the IRS, take a competency examination, and stay current with tax law developments through continuing education. However, a federal district court issued a surprising decision last year invalidating the IRS return preparer regulations as having exceeded the agency's statutory authority.⁸² Just this

⁸¹ United States v. ITS Fin., LLC, 2013 WL 5947222, ¶ 582.

⁸² Loving v. I.R.S., 917 F. Supp. 2d 67 (D.D.C. 2013).

month, the D.C. Court of Appeals upheld the lower court's ruling, handing the IRS a decisive defeat.⁸³

Thus, the only options that remain for regulation of tax return preparers are:

- Congress could pass a law explicitly granting the IRS authority to regulate tax preparers; or
- States could pass laws to regulate tax preparers.

To encourage states to pass laws regulating preparers, NCLC has issued a Model Individual Tax Preparer Regulation Act. The Model Act is based on the existing laws in three of the four states that do regulate tax preparers (Maryland, Oregon and California), as well as the IRS regulations.⁸⁴ In summary, the Model Act requires tax preparers to:

- Obtain a registration unless they fit into one of exceptions for the limited number of tax preparers already regulated, such as certified public accountants, enrolled agents, and lawyers.
- Pass a basic competency exam.
- Have 60 hours of initial education and 15 hours per year of continuing education.
- Provide a standardized disclosure of their fees.

B. Need for Disclosure for Tax Preparation Fees

Another problem faced by taxpayers is the lack of transparency around tax preparation fees. Tax preparation is one of the few consumer services in the United States for which consumers cannot obtain a price for the services before they incur them. Tax preparers assert that they charge by the form, and cannot predict which forms will be generated until they actually finish the tax preparation. Thus, consumers cannot comparison shop, or predict how much tax preparation will cost them. The ability to deduct tax preparation fees from a RAC – or a RAL – compounds the lack of transparency of tax preparation fees, as it makes taxpayers less sensitive to the price.

As a result, low-income consumers face tax preparation fees that are very high, and, in many instances, inflated. Mystery shopper testing has documented preparation fees up to \$400 or \$500.⁸⁵ There are numerous examples of preparers giving artificially low estimates on preparation fees or even refusing to provide testers with a quote, such as:

⁸³ Loving v. I.R.S., 13-5061, 2014 WL 519224 (D.C. Cir. Feb. 11, 2014).

⁸⁴ The fourth state to regulate tax preparers was New York. New York's regulations governing preparers were finalized in December 2013, after NCLC had issued its Model Act.

⁸⁵ Riddled Returns at 18 (providing Table of Tax Preparation Fees).

- Several testers in mystery shopper testing conducted in 2010 recounted how preparers, when asked about fees, “avoided the question,” “let her know up front that the fees were high, but couldn’t get me the exact amount,” or were told that a preparer couldn’t estimate fees because the “computer did it.” One tester was quoted a price of \$70 for tax preparation fees by a Jackson Hewitt outlet, but ended up paying over \$400.⁸⁶
- A mystery shopping tester was charged a \$540 fee by Liberty Tax. Later, the preparer refused to provide a breakdown of the fee, even when a consumer advocacy group called on the tester’s behalf. The preparer stated that customers complained about this particular Liberty Tax store’s fees sometimes, but that the store was able to get customers more money back than other tax preparers. In the case of the tester, it appears that “more money back” was due to the preparer erroneously claiming one of the tester’s daughters for the EITC. Another Liberty Tax preparer informed one tester that the tax preparation fee “depends; and that if he didn’t get a refund they would charge him less.”⁸⁷
- In 2011, mystery shopper testing by First Nations Development Institute found that only 2 out of 12 received anything resembling an accurate, detailed estimate. Testers were given vague estimates that were confusing and made it difficult for the tester to determine total estimated costs.⁸⁸
- The Illinois Attorney General’s lawsuit against Mo’ Money Taxes alleged that Mo’ Money advertised that the cost of its services would be between \$150 and \$350, but in fact charged consumers between \$480 and \$550 to prepare and file their returns, and charged them additional fees totaling \$178 for processing the returns.⁸⁹
- Testing by the GAO in 2006 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.”⁹⁰
- In the Instant Tax Service decision discussed in Section IV.B, a federal judge found that Instant Tax charged fees averaging \$550 for customers who received RACs and

⁸⁶ 2010 RAL Mystery Shopper Report at 9.

⁸⁷ 2011 RAL Mystery Shopper Report at 5-6.

⁸⁸ Sara Dewees, First Nations Development Institute, *Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses*, Apr. 15, 2011, at 14.

⁸⁹ Complaint, *People v. Mo’ Money Tax Service*, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012), ¶¶ 79-81.

⁹⁰ U.S. Government Accountability Office, *Paid Tax Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T, April 4, 2006, at 24, available at <http://www.gao.gov/new.items/d06563t.pdf>.

RALs, for as little as 10 to 15 minutes of tax preparation services. However, for the few consumers who did not get a RAC or RAL, Instant Tax only charged an average of \$200.⁹¹

- This year, a mystery testing shopper was sent to a Liberty Tax office in Massachusetts to obtain the price of RACs offered by that chain. The preparer refused to provide the price of a RAC, even though it is presumably the same for all consumers, *i.e.*, it does not vary by form. The preparer told the tester that she would not provide any pricing information unless the produced his “tax documents.” According to the test, the preparer said this was a “rule” she had and she would not break it.⁹²

Clearly, there is a need for reforms in the disclosure of tax preparation fees. Advocates have recommended that preparers be required to provide a clear, simple disclosure of tax preparation fees to consumers before beginning the process of tax preparation.⁹³ This disclosure should be in a tabular format, similar to the disclosure table used in credit card solicitations. On the next page is a sample table suggested by advocates.

⁹¹ United States v. ITS Fin., LLC, 2013 WL 5947222, ¶¶ 349, 551.

⁹² Memo from Miche Jean to Chi Chi Wu, Feb. 25, 2014, on file with authors.

⁹³ David Rothstein, Policy Matters Ohio, Improving Tax Preparation With a Model Fee Disclosure Box, June 2013, *available at* http://www.policymattersohio.org/wp-content/uploads/2013/06/FeeDisclosure_Jun2013.pdf.

Table 2: Proposed Tax Preparation Fee Box

Service	Cost (examples)
1040 EZ return	--
Basic 1040 return	\$150.00
• Schedule A (itemized deductions)	--
• Schedule B (interest and dividends)	--
• Schedule C-EZ (self-employment)	--
• Schedule C (self-employment)	--
• Schedule EIC (earned income credit)	\$50.00
• Other Schedules (list as needed)	--
State return	\$50.00
Local return	\$25.00
Total preparation fees	\$275.00
Processing fees	
• Document storage and copying	\$25.00
Filing fees	
• Electronic filing and acknowledgement	\$30.00
• Paper filing	--
Additional fees	--
• Tax refund loan	--
• Tax refund check	\$30.00
• Audit protection	\$25.00
• Return review	--
• Tax planning and research	--
• Third party fees from bank or servicer	--
Total fees	\$110.00
Refund options	
• Direct deposit to a bank account	--
• Split refund (Form 8888)	--
• U.S. Savings Bond	--
Total Preparation Cost	\$385.00
<i>Questions? Call xxx-xxx-xxxx</i>	

Taken from: David Rothstein, Policy Matters Ohio, Improving Tax Preparation With a Model Fee Disclosure Box, June 2013

III. INDUSTRY PLAYERS

This section provides basic information on the tax-time financial activity of key industry players, an overview that we provide annually. Historically, the tax-time financial products industry was made up of a handful of RAL lending banks, three commercial preparation chains, and thousands of independent preparers that offered and arranged for RALs. While some of the RAL lending banks, such as HSBC and JPMorgan Chase, exited the market completely, others have switched to making only RACs, such as Republic Bank & Trust. The tax preparation chains all still offer RACs, and some chains offer non-bank RALs or pre-season loans.

A. H&R Block

H&R Block is the nation's largest tax preparation chain, accounting for 16% of all individual tax returns in 2012, or 22.3 million.⁹⁴ H&R Block has not offered RALs since 2011.⁹⁵ The company did process 6.2 million RACs in 2012 through its own bank, Block Bank,⁹⁶ earning it about \$132 million.⁹⁷ Block had offered free RACs that year until February 4, 2012, if the customer agreed to have the RAC deposited on the company's Emerald Card. This decreased the fees that Block earned for RACs by \$49.3 million.⁹⁸

Block prepared 22.2 million returns in 2013, again accounting for 16% of all individual tax returns in that year.⁹⁹ It earned \$158 million from RACs in 2013,¹⁰⁰ which we estimate translates into about 5.4 million RACs.

H&R Block offers the Emerald Card, a prepaid debit card, to its tax preparation customers. H&R Block had about 2.9 million Emerald Card users in 2012,¹⁰¹ and 2.5 million in 2013.¹⁰² The Emerald Card also allows customers to access the Emerald Advance Line of Credit, which is a pre-season or "pay stub" product described in Section I.D above. H&R Block earned about \$60 million in interest from Emerald Advances in both 2012 and 2013.¹⁰³

⁹⁴ H&R Block Inc., 2012 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 2. [hereinafter H&R Block 2012 Form 10-K].

⁹⁵ See NCLC/CFA 2012 RAL Report at 17-18.

⁹⁶ H&R Block, Overview of Financial Services Presentation, Feb. 13, 2013, on file with authors.

⁹⁷ H&R Block 2012 Form 10-K at 20.

⁹⁸ *Id.*

⁹⁹ H&R Block Inc., 2013 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, at 2. [hereinafter H&R Block 2013 Form 10-K].

¹⁰⁰ *Id.* at 22.

¹⁰¹ H&R Block, Inc., H&R Block Management Discusses Q4 2012 Results - Earnings Call Transcript, June 26, 2012, available at <http://seekingalpha.com/>.

¹⁰² H&R Block, Inc., H&R Block Management Discusses Q4 2013 Results - Earnings Call Transcript, June 12, 2013, available at <http://seekingalpha.com/>.

¹⁰³ H&R Block 2013 Form 10-K at 22.

B. Jackson Hewitt

Jackson Hewitt is the second largest tax preparation chain in the country. It has 6,500 company-owned and franchise offices.¹⁰⁴ Because it lost the ability to make RALs in 2010, as well as other factors, Jackson Hewitt has struggled over the past few years. In May 2011, Hewitt filed for bankruptcy protection from its creditors, from which it emerged a few months later.¹⁰⁵

In 2013, Jackson Hewitt offered a pre-season loan product in partnership with BillFloat.¹⁰⁶ However, it appears that few Jackson Hewitt customers were actually approved for this product.

In 2014, Jackson Hewitt did not offer any specific tax-related financial products, but did partner with Credit One Bank and Springleaf Financial Services to offer products issued by those two lenders in certain Hewitt offices.¹⁰⁷ Credit One Bank appears to offer subprime credit cards with extremely high fees and no grace period.¹⁰⁸ Springleaf Financial Services is a finance company formerly known as American General Finance.¹⁰⁹

C. Liberty Tax Service

Liberty Tax is the third significant commercial tax preparation chain in the country, with over 4,500 locations.¹¹⁰ Liberty Tax prepared about 2 million returns in 2012 and 2.1 million in 2013.¹¹¹ The chain is well-known for hiring people to stand outside stores, dressed up in Statue of Liberty costumes, as a form of advertisement during tax season.

Liberty earned \$22.9 million in RAL and RAC fees in 2012, or 17% of its revenue.¹¹² It earned \$30.3 million in RAL and RAC fees in 2013, constituting 20.5% of revenue.¹¹³

In 2012, Liberty sold financial products to 922,000 of its customers, of which 3.4% (or about 70,000) obtained a bank RAL.¹¹⁴ In 2013, Liberty sold financial products to 973,000 of its

¹⁰⁴ Jackson Hewitt, Our Story, www.jacksonhewitt.com/Our-Story/ (viewed Feb. 11, 2014).

¹⁰⁵ Peg Brickley, *Jackson Hewitt Set to Leave Chapter 11*, Wall St. J., Aug. 8, 2011.

¹⁰⁶ See NCLC/CFA 2013 Tax-Time Products Report at 22.

¹⁰⁷ <https://www.facebook.com/jacksonhewitt> (viewed Jan. __, 2014).

¹⁰⁸ Terms and Conditions, Credit One, undated, at <https://prequal.creditonebank.com/termsconditions/popup/Combined-Terms.aspx> (visited Feb. 22, 2014). Credit One charges the maximum fees permitted under federal law, which limits fees to 25% of the credit limit. It then charges an additional \$19 fee if an authorized user is added to the account.

¹⁰⁹ <https://www.springleaffinancial.com/about-us/history.html> (visited Feb. 22, 2014).

¹¹⁰ JTH Holding, Inc., *2013 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 9. [hereinafter "Liberty Tax Service 2013 Form 10-K"].

¹¹¹ *Id.*

¹¹² *Id.* at 49.

¹¹³ *Id.*

customers.¹¹⁵ Since there were no bank RALs, all of these customers obtained a RAC with the exception of those that obtained a non-bank RAL called an Instant Cash Advance (ICA). Thus, about 925,000 Liberty customers obtained a RAC.

Liberty offered ICAs in both 2012 and 2013. We estimated that Liberty made about 22,500 ICA loans in 2012.¹¹⁶ Liberty reported that 2.3% of its customers – or about 48,000, obtained an ICA in 2013.¹¹⁷

In 2013, Liberty has partnered with non-bank lenders to make ICAs in 27 states.¹¹⁸ These non-bank lenders appeared to have been affiliated with Texas payday lenders.¹¹⁹ Apparently, ICAs were only made for 14 days during the 2013 tax season, “due largely to the condensed tax season and the issues caused by the fiscal cliff...”¹²⁰ This year, Liberty Tax Service is again partnering with a non-bank lender to make RALs, but appears to have cut back its program to about 21 states.¹²¹

Liberty also owns an estimated 5% stake in MetaBank, which offers prepaid cards.¹²² MetaBank formerly had a paystub line of credit attached to these cards until it was ordered to terminate the program by its federal regulator.¹²³

D. Banks and Other Companies Offering RACs

A number of banks or other entities continue to offer RACs, including some that previously offered RALs until they were forced to stop. These include:

- Republic Bank & Trust is a state-chartered bank located in Louisville, Kentucky. Republic was the last remaining bank in the RAL market, until it was forced by its federal regulator, the FDIC, to stop offering RALs after the 2012 filing season.¹²⁴

¹¹⁴ JTH Holding, Inc., Amendment No. 5 to Form S-1: Registration Statement under the Securities Act of 1933 (amended version Oct. 15, 2012), at 21, 41 [hereinafter “Oct. 2012 Liberty Tax Service Prospectus”].

¹¹⁵ Liberty Tax Service 2013 Form 10-K at 47.

¹¹⁶ See NCLC/CFA 2013 Tax-Time Products Report at 23.

¹¹⁷ Liberty Tax Service 2013 Form 10-K at 48.

¹¹⁸ *Id.* at 12.

¹¹⁹ See NCLC/CFA 2013 Tax-Time Products Report at 23-24.

¹²⁰ Liberty Tax Service 2013 Form 10-K at 18.

¹²¹ Bob Scott, Liberty Tax Loans Cut Back, *Progressive Accountant*, Dec. 10, 2013, available at <http://www.theprogressiveaccountant.com/index.php/tax-128/3485-liberty-tax-loans-cut-back> (visited Feb. 14, 2014).

¹²² Bob Scott, Bank Product Market Looks for Choices, *Progressive Accountant*, Aug. 28, 2012, available at <http://theprogressiveaccountant.com/index.php/tax-128/2338-bank-product-market-looks-for-choices> (visited Feb. 24, 2014).

¹²³ See NCLC/CFA 2011 RAL Report at 5-6.

¹²⁴ See NCLC/CFA 2012 RAL Report at 5.

- Santa Barbara Tax Products Group (SBTPG) is the former Pacific Capital Bancorp RAL unit that was spun off after that bank was ordered to cease making RALs by its federal regulator, the Office of the Comptroller of Currency.¹²⁵ SBTPG partners with University Bank in Minneapolis, MN, to make RACs.
- River City Bank and Ohio Valley Bank are two other state-chartered banks located in Louisville, Kentucky that are regulated by the FDIC. The FDIC forced River City and Ohio Valley Bank out of the RAL business in 2011.¹²⁶ Both still make RACs. Ohio Valley offers RACs under the name “Refund Advantage.”¹²⁷
- Other RAC providers include:
 - Advent Financial, which offer RACs, including those delivered on the GetIt Prepaid Mastercard.¹²⁸
 - EPS Financial and Bancorp Bank, which offers RACs, including a free RAC if it is deposited on the E1 Visa Prepaid Visa card.¹²⁹
 - Refundo, which promotes itself as a provider with no add-on fees.¹³⁰

E. Tax-Time Products at Fringe Financial Outlets

Storefront financial services outlets -- including check cashers; payday lenders; rent-to-own stores; retailers; car dealers; and other fee-based providers -- have long participated in the frenzy to make money during tax season, when low- to moderate- income consumers receive the largest single infusion of funds at any point in the year. With the demise of RALs, a few fringe outlets, as discussed in Section I.C, offer non-bank RALs. Other fringe outlets offer tax preparation services without selling RALs or other loans labeled as tax-time credit.

Cash America, the large pawn/payday loan national chain, promotes its tax filing services on its website. However, the fine print on the website discloses that Cash America “does not provide tax preparation advice, nor prepare or file tax returns. Cash America is a sales representative of

¹²⁵ See NCLC/CFA 2010 RAL Report at 14-15.

¹²⁶ See NCLC/CFA 2012 RAL Report at 5.

¹²⁷ <https://www.refund-advantage.com/default.aspx>.

¹²⁸ <https://www.adventtax.com/about/index>.

¹²⁹ E-Collect, EPS Financial, at <http://www2.epsfinancial.net/en/solutions/e-collect> (viewed Feb. 13, 2014).

The E1 Prepaid Card is issued by Bancorp Bank. See <http://www2.epsfinancial.net/en/solutions/e-collect/card-connection/e1-card-fees> (viewed Feb. 10, 2013).

¹³⁰ <http://www.refundo.com/home/taxpreparer>.

E-Tax.”¹³¹ E-tax is a remote tax preparation program that promotes itself as a “direct to business” tax preparer.¹³²

PLS Loan Stores is a chain that offers check cashing, payday loans and auto title loans. It also offers in-store tax return preparation for federal and state returns. To get refunds faster, PLS urges filing as soon as possible and use of direct deposit to the taxpayer’s bank account or a RAC.¹³³

National Cash Advance, a payday lender, offers to estimate taxes with actual tax preparation provided by eTax. National Cash Advance’s website also offers a coupon for \$20 off the consumer’s tax preparation fee.¹³⁴ This same offer is made by National Cash Advance’s parent, Advance America, the large national chain of payday lenders.¹³⁵

Some fringe outlets are only promoting tax check cashing services. ACE Cash Express is not promoting tax preparation but is offering \$10 off its check cashing fee for refunds.¹³⁶ ACE is also promoting loading federal tax refunds onto an ACE Elite Visa prepaid card, issued by NetSpend and MetaBank. This year, one sales pitch from an ACE employee was that consumers could load money on the ACE prepaid card to shop at Target and avoid exposing their checking accounts to a data security breach.¹³⁷

CheckSmart is a chain that offers check cashing, auto insurance, money orders, and auto title loans. Auto title loans are made by Buckeye Title Loans.¹³⁸ CheckSmart is offering tax preparation services provided by GC-1 etax Partners.¹³⁹ CheckSmart is also issuing the Insight Card,¹⁴⁰ issued by Urban Trust Bank.¹⁴¹ The Insight Card has been the subject of some controversy, with the Office of the Comptroller of the Currency (OCC) finding “violations of law and regulations and unsafe and unsound banking practices” after NCLC, CFA and the

¹³¹ www.cashamerica.com/FinancialServices/TaxFilingServices.aspx (visited Feb. 21, 2014).

¹³² See NCLC/CFA 2012 RAL Report at 29.

¹³³ www.plshome.com/tax-preparation/ (visited Feb. 21, 2014).

¹³⁴ www.nationalcashadvance.com/ourservices_tax.php (visited Feb. 21, 2014).

¹³⁵ <http://www.advanceamerica.net/services/details/tax-services> (visited Feb. 21, 2014).

¹³⁶ <https://www.acecashexpress.com/store-services/tax-checks> (visited Feb. 21, 2014).

¹³⁷ Conversation with ACE Cash Express employee in Arizona (February 2014).

¹³⁸ <http://www.checksmartstores.com/arizona/title-loans/> (visited Feb. 21, 2014).

¹³⁹ <http://www.checksmartstores.com/arizona/other-services/> (visited Feb. 21, 2014).

¹⁴⁰ <http://www.checksmartstores.com/arizona/prepaid-cards/> (visited Feb. 21, 2014).

¹⁴¹ Urban Trust Bank has had a history of offering high-cost credit products, such as a fee-harvester credit card called the “My Salute Card.” See Rick Jurgens & Chi Chi Wu, National Consumer Law Center, Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers 3 (Nov. 2007), at 19-20, available at www.consumerlaw.org/issues/credit_cards/content/FEE-HarvesterFinal.pdf.

Center for Responsible Lending sent the OCC a letter detailing the use of the Insight Card by CheckSmart to make payday loans in violation of state laws.¹⁴²

Last but not least, the NCLC/CFA annual reports have discussed TRS Refund Services several times. This company is still advertising its TaxMax program for auto dealers, promoting tax preparation and refunds as a way to bolster purchases for autos. The website offers two products, a Fourth Quarter Sales Program and a First Quarter Sales Program.¹⁴³ The Fourth Quarter Sales Program allows car dealers to estimate a taxpayer's refund for the next tax year and allows the dealer to treat future tax refund proceeds as a down payment for a car purchase in October, November or December. The online portal estimates the consumer's refund using the last paystub and, then generates the appropriate supporting documents, including a promissory note for the customer to sign.¹⁴⁴

The First Quarter Tax Max Marketing Program is a tax preparation and loan program designed to allow car dealers to prepare tax returns onsite and use the proceeds to help fund the down payment for a car purchase at the point of sale.¹⁴⁵ TRS Tax Max provides car dealers with an online portal to prepare a taxpayer's return and determine the amount of the refund. Funds are dispersed directly to the dealer in 7 to 20 days.¹⁴⁶ TRS Tax Max charges start at \$139, the fees are deducted directly from the taxpayer's refund, and the bank partner fee is \$59.¹⁴⁷

IV. REGULATION, ENFORCEMENT, LITIGATION AND ADVOCACY

A. Legislation

i. Tax-Time Financial Products

There are currently a total of 20 states regulating RALs: Arkansas, California, Colorado, Connecticut, Illinois, Louisiana, Maine, Maryland, Michigan, Minnesota, Nevada, New Jersey, New York, North Carolina, Oregon, Tennessee, Texas, Virginia, Washington State, and Wisconsin. The laws for 13 of these states are summarized in Appendix A to NCLC's model state RAL law.¹⁴⁸

¹⁴² Press Release, National Consumer Law Center, Banking Regulator Slams Urban Trust Bank, Issuer of Prepaid Card Payday Loans, Sept. 24, 2012, available at <http://www.nclc.org/images/pdf/pr-reports/pr-occ-check-smart.pdf>.

¹⁴³ <https://www.taxmax.com/TRSTaxMax/HowItWorks.aspx> (visited Feb. 21, 2014).

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

¹⁴⁸ Available at http://www.nclc.org/images/pdf/high_cost_small_loans/ral/model-refund-anticipation-loan-act.pdf.

Most of these laws rely on disclosures to protect consumers from RAL abuses, which are limited in their effectiveness. However, RAL laws in Arkansas, Connecticut, Illinois, Maine, Maryland, Minnesota, and New York provide substantive protection by prohibiting add-on fees. The Illinois law caps APRs for non-bank RALs at 36%. The Connecticut law prohibits RAL facilitators from facilitating a RAL costing over 60% APR; however, the federal Court of Appeals for the Second Circuit struck down this provision as applied to national banks, holding that it was preempted by federal banking law.¹⁴⁹ The Connecticut law should be effective as to non-bank RALs.

ii. Preparer Regulation

There are currently four states that regulate paid tax preparers. These states are California,¹⁵⁰ Maryland,¹⁵¹ Oregon¹⁵² and New York.¹⁵³ New York's regulation is the most recent, having been finalized in December 2013.

B. Regulation and Enforcement

The most notable enforcement development in 2013 was the decision in the U.S. Department of Justice's (USDOJ) lawsuit against Instant Tax Service. After a two-week trial, a federal judge issued a permanent injunction banning Instant Tax Service and its owner, Fesum Ogbazion, from operating or being involved with any business related to tax preparation.¹⁵⁴

The court's decision in the Instant Tax Service case is a remarkable litany of what Judge Black characterized as "an astonishing array of repeated fraudulent and deceptive conduct."¹⁵⁵ Some of this conduct included:

- Instant Tax printed duplicate RAL checks from HSBC, then forged customers' signatures on these checks and deposited them. Instant Tax basically stole HSBC's money while leaving the customers on the hook, subjecting them to ruined credit reports and debt collection.
- In 2010 and 2011, Instant Tax defrauded mostly low-income consumers by marketing non-existent RALs, in order to lure them into franchisees' stores, then using the information submitted by these consumers to file their tax returns without their express permission.

¹⁴⁹ Pacific Capital Bank, N.A., v. Conn., 542 F.3d 341 (2d Cir. 2008).

¹⁵⁰ Cal. Bus. & Prof. Code §§ 22250 to 22259

¹⁵¹ Md. Code §§ 21-101 to 21-502

¹⁵² Or. Rev. Stat. §§ 673.605 to 673.740

¹⁵³ 20 N.Y. Comp. Codes R. & Reg. tit. 20, pt. 2600 (Dec. 2013).

¹⁵⁴ United States v. ITS Fin., LLC, 2013 WL 5947222 (S.D. Ohio Nov. 6, 2013).

¹⁵⁵ *Id.* at ¶1.

- In 2007, Instant Tax franchisees took applications for RALs, but did not bother to forward the applications to the RAL lender, Republic Bank & Trust.
- Instant Tax engaged in discriminatory behavior by automatically denying loan applications from male heads of households, targeting African American single mothers, and justifying taking applications even though consumers were very unlikely to get loans by stating: ““Most black folks are used to getting denied so it won’t come to them as a shock. I know that’s a [expletive] thing to say, but it’s the truth.”
- Instant Tax trained franchisees to prepare and file tax returns prematurely with paystubs instead of waiting for a W-2, which is illegal under IRS rules, through classes called “Stub Shop.” The returns illegally filed using paystubs omitted and understated income, and resulted in erroneous returns. The IRS caught some of these errors, resulting in customers owing tax deficiencies.
- Instant Tax obstructed government agents and materially assisted franchisees in circumventing IRS law enforcement efforts, including by training them on how to print phony W-2s. When franchisees had their electronic filing identification numbers (EFINs) suspended, Instant Tax arranged for EFINs from other preparers to be loaned to the suspended preparers.
- Instant Tax required franchisees to charge phony fees, as well as exorbitant fees, of which the parent company kept an average of 18%.

The above is only a partial list of the transgressions by Instant Tax and its principals. Judge Black also noted the remarkable lack of remorse by these principals, stating:

Defendants' repeated attempts at trial and in argument to downplay the gravity of their lawlessness was stunning. The Court concludes that even today Defendants have not fully recognized their culpability. Ultimately, the nature, scope, and gravity of Defendants' offenses, and the unrepentant attitude toward their commission, demonstrate the necessity for a complete injunction putting the Defendants permanently out of business.¹⁵⁶

¹⁵⁶ Id. at *1.

CONCLUSION

The tax-time financial products market is evolving after the departure of bank RALs. Tens of millions of taxpayers continue to be sold RACs, which can be subject to significant add-on fees and may represent a high-cost loan of the tax preparation fee. A few payday lenders and other non-bank businesses are making non-bank RALs, which may be more expensive but are also far less prevalent.

Consumers face other traps in addition to tax-time financial products.

One problem is tax preparation fees, which are a source of potential consumer confusion. Preparation fees seem overly high in some instances, and consumers are unable to obtain estimates to comparison shop. To improve comparison shopping and competitive pressure to lower the cost of tax preparation, tax preparation fees should be subject to a standardized, easy-to-understand disclosure.

Another problem is the lack of regulation for tax preparers, leading to incompetency and fraud. Common sense standards are needed to regulate the industry that is charged with preparing one of the most important financial documents during the year for consumers. There are many challenges remaining to protect low-income taxpayers from profiteering and abuse.

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