

Alternatives to Commercial Tax Preparation: Helping Workers Keep All of Their Refund



The most recent IRS data indicate that 70 percent of EIC recipients pay someone to prepare their tax returns. The National Consumer Law Center has estimated that EIC recipients spend about \$1.6 billion per year on commercial preparation and refund loan fees! Thus, low-wage workers are giving up a substantial portion of the tax benefits they have earned.

What are the choices when it's time to file a tax return?

- **Workers can fill out their own forms.**

Instructions for completing forms 1040, 1040A and 1040EZ include worksheets and tables to help determine eligibility for the EIC and CTC and the credit amounts. In addition, IRS Publication 596, “Earned Income Credit,” contains helpful examples. *These items can be obtained for free wherever tax forms are available, at the IRS website www.irs.gov/formspubs, or by calling 1-800-TAX-FORM.* The tax form instructions for the EIC also give taxpayers the option to fill in all the necessary information and let the IRS calculate the amount of the EIC for them. (This is not an option for the Child Tax Credit refund, however.)

Taxpayers can also complete their own tax returns electronically through the Free File Alliance, which can be visited through the IRS website www.irs.gov. The Free File Alliance offers taxpayers a choice of on-line programs to use for tax filing. Taxpayers should read details about the programs carefully before selecting one. (**Note:** Filing a federal tax return is free through the Free File Alliance, but companies may charge to e-file a state return. Fees for state returns vary from state to state.)

- **Get free help filling out the forms.** Tax returns can be filed through VITA sites and other free tax filing programs. Electronic filing (having a return completed by computer to get a faster turnaround on a refund) is available at some VITA sites and at some local IRS offices.

- **Pay a commercial tax preparer to fill out the forms.** Generally, commercial tax preparers offer these services: completion of tax return forms (about \$55 to \$100 for federal and state tax returns and an extra amount for the Schedule EIC), electronic filing (usually another \$25 to \$35) and refund anticipation loan fees (usually an additional \$100, but can be much higher).

Here's one example that shows why paying for tax preparation may not be the best choice:

Ms. Williamson, who is working and raising two children is expecting an EIC of \$2,500 and is counting on this money to help pay the security deposit she needs to move to her new apartment. If she goes to a commercial tax preparer she may pay a fee of \$150 for preparation and electronic filing. In about 10 days, Ms. Stewart will get a check electronically deposited into her bank account by the IRS for \$2,500, but it is now worth only \$2,350 because of the fees she has paid.

Paying for tax preparation takes money away from EIC and CTC benefits. It means workers have less money to help pay bills and care for themselves and their children. This runs counter to a primary goal of these credits: improving people's financial stability. That's one reason the IRS offers free tax preparation services through the VITA program.

What are refund anticipation loans?

Many commercial tax preparers offer refund anticipation loans (RALs) to enable the taxpayer to get a check in the amount of his or her refund (less the charges for preparing the return and the RAL fee) within a day or two. Actually, the “refund” in this situation is not coming from the IRS — it is a loan from a bank arranged by the commercial preparer. The bank is repaid when the IRS sends it the actual refund check for the taxpayer. The fees charged for RALs are really up-front interest payments on the loan.

There are several things taxpayers should know about RALs:

- Even though the fee may not seem very high, RALs are expensive. Here’s why:

Remember Ms. Williamson, who is expecting an EIC of \$2,500? What if she can’t afford to pay the \$150 return preparation fee out of her pocket? What if she doesn’t have a bank account and would need to wait weeks for the IRS to mail her refund check? She might think the offer of a refund anticipation loan sounds good — she’ll get a check through the preparer in a day or two and won’t have to pay any cash to the preparer. While there are differences in the rates commercial preparation firms charge, a typical RAL fee for this size refund is \$100-\$140, in addition to the \$150 in preparation fees. In fact, the preparer arranges a loan to her for the \$2,500. An interest payment of \$100 is deducted, often along with a \$40 RAL application fee, plus the \$150 to prepare the return. The loan is just for the two weeks it normally takes for the IRS to send her refund check to the preparer’s bank partner. For a two-week loan she is paying \$100 in interest — that’s a rate of about 150 percent! She winds up able to use just \$2,210 of her \$2,500 EIC, losing over 10 percent of the value of her EIC.

- Low-income taxpayers may find they can’t afford the fees at the time the return is prepared. It is easy for them to be persuaded to take a refund anticipation loan, since all the costs of return preparation and the loan charges are taken out of the amount of the expected refund. However, this means paying even higher fees, as explained above.
- If the EIC does not come back from the IRS in the amount expected, the taxpayer will have to repay the difference to the bank that holds the loan arranged through the preparer. When using a RAL, taxpayers agree to all the obligations of a loan.
- Not all preparers make sure their customers understand the extra costs of a RAL — the fine print on the agreement the customer signs — and customers may not realize how much of the EIC refund is being lost to loan charges and preparation fees. Further, some unscrupulous preparers may charge much higher fees.
- Other business may offer tax preparation services, such as furniture stores and used car dealers. Customers may get sold not only a RAL for their tax refund, but also persuaded to use their RAL to make a down payment on a set of furniture or a car.

How can workers get their tax refund quickly without a RAL?

Even after learning about the possible problems with a RAL, some workers may still choose to use one, especially if they have urgent financial needs. To address this, some Outreach Campaigns have partnered with financial institutions to offer low-cost RAL alternatives. Before issuing a RAL alternative, Outreach Campaigns educate taxpayers to make sure they understand that the product is a loan that will reduce the amount of their total refund. Taxpayers are informed that they do not need the loan to have their taxes filed electronically or to receive their refund through direct-deposit. Taxpayers are also notified of the cost of the product, the interest rate and repayment schedule. *To learn more about offering alternative RALs read the National Consumer Law Center’s guide to “Building a Better Refund Anticipation Loan: Options for VITA sites,” found at:* www.consumerlaw.org/initiatives/refund_anticipation/content/BuildingBetterRAL.pdf