

# Efforts to Regulate Refund Anticipation Loan (RAL) Practices



## BACKGROUND

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 charges and fees) within a day or two. The “refund” in this situation is not coming from the IRS: It is a loan from a bank, arranged by the commercial tax preparer. The bank is repaid when the IRS sends it the taxpayer’s refund check. The fees charged for the RAL are really up-front interest payments on the loan. If the Earned Income Credit (EIC) does not come back from the IRS in the amount expected, the taxpayer will have to repay the difference to the bank. According to the National Consumer Law Center and the Consumer Federation of America, RALs drained money from the refunds of about 7.2 million American taxpayers in 2009 at a total cost of \$606 million in loan fees and \$58 million in other fees. This represents a significant decrease from 2008.

Many tax preparers also offer refund anticipation checks (RACs) as an alternative to RALs. When issuing a RAC, a tax preparer opens a temporary bank account, into which the taxpayer’s refund is directly deposited by the IRS. Fees for preparation of the return and the RAC account are then deducted from the taxpayer’s refund and a check is issued to the taxpayer (and the taxpayer may have to pay check-cashing fees). In 2009, about 12.9 million taxpayers received RACs at a total cost of \$387 million, a slight increase from 2008.

The most likely RAL users are also EIC recipients. In 2009, 64% of RAL consumers received the EIC. Between RAL loan fees and add-on fees, the EIC program was drained of \$425 million by RALs.

While regulations have been put in place by both national and state authorities, recent enforcement lawsuits and undercover investigations suggest that the protections have not been adequately implemented.

## RECENT FEDERAL DEVELOPMENTS: AN END TO THE RAL?

In August 2010, the IRS announced that it will no longer provide tax preparers with the “debt indicator,” which tells commercial preparers whether taxpayers will have any of their refund intercepted by the IRS to pay off debts such as back taxes, back child support or unpaid student loans. Three of the main banks providing RALs subsequently discontinued them. In February 2011, the Federal Deposit Insurance Commission (FDIC) notified three remaining RAL-lending banks that the use of RALs without the debt indicator is “unsafe and unsound.” Barring a successful appeal from one of the three RAL-lending banks, this means that there will be no banks left in 2012 that can still issue RALs. In this current tax season, fewer RALs than ever are being issued and now come at a higher cost. Reports indicate that as many as 60 percent of RAL applications are being denied this season. Further, RAL banks have decreased the amount they are willing to loan. While banks previously lent up to \$10,000, enough to cover most refunds, some banks this year now cap RALs at \$1,500. To minimize their loan risk under the new law, tax preparers might now look to a person’s credit rating or their debt indicator status from previous years when deciding whether to issue a RAL to a given person.

It is important to note that while the end may be near for RALs, low-income taxpayers will remain vulnerable at tax-time. Tax preparers might begin to issue more RACs. RACs pose less of a risk to the preparer but are still costly to the taxpayer and preparers may now elect to charge higher fees for them. Further, some businesses are promoting other tax refund products as if they were RALs, such as debit cards, while charging higher fees.

## DEBIT CARD PILOT PROGRAM

In January 2011, the U.S. Treasury Department announced a pilot program which will offer pre-paid debit cards to 600,000 low income families who are likely to not have bank accounts, so that they can have their tax refunds deposited on the card by the IRS quickly and at no charge. This program will provide a much cheaper alternative to RALs. Treasury is testing different card options and promotional messages. About half of the pre-paid cards offered will cost \$4.95 per month and the other half will be free. There will be no fees to use the card at stores or to make withdrawals in the card’s ATM network. The National Consumer Law Center recommends that those who receive this offer from the IRS accept it rather than pay for RALs or RACs. After evaluation of the pilot, the Treasury Department intends to offer a debit card to the general public for tax refund purposes.

## FEDERAL REGULATIONS

IRS regulations require commercial tax preparers to:

- **Disclose** the loan fees and interest rates for the RAL;
- **Tell** people that they can file their return electronically without applying for the RAL, how much electronic filing costs, and about how long it will take to get the refund;
- **Charge the same fee** for basic electronic filing regardless of whether a customer also pays for the RAL and without regard to the amount of the refund; and
- **Inform** people that they will be financially responsible for the loan if the IRS delays the refund, reduces the refund amount, or denies the refund completely.
- **Obtain identification numbers** from the IRS to file returns electronically. The IRS can revoke this number if RAL regulations, designed to give more protection to taxpayers, are violated.

## STATE REGULATIONS

Some state laws require more stringent standards for RALs than federal regulations. For example, many states prohibit tax preparers from charging add-on fees only to RAL and RAC customers and regulate the types of businesses permitted to offer RALs. Until recently, some states also capped RAL interest rates, which frequently exceed 100 percent APR.

The National Consumer Law Center reports that states have enforced RAL regulations through the legal system. In 2008, the California and New Jersey Attorneys General both settled lawsuits against tax preparers for deceptive advertising in promotion of RALs. The New York State Division of Human Rights also sued tax preparers for discriminatory targeting of minorities for RALs. In 2010, Maryland, Colorado, and Louisiana all enacted RAL legislation. Maryland's new law bans most add-on fees. Colorado and Louisiana's laws increase disclosure standards for RAL applications.



### **Find It On the Web**

**National Consumer Law Center's publications:**

[www.nclc.org/issues/refund-anticipation-loans.html](http://www.nclc.org/issues/refund-anticipation-loans.html)

**Consumer Federation of America's publications:**

[www.consumerfed.org/financial-services/credit-and-debt/refund-anticipation-loanstax-prep](http://www.consumerfed.org/financial-services/credit-and-debt/refund-anticipation-loanstax-prep)

**IRS Questions & Answers about disclosure of taxpayer information for RALs:**

[www.irs.gov/newsroom/article/0,,id=177100,00.html](http://www.irs.gov/newsroom/article/0,,id=177100,00.html)

**National Community Tax Coalition's debt indicator fact sheet:**

[www.eitcoutreach.org/wp-content/uploads/2010/12/Debt-Indicator-Fact-Sheet-20111.pdf](http://www.eitcoutreach.org/wp-content/uploads/2010/12/Debt-Indicator-Fact-Sheet-20111.pdf)

**U.S. Treasury Department debit card news release:**

[www.treasury.gov/press-center/press-releases/Pages/tg1021.aspx](http://www.treasury.gov/press-center/press-releases/Pages/tg1021.aspx)