



IRS Announces New Policy Affecting Refund Anticipation Loans

The Internal Revenue Service recently announced that starting with the 2011 tax filing season it will no longer provide tax preparers and financial institutions with the “debt indicator” on electronically filed tax returns, which is used to facilitate Refund Anticipation Loans (RALs). IRS Commissioner Doug Shulman stated that “as we prepare for tax season every year, we look at past practices and consider whether they still make sense. We no longer see a need for the debt indicator in a world where we can process a tax return and deliver a refund in 10 days. We encourage taxpayers to use e-file with direct deposit so they can get their refunds in just a few days.” Currently, 70 percent of all tax returns are e-filed; over 80 percent of Earned Income Tax Credit claims are e-filed.

What is the Debt Indicator? The debt indicator appeared after a tax preparer e-filed a tax return. It was simply an information message that informed the preparer whether the taxpayer owes any federal debt that would cause the refund to be less than expected. Federal debt can arise from back taxes owed, unpaid child support or other payments that are due to the federal government. The IRS’ expectation in providing the debt indicator was that it would be a public service to taxpayers.

How have Paid Preparers Used the Debt Indicator? Tax preparers used the debt indicator to determine a taxpayer’s ability to pay back a Refund Anticipation Loan (RAL). A RAL is a short term loan against a taxpayer’s IRS refund that can be quickly issued within 24 to 72 hours. Without a RAL, obtaining a refund using direct deposit can take 5-10 business days, or several weeks if a paper check is mailed. Since a tax refund is a government payment, a clean debt indicator nearly guarantees the loan will be repaid to the preparer. In February 2011, the National Consumer Law Center reported that consumers paid \$606 million in fees to obtain RALs in 2009. This figure includes only fees, not interest accrued on the loans. Though RALs are short term loans, NCLC reports the annual percentage rate can reach triple digits. RAL fees, on top of fees to prepare and file the tax return, can drain hundreds of dollars away from tax benefits earned by lower-income tax filers.

How Will the IRS Decision to Eliminate Access to the Debt Indicator Impact the RAL Industry? It is still unknown what the short-term and long-term impact of this decision will be on the RAL industry. However, smaller tax preparers are likely to think twice about offering RALs during the 2012 tax season. On the other hand, some of the bigger tax preparation companies may look for alternative ways to offer RALs while raising the cost. These larger companies may rely on a returning customer’s debt indicator from prior years or on a taxpayer’s credit score. Either way, it is becoming more difficult and more risky for these companies to offer refund anticipation products. Even before the IRS announced the elimination of the debt indicator, many banks who had previously provided RAL loans decided to get out of the risky RAL business.

How Should VITA Programs Educate Taxpayers About This Change? We continue to move closer to an environment where RALs are no longer necessary. The IRS has made significant changes over the last few years to make it easier and faster for taxpayers to receive their refund. In addition to offering free return preparation and e-filing services, many more VITA programs partner with financial institutions to enable filers to open accounts to take advantage of direct deposit or to obtain a stored value card on which to deposit a refund. EITC outreach efforts should weave in the messages about these free services at community VITA sites. See *Consumer Protections* for more information about taxpayer outreach and education about RALs at www.tax-coalition.org or visit CBPP’s Tax Credit Outreach site, www.eitcoutreach.org.

