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Date: June 3, 2009
To: Members of the Assembly Committee on Financial Institutions
From: John Keckhaver, Wisconsin Council on Children and Families
Re: AB 265, Disclosure Requirements of Refund Anticipation Loan Providers

The Wisconsin Council on Children and Families supports passage of AB 265 – enhanced disclosure requirements on those providing Refund Anticipation Loans (RALs). RALs are an unnecessary drain on the pocketbooks of low-income consumers throughout Wisconsin, they appear to increase the incidence of tax fraud, and they have brought unqualified vendors into the tax preparation field.

Targeted at the Working Poor

The marketing and offering of RALs are clearly targeted to low-income communities. In 2007, 85 percent of taxpayers who applied for an RAL earned \$38,348 or less according to the IRS. In low-income communities there are higher concentrations of residents who are eligible for the Earned Income Tax Credit, and who are likely to receive a refund. Low-income workers are also less likely to have a bank or credit union account, making the RAL “dummy account” set up for the purposes of receiving the refund more attractive.

In Wisconsin, 64 percent of RAL consumers were EITC recipients. Put another way, 18.4 percent of EITC recipients received their refund through an RAL compared with only 3.3 percent of all tax filers.

High Costs to the Consumer

The costs of RALs are high, though there appears to now be more variation in pricing from preparer to preparer. There are a number of fees to consider when calculating the fee to the consumer for an RAL, including the loan fee, tax preparation fee, and any other add on fees which many of the preparers charge, referred to by many different names, “application,” “administrative,” “e-filing,” “service bureau”, “transmission,” or “processing” fees.

As an example, though, a typical RAL is for \$3,000. At H&R Block, the RAL loan fee was about \$62 for this size of a refund in 2009. If tax preparation is included, costs can be anywhere from \$150 to \$250. This does not include any add-on fees. The National Consumer Law Center and Consumer Federation of America use an average cost of \$250 for RAL consumers.

At an average of \$250, Wisconsin’s 89,523 RAL consumers paid out over \$22.3 million to receive their refunds anywhere from a few days to a couple of weeks earlier than they otherwise would. For EITC recipients in Wisconsin, \$14.3 million was drained from their refunds due to RAL usage.

Further Problems with RALs

There is little doubt that the marketing and offering of RALs are targeted at the working poor. There is also little debate about the high cost of RALs and the particular impact those costs are having on the pocketbooks of EITC recipients (and the dilution of that significant anti-poverty effort). But an important point to make is that the decision to take out an RAL is often not made on a level playing field. Extensive evidence indicates a variety of abusive lending practices taking place surrounding the offering of RALs.

A number of state regulators have taken significant enforcement action against a number of RAL providers. For example, the California Attorney General settled a lawsuit against H&R Block in which they agreed to pay \$4.9 million in refunds and penalties. In New Jersey, the Attorney General sued 38 paid tax preparers for deceptive advertising of RALs, and the New York State Division of Human Rights is continuing a series of lawsuits claiming discriminatory targeting by tax preparers of offering RALs. There is a long list of tax fraud cases involving RALs compiled by the National Consumer Law Center and the Consumer Federation of America as well that we can point you to.

The Internal Revenue Service, in 2008 opened up a comment period for potential rules to more tightly regulate RALs, and specifically asked the question of whether RALs were providing incentive to inflate refund claims in order to receive a larger fee. The IRS received a great deal of evidence suggesting that tighter regulation of RALs should occur, as well as thousands of emails opposing that proposal. The IRS then conducted its own study and found that RAL users were 27 to 36 percent more noncompliant than taxpayers who do not use a bank product. They concluded that this does not necessarily mean that tax fraud has occurred.

Research has also shown that the promise of RAL-based revenue has lured unqualified tax preparers into the tax preparation market, including at payday loan stores, check cashers, used car dealerships, and others.

Conclusion

Meaningful disclosure of financial terms and conditions should be a pre-requisite in all dealings with financial institutions. Strong RAL protections will benefit not only consumers around the state, and particular those in some of our poorest communities, but it will help ensure the effectiveness of the EITC, arguably the most effective anti-poverty effort ever implemented.

We feel this bill will enhance the state's current disclosure requirements in a number of positive ways and we urge you to support it.

There may be additional ways of ensuring that low-income consumers are not subject to predatory lending practices within the RAL market. For instance:

- Regulations in other states include provisions that RAL facilitators be primarily involved in tax preparation or financial services and be authorized as an e-file provider with the IRS. Such a provision in Wisconsin may help deal with some of the issues related to the growth of fringe preparers offering RALs.
- While state regulation can not limit the loan fees charged by the banks due to federal preemption, they can regulate and even prohibit the "add-on" fees – part of the process that appears particularly fraught with lending abuses.