



Dora
Department of Regulatory Agencies

Office of Policy, Research and Regulatory Reform

**2010 Sunrise Review:
Refund Anticipation Loan
Facilitators**

February 11, 2010





Executive Director's Office

Barbara J. Kelley
Executive Director

Bill Ritter, Jr.
Governor

February 11, 2010

Members of the Colorado General Assembly
c/o the Office of Legislative Legal Services
State Capitol Building
Denver, Colorado 80203

Dear Members of the General Assembly:

The mission of the Department of Regulatory Agencies (DORA) is consumer protection. As a part of the Executive Director's Office within DORA, the Office of Policy, Research and Regulatory Reform seeks to fulfill its statutorily mandated responsibility to conduct sunrise reviews with a focus on protecting the health, safety and welfare of all Coloradans.

DORA has completed its evaluation of the sunrise application for regulation of refund anticipation loan facilitators and is pleased to submit this written report. The report is submitted pursuant to section 24-34-104.1, Colorado Revised Statutes, which provides that DORA shall conduct an analysis and evaluation of proposed regulation to determine whether the public needs, and would benefit from, the regulation.

The report discusses the question of whether there is a need for regulation in order to protect the public from potential harm, whether regulation would serve to mitigate the potential harm, and whether the public can be adequately protected by other means in a more cost-effective manner.

Sincerely,

Barbara J. Kelley
Executive Director

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Background

Consistent, flexible, and fair regulatory oversight assures consumers, professionals and businesses an equitable playing field. All Coloradans share a long-term, common interest in a fair marketplace where consumers are protected. Regulation, if done appropriately, should protect consumers. If consumers are not better protected and competition is hindered, then regulation may not be the answer.

As regulatory programs relate to individual professionals, such programs typically entail the establishment of minimum standards for initial entry and continued participation in a given profession or occupation. This serves to protect the public from incompetent practitioners. Similarly, such programs provide a vehicle for limiting or removing from practice those practitioners deemed to have harmed the public.

From a practitioner perspective, regulation can lead to increased prestige and higher income. Accordingly, regulatory programs are often championed by those who will be the subject of regulation.

On the other hand, by erecting barriers to entry into a given profession or occupation, even when justified, regulation can serve to restrict the supply of practitioners. This not only limits consumer choice, but can also lead to an increase in the cost of services.

There are also several levels of regulation.

Licensure

Licensure is the most restrictive form of regulation, yet it provides the greatest level of public protection. Licensing programs typically involve the completion of a prescribed educational program (usually college level or higher) and the passage of an examination that is designed to measure a minimal level of competency. These types of programs usually entail title protection – only those individuals who are properly licensed may use a particular title(s) – and practice exclusivity – only those individuals who are properly licensed may engage in the particular practice. While these requirements can be viewed as barriers to entry, they also afford the highest level of consumer protection in that they ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Certification

Certification programs offer a level of consumer protection similar to licensing programs, but the barriers to entry are generally lower. The required educational program may be more vocational in nature, but the required examination should still measure a minimal level of competency. Additionally, certification programs typically involve a non-governmental entity that establishes the training requirements and owns and administers the examination. State certification is made conditional upon the individual practitioner obtaining and maintaining the relevant private credential. These types of programs also usually entail title protection and practice exclusivity.

While the aforementioned requirements can still be viewed as barriers to entry, they afford a level of consumer protection that is lower than a licensing program. They ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Registration

Registration programs can serve to protect the public with minimal barriers to entry. A typical registration program involves an individual satisfying certain prescribed requirements – typically non-practice related items, such as insurance or the use of a disclosure form – and the state, in turn, placing that individual on the pertinent registry. These types of programs can entail title protection and practice exclusivity. Since the barriers to entry in registration programs are relatively low, registration programs are generally best suited to those professions and occupations where the risk of public harm is relatively low, but nevertheless present. In short, registration programs serve to notify the state of which individuals are engaging in the relevant practice and to notify the public of those who may practice by the title(s) used.

Title Protection

Finally, title protection programs represent one of the lowest levels of regulation. Only those who satisfy certain prescribed requirements may use the relevant prescribed title(s). Practitioners need not register or otherwise notify the state that they are engaging in the relevant practice, and practice exclusivity does not attach. In other words, anyone may engage in the particular practice, but only those who satisfy the prescribed requirements may use the enumerated title(s). This serves to indirectly ensure a minimal level of competency – depending upon the prescribed preconditions for use of the protected title(s) – and the public is alerted to the qualifications of those who may use the particular title(s).

Licensing, certification and registration programs also typically involve some kind of mechanism for removing individuals from practice when such individuals engage in enumerated proscribed activities. This is generally not the case with title protection programs.

Regulation of Businesses

Regulatory programs involving businesses are typically in place to enhance public safety, as with a salon or pharmacy. These programs also help to ensure financial solvency and reliability of continued service for consumers, such as with a public utility, a bank or an insurance company.

Activities can involve auditing of certain capital, bookkeeping and other recordkeeping requirements, such as filing quarterly financial statements with the regulator. Other programs may require onsite examinations of financial records, safety features or service records.

Although these programs are intended to enhance public protection and reliability of service for consumers, costs of compliance are a factor. These administrative costs, if too burdensome, may be passed on to consumers.

Sunrise Process

Colorado law, section 24-34-104.1, Colorado Revised Statutes (C.R.S.), requires that individuals or groups proposing legislation to regulate any occupation or profession first submit information to the Department of Regulatory Agencies (DORA) for the purposes of a sunrise review. The intent of the law is to impose regulation on occupations and professions only when it is necessary to protect the public health, safety or welfare. DORA must prepare a report evaluating the justification for regulation based upon the criteria contained in the sunrise statute:¹

- (I) Whether the unregulated practice of the occupation or profession clearly harms or endangers the health, safety, or welfare of the public, and whether the potential for the harm is easily recognizable and not remote or dependent upon tenuous argument;
- (II) Whether the public needs, and can reasonably be expected to benefit from, an assurance of initial and continuing professional or occupational competence; and
- (III) Whether the public can be adequately protected by other means in a more cost-effective manner.

Any professional or occupational group or organization, any individual, or any other interested party may submit an application for the regulation of an unregulated occupation or profession. Applications must be accompanied by supporting signatures and must include a description of the proposed regulation and justification for such regulation.

Methodology

DORA has completed its evaluation of the proposal for regulation of refund anticipation loan (RAL) facilitators. During the sunrise review process, DORA performed a literature search, contacted and interviewed the applicant, reviewed licensure laws in other states, interviewed various stakeholders, including, but not limited to the Public Accountants Society of Colorado, Rent-A-Center, Inc. and the Colorado Society of Certified Public Accountants. In order to determine the number and types of complaints filed against RAL facilitators in Colorado, DORA contacted representatives of the Attorney General's Office with responsibility for administering the Uniform Consumer Credit Code and Collection Agency Board.

¹ § 24-34-104.1(4)(b), C.R.S.

Profile of the Profession

According to the Bell Policy Center, a refund anticipation loan (RAL) facilitator is,

a person who receives or accepts for delivery an application for a refund application loan, delivers a check in payment of refund anticipation loan proceeds, or in any other manner acts to allow the making of a refund anticipation loan. A refund anticipation loan facilitator does not include a bank, thrift, savings association, industrial bank, or credit union, an affiliate that is a servicer for such an entity, or any person who acts solely as an intermediary and does not deal with a taxpayer in the making of the refund anticipation loan.

To grasp the scope of the profession, one must understand the RAL industry, how, and to whom the RALs are made.

RALs are short-term bank loans, based on anticipated income tax refunds. The loans are subject to federal Truth in Lending Act (TLA) disclosures by the lender. TLA-mandated disclosures must include finance charges including: interest; service, transaction, activity, and carry fees; loan fees; and any additional fees resulting from a consumer obtaining an RAL. Finance charges may not include application fees or late charges.²

Prior to loan acquisition, a clear, conspicuous, written declaration must be provided for a borrower to retain, which itemizes the following:³

- The amount borrowed minus prepaid charges;
- The finance charges or the cost of the credit;
- The cost of the credit as a yearly rate or annual percentage rate (APR); and
- The total of payments, or the sum paid after making all payments.

² Letter dated June 5, 2008, from the U.S. Government Accountability Office to the Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives, p.4. Retrieved December 2, 2009, from <http://www.gao.gov/new.items/d08800r.pdf>

³ Letter dated June 5, 2008, from the U.S. Government Accountability Office to the Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives, p.4. Retrieved December 2, 2009, from <http://www.gao.gov/new.items/d08800r.pdf>

In 2007, there were an estimated 8.7 million RALs provided nationwide, approximately one for every 15 tax returns.⁴ Most national tax preparation chains assist clients in applying for an RAL and give them proceeds quickly. An executive with one of the largest RAL lenders describes the loan, “like opting for overnight shipping for faster delivery and being willing to pay more for quicker service.”⁵

Typically, a person goes into a tax preparer’s office, has his or her tax return prepared, and, because the loan information is already contained in the tax return, the preparer electronically submits both the tax return to the U.S. Internal Revenue Service (IRS) and the RAL application to a lending institution simultaneously. By acting in this fashion, the tax preparer is *facilitating* procurement of the RAL. For providing this extra service, the client pays an application fee in addition to the tax preparation fee. The bank providing the loan also pays the facilitator, or the facilitator’s employer, a fee or *incentive*.

The bank incentives the RAL facilitators receive can range from a flat per-loan fee, to actual participation and performance shares in the loans.⁶

There is more than one RAL product available to consumers. One national preparer offers a Federal Refund Anticipation Check, for people who need the money within 8-15 days; a Classic RAL, which may fund the same day as the application or up to two days after the application is submitted and it requires no out-of-pocket preparation fees; an Instant RAL, which funds within minutes and requires no out-of-pocket preparation fees; and a State Refund Anticipation Check.⁷

There are also “pay stub” and “holiday” RALs. These are made by banks prior to the tax filing season and before a taxpayer receives an actual IRS Form W-2. These RALs are based on an estimated tax refund calculated from a consumer’s most recent pay stub. Repayment is expected from tax refund proceeds and not from current income.⁸

⁴ *Consumers Urged to Keep More of Their Tax Refunds by Avoiding Quickie Loans*, Consumer Federation of America and the National Consumer Law Center, January 21, 2009.

⁵ CreditCards.com. *Don’t take the refund anticipation loan bait*. Retrieved December 9, 2009 from <http://www.creditcards.com/credit-card-news/refund-anticipation-loans-1264.php>

⁶ Comments of the National Consumer Law Center (on behalf of its low-income clients), Consumer Federation of America and Consumer Action, Consumer Union, U.S. Public Interest Research Group regarding Advance Notice of Proposed Rulemaking Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products in Connection With the Preparation of a Tax Return, p. 22.

⁷ H&R Block, *Get Money Quickly and Conveniently*. Retrieved December 9, 2009 from, http://www.hrblock.com/taxes/products/office/refund_settlement_options.html?wwparam=1260554663

⁸ Letter dated December 18, 2006, from the National Consumer Law Center, Consumer Federation of America, AARP, California Reinvestment Coalition, Community Reinvestment Ass’n of NC, Consumer Action, Consumers Union, National Association of Consumer Advocates, Neighborhood Economic Development Advocacy Project, U.S. Public Research Interest Group, and Woodstock Institute to John C. Dugan, Comptroller of the Currency, p. 1.

Not all of the companies that offer RALs have tax preparation as a primary business. Some facilitators are in retail merchandise outlets such as stores and automobile dealerships or retail financial services centers. A 2008 U.S. Government Accountability Office (GAO) investigation showed that nearly one-third (32.5 percent) of the tax preparer RAL facilitators were located in businesses that target low-income customers including:⁹

- Auto Dealership - One offered free tax preparation with car purchase;
- Payday Loan and Check Cashing Outlets – One offered a discounted check cashing fee;
- Discount Shoe Store – Offered free pair of shoes with tax preparation;
- Pawn Shops – One offered an in-store gift certificate; and
- Rent-to-Own Stores.

IRS data point out that a majority of the people who obtained RALs are classified as low-income taxpayers. The National Taxpayer Advocate sets down multiple reasons taxpayers procure RALs, among them are the need for immediate cash, lack of information about the product or alternatives, and an inability to pay preparation and filing fees out-of-pocket.¹⁰

While the major tax preparation chains typically refrain from doing so, the independent preparers, located in temporary sites and retail outlets, sometimes charge additional fees for transmission, administration, filing, and service bureau¹¹ among other loan related services. When considering all of the fees as an APR, because the life of the loans is typically only 10 days, it is quite high, sometimes as much as 500 percent.¹² Because of the short term, high APR, and target clientele, RALs are sometimes compared to payday loans.¹³

⁹ Letter dated June 5, 2008, from the U.S. Government Accountability Office to the Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives, pp.5-6. Retrieved December 2, 2009, from <http://www.gao.gov/new.items/d08800r.pdf>

¹⁰ Letter dated June 5, 2008, from the U.S. Government Accountability Office to the Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives, pp.3-4. Retrieved December 2, 2009, from <http://www.gao.gov/new.items/d08800r.pdf>

¹¹ Service bureaus are organizations contracted by lending institutions to provide financial services for their loans. Source: *FHA Connection Guide, Service Bureau Administration*. Retrieved January 7, 2010 from https://entp.hud.gov/pdf/mp_gs5_srvcbur.pdf

¹² National Consumer Law Center, *Model Refund Anticipation Loan Act* (December 2008), pp.1-2.

¹³ Letter dated December 18, 2006, from the National Consumer Law Center, Consumer Federation of America, AARP, California Reinvestment Coalition, Community Reinvestment Ass'n of NC, Consumer Action, Consumers Union, National Association of Consumer Advocates, Neighborhood Economic Development Advocacy Project, U.S. Public Research Interest Group, and Woodstock Institute to John C. Dugan, Comptroller of the Currency, pp.2-3.

Proposal for Regulation

The Bell Policy Center (Applicant) submitted a sunrise application to the Department of Regulatory Agencies (DORA) for review in accordance with the provisions of section 24-34-104.1, Colorado Revised Statutes. The application identifies licensure as the appropriate level of regulation to protect the public.

According to the sunrise application, licensing may help limit instances of fraud, protect consumers, and improve the accuracy of tax returns by eliminating unqualified practitioners. The Applicant specifically presents several premises for regulation:

- Taxpayers are ultimately liable for the accuracy of their tax return and fraudulently prepared returns may subject an unsuspecting citizen to liabilities.
- If not detected, the state loses money from excessive refunds if tax returns are inaccurate.
- Facilitators do not always inform taxpayers they are purchasing a loan.
- Some taxpayers are not given an option to have their taxes done without purchasing a loan.
- Taxpayers pay additional fees for faster refunds but the service is not faster than filing ones return personally.

Summary of Current Regulation

The Colorado Regulatory Environment

Colorado does not license, certify or register facilitators of refund anticipation loans (RALs), and there is no federal law requiring facilitators to be licensed, certified, or registered. However, many RAL facilitators submit tax returns to the U.S. Internal Revenue Service (IRS) electronically, and in order to provide such e-filing services, facilitators must register with the IRS as electronic return originators (EROs) and adhere to IRS guidelines regarding RALs.

In order to qualify for an ERO registration, an applicant must designate a responsible official to oversee the e-filing operation, to serve as a first point of contact with the IRS, and to assure that the ERO complies with all e-file policies. Each responsible official must demonstrate that he or she is lawfully present in the United States, is at least 21 years of age, and meets any applicable state licensing or bonding requirements for tax preparers.¹⁴ Further, the responsible official, as well as the principal managers of the business or organization, must undergo a suitability check, which may include the following:¹⁵

- A criminal background check;
- A credit history check;
- A tax compliance check to ensure that all required returns are filed and paid, and to identify assessed penalties; and
- A check for prior non-compliance with IRS e-file requirements.

The suitability check requirement is waived for those who hold specific professional credentials—e.g., licensed attorneys, certified public accountants, and enrolled agents.¹⁶

¹⁴ *Publication 3112, IRS E-File Application and Participation*, Internal Revenue Service, p. 9.

¹⁵ *Publication 3112, IRS E-File Application and Participation*, Internal Revenue Service, p. 11.

¹⁶ An enrolled agent is a federally authorized tax practitioner who is empowered by the U.S. Department of the Treasury to represent taxpayers before all administrative levels of the IRS for audits, collections, and appeals. Source: National Association of Enrolled Agents. *What is an Enrolled Agent?* Retrieved January 7, 2010, from http://www.naea.org/memberportal/Resources/ForTaxpayers/whatis_EA.htm

EROs providing RALs must advise consumers, among other things, that:¹⁷

- By agreeing to an RAL, they will not receive their refund from the IRS as the IRS will send their refund to the financial institution;
- RALs are interest-bearing loans and not a quicker way of receiving their refunds from the IRS;
- If the proceeds of the refund are not deposited within the expected time frame, the taxpayers may be liable to the lender for additional interest and other fees; and
- All fees associated with the RAL will be deducted from the total refund amount, and consumers will receive the balance of the refund that remains after all fees have been paid.

Further, the IRS forbids EROs from basing their fees on a percentage of the refund amount. An ERO offering an RAL may charge a flat fee for that service. When advertising RAL products, an ERO must clearly identify the RAL as a loan, rather than a refund.¹⁸

RAL facilitators who are registered as EROs are subject to federal oversight, but not all facilitators are so registered. For example, facilitators that contract with a third party to prepare the tax return and process the loan application would not be required to register with the IRS, and would consequently not be subject to IRS guidelines.

There are also numerous state and federal laws that establish protections for consumers who enter into a loan transaction.

The federal Truth in Lending Act (TLA) seeks to promote the informed use of consumer credit by compelling lenders to make specific material disclosures to consumers. The TLA is necessarily broad to cover all types of credit transactions, including credit cards and mortgages, but many of the required disclosures apply to RALs. Specifically, lenders must disclose the amount of the loan; its annual percentage rate; the method of determining any applicable finance charges associated with the loan, and the balance upon which the finance charge will be imposed.¹⁹

¹⁷ *Publication 1345, Handbook for Authorized IRA E-file Providers of Individual Tax Returns*, Internal Revenue Service, p. 46.

¹⁸ *Publication 1345, Handbook for Authorized IRA E-file Providers of Individual Tax Returns*, Internal Revenue Service, p. 47.

¹⁹ 15 U.S.C. § 1602(u).

Regulation Z of the Board of Governors of the Federal Reserve System further requires such disclosures to be made clearly and conspicuously in writing, in a form that the consumer may keep,²⁰ before the consummation of the transaction.²¹ Regulation Z also requires that lenders meet specific requirements when advertising available loan products: namely, the annual percentage rate of the loan and any possible increase in such rate after consummation of the loan, and the terms of repayment of the loan.

Additionally, the RAL process is covered, at least in part, by the Equal Credit Opportunity Act, Fair Credit Reporting Act, Gramm-Leach-Bliley Act, National Bank Act, and the USA Patriot Act.²²

The Colorado Uniform Consumer Credit Code mirrors the TLA, requiring identical material disclosures for consumer credit transactions.²³

Regulation in Other States

According to the Applicant, 14 states have laws that regulate RALs.

All 14 states—California, Connecticut, Illinois, Minnesota, Nevada, New Jersey, New York, North Carolina, Oregon, Tennessee, Texas, Virginia, Washington, and Wisconsin—have enacted laws requiring RAL facilitators to make certain disclosures when entering into an RAL contract. As a typical example, Washington law requires facilitators to disclose, in writing, to consumers:²⁴

- The refund anticipation loan fee schedule;
- That an RAL is a loan, and is not the borrower's actual income tax refund;
- That the taxpayer can file an income tax return electronically without applying for a refund anticipation loan;
- The average times, according to the IRS, within which a taxpayer who does not obtain an RAL can expect to receive a refund if the taxpayer's return is (A) filed electronically and the refund is directly deposited to the taxpayer's bank account or mailed to the taxpayer, and (B) mailed to the IRS and the refund is directly deposited to the taxpayer's bank account or mailed to the taxpayer;
- That the IRS does not guarantee that it will pay the full amount of the anticipated refund and it does not guarantee a specific date that a refund will be deposited into a taxpayer's financial institution account or mailed to a taxpayer;

²⁰ 12 C.F.R. §226.17(a)(1).

²¹ 12 C.F.R. §226.17(b).

²² Coalition for Taxpayer Financial Choice. *Refund Anticipation Loan (RAL) Basics*. Retrieved December 14, 2009 from http://www.taxpayerfinancialchoice.com/taxpayer_choices/RAL-information.html

²³ § 5-3-101(2), C.R.S.

²⁴ Washington Rev. Code § 19.265.030.

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- That the borrower is responsible for repayment of the loan and related fees in the event that the tax refund is not paid or paid in full;
 - The estimated time within which the loan proceeds will be paid to the borrower if the loan is approved;
 - The fee that will be charged, if any, if the borrower's loan is not approved;
 - The estimated total fees for obtaining the refund anticipation loan; and
 - The estimated annual percentage rate for the borrower's refund anticipation loan, using the guidelines established under the federal TLA.

The required written disclosures vary slightly from state to state. Washington law requires the disclosure to be made in at least 10-point type.²⁵ Both Minnesota²⁶ and New York²⁷ require that disclosures be in at least 14-point type. Tennessee²⁸ and Virginia²⁹ both require facilitators to post, at their place of business, RAL fee schedules in no less than 28-point type. Texas requires that facilitators that advertise or negotiate disclosures in Spanish provide all disclosures in Spanish,³⁰ while New York has additional requirements that disclosures also be made orally in the language primarily used for communication between the tax preparer and the consumer.³¹ Despite these variations, the disclosures are substantially similar from state to state, and largely mirror those that the IRS requires registered EROs to make regarding RALs.

At least 10 of the 14 states have the statutory authority to levy fines against RAL facilitators that fail to meet the disclosure requirements, or that engage in any other unlawful activities. In most cases, states can fine facilitators up to \$500 per violation, but Minnesota³² can fine facilitators up to \$1,000 per violation, and Oregon up to \$5,000 per violation.³³ In North Carolina, a facilitator who violates the RAL law can be held liable to the consumer for damages of three times the amount of the RAL fee, plus reasonable attorney's fees.³⁴

²⁵ Washington Rev. Code § 19.265.030(1)(b).

²⁶ Minnesota Stat. § 270C.445 Subd. 4.

²⁷ New York Gen. Bus. Law § 372(e)(2)(i).

²⁸ Tennessee Code 69-29-202(b) and (c).

²⁹ Virginia Code § 6.1-475(B) and (C).

³⁰ Texas Fin. Code § 352.004 (c).

³¹ New York Gen. Bus. Law § 372 (f)(1).

³² Minnesota Stat. § 270C.445 Subd. 6.

³³ Oregon Rev. Stat. § 673.735(1).

³⁴ North Carolina Gen. Stat. § 53-251(c).

A total of four states have specific licensing or registration requirements in place for RAL facilitators.³⁵

North Carolina requires RAL facilitators to register with the Commissioner of Banks (Commissioner). Banks, savings associations, or credit unions are exempted from the registration requirements.³⁶

To qualify for registration, an applicant must apply on a prescribed form and submit a \$250 fee. The Commissioner will register the applicant upon finding that the responsibility and general fitness of the applicant are such as to command the confidence of the community and to warrant belief that the business of facilitating RALs will be operated within the laws of that state.³⁷ Every year, facilitators must file their fee schedules with the Commissioner. If the Commissioner finds an RAL fee to be unconscionable, facilitators charging such a fee can be held liable to the consumer in an amount three times the amount of the fee, and might have its registration revoked.³⁸

The registration must be renewed yearly,³⁹ and facilitators must also post both their fee schedule⁴⁰ and evidence of their registration⁴¹ at their place of business.

Oregon does not specifically license RAL facilitators. Rather, it licenses tax preparers and consultants. However, since only licensed tax preparers or consultants may facilitate RALs in Oregon,⁴² Oregon does in effect license facilitators.

To qualify for a tax preparer license, an applicant must apply to the State Board of Tax Practitioners and meet the following requirements:⁴³

- Be at least 18 years old;
- Have a high school diploma or equivalent;
- Provide evidence of completion of at least 80 hours of basic personal income tax law, theory and practice at a school training session or educational institution approved by the board; and
- Pass an examination demonstrating knowledge of Oregon tax law, theory, and practice.

³⁵ Although California has a tax preparer registration program, and the tax preparer laws include provisions regarding RALs, current law does not require individuals to acquire such registration before facilitating RALs in California.

³⁶ North Carolina Gen. Stat. § 53-247.

³⁷ North Carolina Gen. Stat. § 53-248(a).

³⁸ North Carolina Gen. Stat. § 53-249 (a) and (b).

³⁹ North Carolina Gen. Stat. § 53-248 (b).

⁴⁰ North Carolina Gen. Stat. § 53-249 (c).

⁴¹ North Carolina Gen. Stat. § 53-248 (c).

⁴² Oregon Rev. Stat. § 673.615(3).

⁴³ Oregon Rev. Stat. § 673.625(1).

To qualify for a tax consultant license, applicants must meet all of the above requirements, as well as accrue additional work experience and pass a more rigorous examination.

Texas requires RAL facilitators to register with the Office of Consumer Credit Commissioner (Credit Commissioner). Facilitators must also be engaged in the business of preparing tax returns, be primarily involved in financial services or tax preparations, and be authorized by the IRS as an e-file provider (e.g., as an ERO).⁴⁴ Banks, savings associations, credit unions, and industrial banks are exempt from the registration requirement, as are individuals who act solely as intermediaries and do not interact directly with taxpayers in the making of the RAL.⁴⁵

When applying for the registration, an applicant must provide to the Credit Commissioner a list of all the locations at which IRS-authorized e-file providers file tax returns on behalf of consumers for whom the facilitators make the RALs and pay a processing fee for each such location.⁴⁶

The Credit Commissioner may revoke the registrations of facilitators who violate the RAL laws.⁴⁷

Washington requires RAL facilitators to register with the Department of Financial Institutions (Department). Facilitators must also be engaged in the primary business of preparing tax returns and be authorized by the IRS as an e-file provider (e.g., an ERO).⁴⁸ Banks, savings associations, or credit unions are exempted from the registration requirement, as are individuals who act solely as intermediaries and do not interact directly with taxpayers in the making of the RAL.⁴⁹

To register as a facilitator, an applicant must submit to the Department, on or before December 31st of each year, a list of its IRS-authorized e-file providers in the state of Washington, and pay a \$35 processing fee for each such provider.⁵⁰

⁴⁴ Texas Fin. Code § 352.002.

⁴⁵ Texas Fin. Code § 352.002(b).

⁴⁶ Texas Fin. Code § 352.003(a).

⁴⁷ Texas Fin. Code § 352.006(a).

⁴⁸ Washington Rev. Code § 19.265.020(1).

⁴⁹ Washington Rev. Code § 19.252.010(4).

⁵⁰ Washington Rev. Code § 19.265.020(2).

Analysis and Recommendations

Public Harm

The first sunrise criterion asks:

Whether the unregulated practice of the occupation or profession clearly harms or endangers the health, safety or welfare of the public, and whether the potential for harm is easily recognizable and not remote or dependent on tenuous argument.

Before moving forward in the analysis of harm, it is important to identify what constitutes harm to consumers. Improper actions and the failure to disclose the principal terms of a transaction concerning refund anticipation loan (RAL) facilitators could result in financial harm to consumers. Additionally, consumers could be harmed financially if their taxes are prepared incorrectly and they receive an RAL based on the incorrect refund amount, thereby requiring re-payment of a loan which is more than the actual tax refund.

While the Bell Policy Center (Applicant) did not provide specific examples of harm, the sunrise application did delineate instances where consumers could potentially incur harm. For example, the sunrise application states that there are instances where taxpayers (consumers) are not informed by the RAL facilitator that along with a fee for preparing the tax return, they are also purchasing a loan with high fees. The contention is, taxpayers are harmed financially because they are not fully informed of the costs associated with the RAL nor are they given the option to decline purchasing a loan.

The sunrise application further states that the U.S. Internal Revenue Service (IRS) found that the marketing and sale of RALs in the tax preparation process significantly increased the likelihood of fraudulently prepared tax returns.

More specifically, the sunrise application states that in 2004, the IRS reported that 80 percent of fraudulently prepared tax returns were connected to RALs, and in 2005, 75 percent of fraudulently prepared tax returns were connected to RALs. The information is not accurate. The Applicant's information was obtained from a Consumer Federation of America document, which states,

The RAL contribution to tax fraud is no secret to the IRS. In 2004, then Director of the IRS Criminal Investigation Division's Refund Crimes Unit reported that 80 percent of fraudulent e-filed returns were tied to a RAL or other refund financial product. In 2005, the Chief of the Criminal Investigations Division told Congress that 75 percent of tax returns identified as questionable and/or fraudulent were associated with a RAL.⁵¹

⁵¹ Consumer Federation of America. *IRS Commissioner's Return Preparer Review Forum*. Retrieved December 2, 2009, from

Although the Department of Regulatory Agencies (DORA) was unable to locate the original IRS document to conduct an analysis of the aggregate data, the documentation provided highlights two instances where consumers may be susceptible to financial harm through the utilization of an RAL. The first claim is that in 2004, 80 percent of fraudulent e-filed returns were tied to RALs or other financial products, which represents a significant number of fraudulent e-filed returns.

The second claim is, in 2005, 75 percent of tax returns identified as questionable and/or fraudulent were associated with RALs. This assertion could be significant in determining harm caused by RALs. However, it is unknown how many, in either real numbers or a percentage, returns nationwide were questionable or fraudulent.

Therefore, although there are limitations to the data (as an example, it is not possible to determine the actual number of fraudulent returns attributable to RALs) this data does lead to the reasonable conclusion that the potential for harm is significant.

Further research conducted by DORA to identify additional instances of consumer harm by RAL facilitators, included contact with the Colorado Attorney General's Office (AGO). Specifically, DORA staff interviewed the AGO's administrator of the Uniform Consumer Credit Code (UCCC).

The AGO administrator stated that complaint intake staff did not recall receiving any complaints concerning RAL facilitators in the past five years.

DORA staff also interviewed representatives of the National Consumer Law Center. That organization did provide examples of documented harm to consumers. The examples provided are located in Appendix A on page 22.

Among the examples, the National Consumer Law Center reported the results of a "mystery shopper" study in 2008, where nonprofit groups conducted 17 tests of paid tax preparers to identify issues associated with RAL facilitators. The study focused on two states: Pennsylvania, which does not regulate RAL facilitators, and North Carolina, which regulates RAL facilitators.

The major findings in the "mystery shopper" study were as follows:⁵²

- Paid tax preparers were not informing taxpayers that the RAL was a loan;
- Paid tax preparers did not give clear price information about RALs, other bank options and fees; and
- Paid tax preparers provided poor tax preparation service, including errors that significantly affected tax liability.

http://www.consumerfed.org/elements/www.consumerfed.org/file/CFA_and_NCLC_comments_on_RALs_to_IRS_8-12-09.pdf

⁵² National Consumer Law Center. *Tax Preparers Take A Bite Out of Refunds*. Retrieved December 30, 2009, from http://www.consumerlaw.org/issues/refund_anticipation/content/shopper_report.pdf

Finally, DORA staff analyzed a 2008 U.S. Government Accountability Office report to the Subcommittee on Oversight, Committee on Ways and Means in the United States House of Representatives, concerning RALs in several states: Alabama, Kentucky, Maryland, Mississippi, Missouri, New Hampshire, North Carolina and Virginia. The concerns focused on the fact that these products are marketed to, for the most part, economically disadvantaged consumers. For example, the report highlighted a rent-to-own store that advertised that it “will put money in your hands in as little as four hours!”⁵³ The report further stated that getting taxes done at the rent-to-own store would increase a consumer’s buying power to purchase merchandise within the store.⁵⁴

The absence of Colorado complaints related to RAL facilitators weakens the argument that state regulation is necessary to protect Colorado citizens. However, analysis of national data reveal that the potential for harm is real.

Need for Regulation

The second sunrise criterion asks:

Whether the public needs and can reasonably be expected to benefit from an assurance of initial and continuing professional or occupational competence.

This criterion asks whether the state should require education and/or impose an examination requirement for licensure.

According to the information provided to DORA for this sunrise review, evidence was not provided highlighting that RAL facilitators do not possess adequate skills, education, or competence to provide RALs to consumers. Moreover, this review uncovered no other evidence of consumer harm from a lack of facilitator education.

Rather, the examples of harm discovered during this review involve issues related to disclosures to consumers, i.e., explaining that RALs are loans, or concerns over fees and annual percentage rates (APR).

The absence of issues related to competency calls into question the need to require RAL facilitators to acquire education and/or pass an examination prior to providing services. Without the need for education or examination, the call for special licensure is, at best, dubious.

⁵³ Letter dated June 5, 2008, from the U.S. Government Accountability Office to the Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives. Retrieved December 2, 2009, from <http://www.gao.gov/new.items/d08800r.pdf>

⁵⁴ Letter dated June 5, 2008, from the U.S. Government Accountability Office to the Subcommittee on Oversight, Committee on Ways and Means, U. S. House of Representatives. Retrieved December 2, 2009, from <http://www.gao.gov/new.items/d08800r.pdf>

Alternatives to Regulation

The third sunrise criterion asks:

Whether the public can be adequately protected by other means in a more cost-effective manner.

Consumer protection could potentially be realized in a more cost-effective manner in a variety of ways. First, utilizing the National Consumer Law Center's model RAL Act (Act) could offer protection to consumers. The Act requires a variety of safeguards, including, but not limited to:

- Registering RAL facilitators;
- Implementing a bond requirement; and
- Providing additional disclosure requirements concerning RALs.

According to provisions outlined in the Act, all RAL facilitators would be required to register with the state agency assigned to provide oversight. One of the main qualifications for registration is that the registrant's primary business must be the preparation of taxes. In other words, the Act precludes businesses such as rent-to-own stores from obtaining a registration in order to facilitate an RAL.

The Act also requires each registered RAL facilitator to post a \$50,000-bond, which must continue in effect for five years after the RAL facilitator ceases providing RALs to consumers. The bond must be available to pay damages and penalties to consumers harmed by any violation of the Act.⁵⁵

A bond is not required for the following:⁵⁶

- A bank, thrift, savings association or credit union;
- A licensed certified public accountant;
- A licensed attorney; or
- A volunteer with or employee of a nonprofit organization that provides free tax preparation services to low and moderate income taxpayers, such as a Volunteer Income Tax Assistance program.

⁵⁵ *Model Refund Anticipation Loan Act*, National Consumer Law Center (December 2008), p. 11.

⁵⁶ *Model Refund Anticipation Loan Act*, National Consumer Law Center (December 2008), p. 11.

Although the TLA contains many disclosure requirements, the model Act requires additional RAL-facilitator-specific disclosure requirements. For example, the Act requires an RAL facilitator to disclose on a form separate from the RAL application, in 14-point type, the following:

- The fee for the RAL; and
- The fee for tax preparation and any other fee charged to the consumer.

Although the model Act appears to provide additional protection to consumers, the limited harm discovered during this sunrise review does not warrant adoption of the model Act. In fact, some of the provisions, such as limiting registration to only registrants whose primary business is tax preparation, could create an unnecessary barrier to entry, given the limited harm caused in Colorado by businesses that do not provide tax preparation as their primary business but offer RALs to their consumers.

Additionally, there was limited evidence discovered during this sunrise review justifying a bond requirement for RAL facilitators. According to the model Act, a bond should be required to pay damages to consumers harmed financially. The lack of harm discovered during this review calls into question the need for a bond requirement.

Consumer protection could also be realized by requiring additional disclosures by RAL facilitators to consumers who choose to utilize RALs. RAL facilitators who do not comply with this requirement would be violating the UCCC, which, among other responsibilities, provides regulatory oversight related to disclosures on credit issues. In other words, the affirmative obligation to comply with the mandatory disclosure requirements could be codified in the UCCC, which could include penalties for violations. The UCCC is enforced by the AGO Consumer Protection Section. Implementing this requirement could provide additional protection to consumers.

Conclusion

RALs are products offered to consumers in a variety of venues, including but not limited to:

- Tax preparation services;
- Rent-to-own stores; and
- Automobile repair shops.

An RAL is a short-term loan that typically is associated with a very high annual percentage rate. Consumers who utilize RALs usually receive their funds in one to two days from the RAL facilitator.

In order to obtain an RAL, a consumer is required to either open a one-time or “dummy” bank account or use an existing bank account. The tax refund proceeds are directly deposited into this account within one to two days, or even on the same day, after the IRS processes the borrower’s tax return. Post deposit, the bank collects its loan payoff.

There are situations where consumers who need quick access to their tax refunds for a variety of reasons utilize RALs, including, but not limited to:

- Unforeseen medical bills;
- Rent or mortgage payments; or
- Automobile repairs.

RALs are an attractive alternative for certain consumers, although the RAL is often not a significantly faster alternative.

In order to provide protection to consumers concerning RALs, there are two federal requirements in place: the Truth in Lending Act (TLA) and the registration of RAL facilitators who utilize e-filing for tax returns. The TLA, the major consumer protection law applicable to lending, mandates that lenders (banks) make several disclosures to borrowers regardless of whether the loan is for the purchase of a home, car, or an RAL.

However, the TLA does not require RAL facilitators, who in essence act as the middleman between the consumer and the lender on an RAL transaction, to comply with the disclosure requirements. Because RAL facilitators are not required to comply with the TLA, consumers could be susceptible to financial harm.

Meanwhile, the IRS mandates disclosures for all electronic return originators (EROs) who facilitate RALs, and as identified through interviews with interested parties and stakeholders, the vast majority of RALs are e-filed. The mandatory disclosures including, but not limited to the following:⁵⁷

- Ensure taxpayers understand that by agreeing to a RAL or other financial product they will not receive their refund from the IRS as the IRS will send their refund to the financial institution;
- Advise taxpayers that RALs are interest bearing loans and not a quicker way of receiving their refunds from the IRS;
- Advise taxpayers that if a direct deposit is not received within the expected time frame for whatever reason, the taxpayers may be liable to the lender for additional interest and other fees, as applicable for the RAL or other financial product;

⁵⁷ Internal Revenue Service, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*. Retrieved December 15, 2009 from <http://www.irs.gov/pub/irs-pdf/p1345.pdf>

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- Advise taxpayers of all fees and other known deductions to be paid from their refund and the remaining amount the taxpayers will actually receive;
 - Secure the taxpayer's written consent to disclose tax information to the lending financial institution in connection with an application; and
 - Adhere to fee restrictions and advertising standards:
 - Fees cannot be based on a percentage of the refund;
 - Fees must be identical for all customers;
 - Fees may not be contingent on the amount of refund or RAL;
 - Facilitators may not use improper or misleading advertising, including time frames;
 - Facilitators must clearly refer to advanced funds as a loan;
 - Advertisements must be in a readable print and be clear that the loan is against anticipated refund; and
 - Advertisements must not imply that facilitator does not need tax forms or that pay stubs or other documentation of earnings is sufficient to file an income tax return.

Failure to act according to the responsibilities required of an ERO (including the discloser of the APR) may incur fines that range from \$50 per incident, for failing to provide a tax return copy to the taxpayer or failing to provide an identification number,⁵⁸ to \$1,000 or 50 percent of the preparer's fee for each claim of understating tax liability.⁵⁹

It is important to note that during this sunset review, DORA was unable to identify situations where either the lenders or RAL facilitators failed to disclose pertinent information to consumers, such as APR, fees, etc.

However, there is a potential hole in the regulatory shield. As previously mentioned, there are disclosures required of lenders and RAL facilitators registered as EROs, but there are no disclosures required of RAL facilitators who do not file the tax returns electronically.

As such, the least restrictive regulation consistent with protecting public health, safety and welfare, since, according to DORA sources, virtually all RALs are e-filed, is to require **all** RAL facilitators in Colorado to be registered EROs with the IRS.

An analysis of RAL facilitator regulation promulgated by the few states that regulate RAL facilitators, highlights that disclosure is the major component of the regulations. The mandated disclosures basically mirror what the IRS requires of EROs. Requiring IRS ERO registration streamlines the same process.

⁵⁸ 26 U.S.C. § 6695

⁵⁹ 26 U.S.C. § 6694

In addition to the IRS ERO disclosure requirements, there are certain requirements in the National Consumer Law Center model act that should be required for RAL facilitators in Colorado, including:

- Providing information to consumers informing them that if their tax refund is less than expected, they will be responsible for the entire amount of the RAL;
- Implementing specific requirements related to font size, bold type, etc.;
- Providing oral disclosures regarding an RAL (e.g., loan terms, fees, etc.);
- Providing disclosure statements in English and in the language primarily used for oral communication between the facilitator and the consumer;
- Providing a timeframe in which the proceeds of an RAL will be paid; and
- Displaying the current fee schedule for an RAL at the place of business.

Requiring these disclosure requirements in addition to the IRS ERO disclosure requirements could serve to better inform consumers about RALs, which could assist in protecting consumers.

To further enhance consumer protection, the registration requirement should be accompanied by civil and/or criminal penalties for non-compliance which would be enforced by the UCCC Administrator. The UCCC is the state law that regulates the terms and conditions of consumer credit in Colorado.⁶⁰

Recommendation – Require all RAL facilitators in Colorado to be IRS-registered EROs and require additional disclosure requirements as highlighted in the Consumer Law Center model act.

⁶⁰ Colorado Attorney General, *Uniform Consumer Credit Code*. Retrieved January 28, 2010 from http://www.coloradoattorneygeneral.gov/departments/consumer_protection/uccc_cab/uccc

Appendix A – Stories of Harm Submitted by the National Consumer Law Center

STORIES OF CONSUMERS HARMED BY RALS

Over the years, we have received stories about consumers who have suffered harm from the risks of RALs. Some of these stories are reproduced below:

I. General Risks Of RALs

From an email sent to NCLC by a consumer:

I went into a local to Las Vegas NV HR Block to file my tax return. Everything went through just fine and I went ahead and filed for a rapid refund. I received my rapid refund as expected but that was the end of the smooth ride with HR Block and HSBC.

What I was told by the IRS was that HR Block transmitted an incorrect Account number for the deposit of my tax refund check so HSBC would not be getting it on time. So I called (after hunting around a while) HSBC to make them aware of the situation. At the time they were nothing but helpful. Told me when I received the check just send it there way via FedEx so I could track it, and they could deposit it.

For some reason I never did receive the check from the IRS. I called a number for times, they would remail me the check and it would never show up in my mail box. To this day we still are unaware of just where that check has gone. And the IRS is trying to figure this one out on there end.

Things began to get a tad harry [sic] 3 months later. I asked if I could make payment arrangements so that I can repay what was owed to HSBC due to HR blocks error. At first HSBC was more then willing to make arrangements for me to pay them back via increments of 250 dollars a month until I was able to pay off the full amount, of something to the tune of 4500 dollars.

A month after they had agreed to the payments they defaulted on there end of the deal, started calling me daily asking where there money was, not the 250 mind you but the full amount due. I told them time and time again that I was making payments per there arrangement and that was all I could afford. Day after day, and for three months daily I would receive calls at home, work, anywhere they had my personal information. They wouldn't just call once however, they would call upwards of 5 times a day. The whole time they where calling I was continuing to pay them there 250 dollar a month payment. And I have full proof of this. I have currently as of today paid about 3000 back of the original note, and still am being harassed.

Now also as a part of a deal with an arbitrator. They where to stop placing derogatory marks on myself, and my husbands Credit because we where making payments when they where asking for them on time every month. To date they have yet to stop, yesterday they placed it on Charge Off status on my Credit even though I have made all payments that I said I would. They refuse to stop pounding my credit.

I also have been threatened with wage garnishment, and that I know is illegal. Considering they have to go through the courts before they can make such a statement over a phone line.

From a legal services attorney in Vermont:

I am trying to help a client who received a RAL which she now has to pay back to HR Block. The client has a very limited income and does not speak English. She filed initially based upon having 2 minor children as dependents and I believe she claimed the EITC. The RAL was based on the amount she would receive under those circumstances. She got the money and then spent it. Meanwhile her return was rejected because the father of the children claimed them both as dependents as well. He had no right to do this. He only has any visitation rights to one and hasn't seen either for almost 2 years. This wasn't an issue before now because the client had not been working, so no tax return. HR Block had the client re-file her return electronically with no dependents. Then they have been demanding a return of the loan, with the client making monthly payments.

From a letter to NCLC from the parents of a consumer:

I am writing on behalf of my son, Steven, and the many others like him and his circumstances that use the tax preparation services of Jackson Hewitt.

Steven is disabled and lives in a permanent shelter residence in Atlanta Georgia. He receives a monthly S.S.I. Disability check and derives a modest supplementary income working within the residence as a part-time receptionist/security person. His total income is very meager and his tax preparation only warrants the short form: easy, simple and quick.

We have generally received his W-2 forms through the mail and had our accountant prepare the tax with the refund going directly to his address. The charge for this service was about \$60 to \$70. This year, because of the new IRS feature of electronic refunding, Steven decided to use a local tax preparer and receive his annual \$430 refund check delivered through direct deposit to his checking account which we are helping him manage. He has always strived to be independent and self-sufficient and "work through" his handicap. Thus he went to his local tax preparation service, Jackson Hewitt. For the easy, simple and quick short tax form he was charged an outrageous fee of \$150. He was shocked and short of funds to pay for the service. Jackson Hewitt tacked on another \$35 as a fee to cover the service and the processing of a "loan" to pay the fee. So for grand refund of \$430 Steven would pay \$185, 43% of his refund. I am sure they have the legal basis for this but there is something definitely morally wrong with this picture.

We have contacted the local office as well as the corporate office in Parsippany, New Jersey, and the best they would do is offer Steven \$50 discount of his next year's tax preparation. Of course, this is unacceptable. He would never use the services of this unscrupulous organization again.

From a legal services attorney in Minnesota:

I have a client who heard a radio advertisement stating that he could have his taxes done for free and use the money as a downpayment on a vehicle without a credit check. The paperwork he completed at the initial visit consisted of a document labeled as "refund anticipation loan," and stated that his tax refund would be \$4222, and \$3959 after fees. He also signed a paper entitled, "refund check assignment authorization" agreeing that \$3,500 would be used as a downpayment on a used vehicle. He also signed his tax forms. He did not sign any type of purchase agreement or disclosures. The dealership had difficulty obtaining the vehicle he wanted to purchase and our client said he wanted his tax refund. He was told that he had signed a contract and the refund belonged to the dealership, so of course he signed it over to them. He did not sign any further paperwork, instead his girlfriend purchased the vehicle and signed a [contract] stating the terms and listing the APR as 18.99%, when it appears that it is really 19.4%. Of course, the car is no good, and too old to be covered by any type of warranty.

From a legal services program in Los Angeles:

Yesterday I met with a young woman who went to H&R Block in LA to file her tax return. She prepared the return herself and was hoping to get a discount. She qualifies for an EIC. She ended up paying \$135 tax preparation fee, a bank fee of \$89.95, a finance charge of \$65, and a refund account fee of \$24.95. She has her own bank account. She picked up her refund check (RAL) the next day and cashed it in one of the machines at the H&R Block office for \$79. She is upset about all the charges.

From a legal services program serving Native Americans in the Southwest:

J.D. is a Native American woman who is the mother of three children. She is paraplegic and lives in a remote area of Arizona. In 2000, J.D. went to an H&R Block office to have her 1999 tax return done. J.D. thought she was getting a "Rapid Refund," but she actually was sold a refund anticipation loan. Subsequently, the IRS disallowed J.D.'s earned income tax credit. As a result, J.D. ended up owing Household Finance close to \$5,000. Household tried to collect this money in several ways, including calling J.D. on a daily basis and charging her late fees of \$75 per month.

From a legal services program in Minnesota:

M.X. is an immigrant who does not speak or read English. He went to a tax preparer and showed the preparer his children's social security cards. The social security cards clearly state "not valid for employment," indicating that his family is not eligible for the EITC. The preparer not only claimed an EITC for

M.X., but had him apply for a RAL with an APR of 176.89%. The preparer, who was working on commission, did not tell M.X. that he was applying for a loan. M.X. spent the loan, and now must pay back the bank. The bank is adding late fees to the loan payments.

There have been several stories of RAL abuse posted on the Low-Income Tax Clinic listserve of the American Bar Association. One example is:

- I have a client with the same problem...taxpayer told preparer the child was her God-daughter, preparer put down 'daughter' in the software so that the EITC would be calculated, and sold her a RAL product...now TP has no way of proving preparer knew this, even though she stressed that she told him from the beginning she was not related to the child. So now she has to repay monies she no longer has...which she never would have gotten in the first place if these people followed the rules...

II. CROSS COLLECTION

We have received several stories of taxpayers who lost their refunds to repay old RAL debts – some as old as 12 years – because of cross lender debt collection.

From our lawsuit in Hood v. Santa Barbara Bank & Trust:

Canieva Hood and others sued Santa Barbara Bank & Trust (SBBT), claiming that the bank illegally seized her 2002 tax refund to pay back an alleged 7 year-old debt to Household Bank. SBBT seized Hood's tax refund of over \$2,000 in February, 2002 after Hood signed an application for a refund anticipation loan at a branch of Jackson Hewitt, a commercial tax preparation chain. Unbeknownst to Hood, the application contained a clause permitting SBBT to take the Hood's refund to pay back any debts allegedly owed, not only to SBBT itself, but to any lender that makes refund anticipation loans, including Household Bank.

From a legal services program in Iowa:

Client contacted Iowa Legal Aid for assistance after her income tax and Earned Income Tax Credit refund was intercepted for collection of an unpaid refund anticipation loan from 1995. Client had a paycheck advance business prepare her 2002 tax return. The paycheck advance business told client that her 2002 refund and EITC totaled \$3,600.05.

The paycheck advance business further advised client that she did not qualify for a refund anticipation loan, but she could return in two weeks to get her refund. When client returned two weeks later, she discovered that Household Bank (the entity who set up the electronic bank account to receive client's 2002 refund) had deducted \$2,703.96 from the refund for an unpaid refund anticipation

loan client had received in 1995 while she was living in Kansas City. Client received only \$958.09 of her \$3,600.05 tax refund and EITC. After examining client's tax return documents, Iowa Legal Aid discovered a provision which authorized Household Bank to collect any and all unpaid debts owed by client to Household Bank or any other entity. Client had not been provided a full copy of the agreement at the time she signed it, only the signature page.

From a legal services program in Texas:

Our monolingual Spanish speaking client went to World Finance Co. for year 2000 tax prep., return prepared/submitted 2/5/01 seeking \$4100 EITC refund. He signed in English the standard RLA agreement saying Bank One would issue the loan, and also stating Household Bank's right to cross-collection with Bank One. On 2/22/01 client was called in to World Finance and told his check for \$1500 was ready, and that his refund wasn't what he expected due to some deduction. On his check the only reference to the refund is this: "Household \$2647" Client had no idea where the extra money went, and couldn't get straight answers from World Finance. He called legal aid. World Finance referred us to IRS, which said it paid the entire \$4100 to Bank One. Bank One, after losing client's file, eventually told us that the money was taken out by Household Bank. Another run around w/ Household revealed that they claimed our client owed the \$2647 from an unpaid 1997 RAL. Our client swears he never had a tax prep done or an RAL in 1997, and never heard of Household. He says someone else used his social security number. The RAL contract only provides a right of auto cross collection if "you" owe money on a previous RAL, and says nothing about auto cross-collection simply if social security numbers match. I'd like to sue World Finance, Bank One, and Household Bank in state court for breach of contract, fraud, and under the TX Deceptive Trade Practices statute based on (1) taking the money in the first place based only on SSN match; and (2) failing to give adequate notice about who took the money and why.

From a legal services program in Minnesota:

Someone came into our consumer unit because her 2007 refund was taken for a debt from 1991 that she was not aware even existed. . . . she applied for the RAL for the first time in over 10 years because her car was going to be repossessed and she was facing eviction - she couldn't keep up the payments after the father of her children left. She thought she would get the money quickly enough to save the car/house.

When the [taxpayer's] advocate wrote a letter contesting arbitration she got a letter back saying they had no more information on the debt and would therefore be issuing her refund. So, she went into the tax preparer specifically to get the quick refund to save her housing and instead waited 6-8 weeks and needed an advocate to get the refund.

III. IDENTITY THEFT

On both the Low-Income Tax Clinic as well as other listserves, there have been numerous stories of tax identity theft victimizing taxpayers, such as:

- Single mother filed RAL for TY 2006 refund (\$5K - \$6K) but was denied, and told she had already filed. She thinks preparer she used last year fraudulently used her identity information and filed her TY 2006 return and received refund. The preparer she used last year is no longer operating at last place of business. She contacted TAS and informed them of her situation. In July, 2007, TAS informed her that they released her refund to Santa Barbara in payment of the RAL. Santa Barbara says they paid her by sending out a debit card, and sent her the records showing the transactions made on the card, none of which were by client.
- I saw the client one week ago. It seems to me, so far, that someone filed a SE income return early in the tax year (2004) and obtained a refund via RAL. The refund was the maximum EITC for two kids minus the unpaid SE tax. The original owner of the social security number worked for wages that same tax year and went to file her return with a paid preparer. She had zero tax liability and was (also) entitled to the max EITC. However, the electronic return was rejected because a tax return using that same social security number had already been filed. The taxpayer made her way to a VITA site and a return was prepared and mailed in. The taxpayer waited and waited for her refund. Eventually she herself got a TA involved. The TA saw that a refund had been paid via RAL and treated the case as a partial refund case, and, after proof by the taxpayer that she was entitled to the EITC, released the balance of the refund, i.e., the difference between the first refund paid as a RAL to the first filer (whoever that was) and the maximum EITC, plus some interest on account of the delay. No money is owed on this one, except to the actual owner of the social security number.

From a consumer attorney in New York City:

- An impostor went into H&R Block and had them prepare and file a tax return in my client's name which resulted in a \$5000 refund due. He then applied for an H&R Block Rapid Refund loan through HSBC for the \$5000. That loan was denied and client received the denial letter. Client advised the IRS who advised him they have rejected the fraudulent return and required him to file his return in person.

Complaints about RAL-related tax ID theft on websites show up on websites as well:

- My wife and I have gotten into the habit of visiting www.annualcreditreport.com each year to check our credit reports. My wife checked hers before I left for New Mexico. She noticed her current address had changed to a suburb of Dallas Texas and a loan had been opened and closed by HSBC bank in Dallas. Upon contacting

HSBC she was informed that HSBC had issued a Return Anticipation Load (RAL) to someone using my wife's information.

So what to do? Spend an hour convincing HSBC that this is a fraudulent loan opened. Spend several hours filling out forms. Spend a few hours talking to the IRS. Spend a couple hours waiting on the local police department to arrive to take a report. Spend an hour convincing the officer he needs to actually take a report. Wait for more paperwork and hassles. The IRS expects a six month delay in our return while they confirm which return is the correct one.

Last week was my turn to check my report. Guess what! Yep. Me too. According to HSBC I now live in Texas. Not that I have anything against Texas, or it's fine residents, but I've never been to Texas. Now I have to repeat exactly what my wife has been through.

I know for a fact that neither my wife or myself have given out our information either online or in person. We currently suspect someone in the chain of our recent home and car purchases. An "inside" job. What ticks me off is the fact that neither the tax preparer nor HSBC itself put much effort into verifying the identity of the persons filing false tax returns to get these fraudulent RAL loans. Do you think they would have pulled a credit check themselves and noticed I've never lived in Texas, held my current job for over 16 years, and bought a new home in Indiana within the last year? These would have been red flags to me!

I don't know yet whether HSBC filed the fraudulent tax returns themselves or issued the loans as a service to another agency. Because both instances are through HSBS leads me to believe someone within HSBS or an agency related to them must be involved. It's too happenstance that both of us would have this happen at the same time and through the same RAL provider.

The sad part of this is these companies can actually file a tax return and issue a loan without exercising due diligence in proving the identity of the actual person sitting in front of them. Then they add negative remarks to a credit report of a completely innocent person when the whole issue is really their mistake.¹

- I can vouch for the fraud part. Someone stepped into an H&R Block office last February to file a bogus tax return in my name and a second one in my wife's name. Taking advantage of H&R Block's Instant Money service, they walked out of the office with hundreds of dollars on a pre-paid debit card from HSBC.

Even after clearing the matter, we were unable to file our legitimate taxes electronically last year and had to endure months of harassing phone calls from HSBC.²

¹ Dave's Computer Tips Newsletter, Issue #15, March 15th, 2007, available at <http://www.davescomputertips.com/newsletters/20070315.php>.

² Rick Aristotle Munarraz, Good Riddance to Tax Refund Loans?, The Motley Fool, Jan 4., 2008, available at <http://www.fool.com/investing/value/2008/01/04/good-riddance-to-tax-refund-loans.aspx>.