

Comments of the  
Community Reinvestment Association of North Carolina

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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**

**26 CFR Part 301**

**[REG- 136596-07]  
RIN- 1545-BH12**

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April 4, 2008

April 4, 2008

R:CC:PA:LPD:PR (REG-136596-07)

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Internal Revenue Service

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Washington, DC 200044

The Community Reinvestment Association of North Carolina is a nonprofit agency that promotes and protects community wealth. The agency is submitting comments in support of the Internal Revenue Service issuing rules which prohibit the use of taxpayer information for the purposes of making Refund Anticipation Loans (RALs).

In our comment letter we make four arguments to support this prohibition.

- 1) RALS are exploitative of tax-filers in the disparate and adverse social impact on borrowers who are low income, and/or minority households and/or EITC recipients.
- 2) RALS are exploitative in that they are administered inconsistently without adequate explanation or understanding by consumers.
- 3) RALS contribute to the filing of fraudulent returns.
- 4) RALS circumvent consumer choice in whether to share private information with third parties.

Our agency coordinates the Durham County Earned Income Tax Credit Campaign to increase the EITC claim rate and provide free tax services. It is a leader in North Carolina's state EITC outreach efforts. The agency is a national leader in fighting predatory lending and has focused on the issue of refund anticipation loans. The agency has conducted extensive research on the RALs including data analysis, policy and legal research, as well as mystery shopping testing of RAL providers. The agency has met with the leadership of H&R Block, HSBC North America, JP Morgan Chase, Santa Barbara Bank and Trust and Republic Bank as well as the Comptroller of the Currency and Director of the Office of Thrift Supervision to discuss our concerns. This comment letter is based on an informed and active engagement in the issue of RALS.

**1) RALS are exploitative of tax filers**

RALS are exploitative of tax-filers in the disparate and adverse social impact on borrowers who are low income, and/or minority households and/or EITC recipients.

Nationwide, fewer than 8 percent of filers use a RAL<sup>1</sup>. In North Carolina, about 11 percent of filers use a RAL<sup>2</sup>. Some analysts have presented RALs as a product that meets a short-term need for credit and that can often represent a less costly credit product than others, when factoring for savings opportunities and potential fees associated with late payments.

Yet while it is only a few who elect to use RALs, the ranks of RAL filers are drawn disproportionately from low income, minority, and EITC households. The same bias that impacts poor and minority households carries over to poor and minority neighborhoods.

Proponents of RALs claim that they serve a need to meet the short-term credit challenges of a percentage of people with emergency credit demands. But this is hardly a product that should be draped in the image of a public service. Because RAL loan sizes increase with the size of a refund, fees associated with RALs are driven by refunds. The main driver of refund size is the Earned Income Tax Credit, the nation's largest antipoverty program.

RALS can range in price from \$32 to \$130 in loan fees, resulting in triple digit interest rates. These high interest rates are usury and exploitative under North Carolina and many other states that regulate interest rates on consumer loans.

Taken as a whole an estimated \$900 million in RAL fees were taken in 2006, plus \$324 million in other fees. That the high cost of these short term loans disproportionately impacts protected classes under fair lending laws and those receiving federal anti-poverty benefits of the EITC is a key basis for the claim of exploitation.

*RALS are exploitative it that they go to people who cannot afford them -- the poor and recipients of the Earned Income Tax Credit:*

RALs are utilized by the people who least can afford to pay their high fees. RALs are used disproportionately by households at the upper ends of poverty. A study examining the demographics of RAL users in the United States in 2004 found that while about same percent of RAL users in the lowest income category (under \$15,000) was no larger than the percent of filers in that category, there were higher percentages of RAL users in the next two highest income groups – filers with household incomes from \$15,000 to \$25,000 and from \$25,000 to \$40,000 than would have been expected<sup>3</sup>. In those categories, filers are drawn to use RALs at a rate beyond the amount that would be expected if income was not a contributing factor to RAL choice.

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<sup>1</sup> Elliehausen, Gregory. 2005. *Consumer Use of Tax Refund Anticipation Loans*. Credit Research Center Monograph #37. Georgetown University. April.

<sup>2</sup> Skillern, Peter and Adam Rust. 2007. "The High Cost of Refund Anticipation Loans in North Carolina." Community Reinvestment Association of North Carolina. Jan. 25th.

<sup>3</sup> Elliehausen, Gregory. 2005. *Consumer Use of Tax Refund Anticipation Loans*. Credit Research Center Monograph #37. Georgetown University. April. Pg. 40.

Income Range	Percent Using RALs	Percent of Filers using Tax prep/overall
Less than \$15,000	18.6 percent	12.2/19.3
\$15,000 to \$24,999	27.9	15.8/15.1
\$25,000 to \$39,999	27.4	22.1/20.1
40,000 to \$49,999	11.4	11.7/10.5
\$50,000 to \$74,999	10.8	17.5/16.2
\$75,000 or more	4	20.8/18.7
TOTAL	100	100/100

Source: Credit Research Center, Tax Year 2004

The group of households with incomes from \$15,000 to \$25,000 is the ones most impacted by RALs. A household with an income in \$15,000 to \$25,000 range and the \$25,000 to \$40,000 range are approximately 1.85 and 1.36 times more likely to utilize a RAL than is the general population, respectively.

Nationwide, the impact of RALs is extensive. Even as the number of RALs appears to have gone down during the 2005 tax season (the last year that records are publicly available), the “loans” still extracted approximately \$900 million from the returns of 9 million American filers. Those same filers also paid another \$324 million in additional financial products (account handling fees, card fees, et al) to get their returns<sup>4</sup>.

RALs go to young filers. The same report found that 86.3 percent of RALs go to filers under the age of 45, even though this group only makes up half of the population of filers and half of the population of filers utilizing a tax preparation service.

*They are disproportionately issued to minority Households and Communities of Color* RALs are utilized most often by minority filers. State regulatory agencies have noticed the problem. In January of this year, the New York Division of Human Rights filed complaints against Jackson Hewitt, Inc. and JTH Tax, Inc., alleging that both companies “disproportionately target[] and sell[] these abusive products to communities of color and communities with a high concentration of military families, in violation of the Human Rights Law.”<sup>5</sup>

<sup>4</sup> Wu, Chi Chi and Fox, Jean Ann. 2008. “Positive Improvements for Tax Refund Loans, but Consumers Still Warned to Avoid Them: Number of Refund Anticipation Loans Less than 10 million in 2006; Price Drop by Major Industry Players.” Consumer Federation of American and the National Consumer Law Center. January 18<sup>th</sup>, 2008.

<sup>5</sup> *New York State, Division of Human Rights v. Jackson Hewitt, Inc. and Jackson Hewitt Tax Service, Inc.* Verified Complaints, available at [http://www.dhr.state.ny.us/pdf/Division%20vs.%20Jackson%20Hewitt\\_Complaint.pdf](http://www.dhr.state.ny.us/pdf/Division%20vs.%20Jackson%20Hewitt_Complaint.pdf) and *New York State, Division of Human Rights v. JTH Tax, Inc. and Subsidiaries, d/b/a Liberty Tax Service*, available at [http://www.dhr.state.ny.us/pdf/Division%20vs.%20Liberty%20Financial\\_Complaint.pdf](http://www.dhr.state.ny.us/pdf/Division%20vs.%20Liberty%20Financial_Complaint.pdf). Filed January 17, 2008

These same patterns are amply demonstrated by our own analysis of the use of RALs in North Carolina. There are many African-American households in North Carolina. The greatest concentrations are in the urban areas along the Interstate 85 corridor (the cities of Charlotte, Greensboro, Durham, and Raleigh) and in the less developed Eastern portion of the state.

RAL use in a zip code is strongly correlated with the amount of minorities living in that region. In our study of 2004 tax returns in North Carolina, RAL use was very high in the portions of the state listed above. In fact, the two numbers (percent of minority residents and percent of filers using a RAL) was statistically significant. For each percentage point increase in the percent of non-whites in a zip code, another three-quarters of a percentage point of all filers utilized RALs. This is expressed statistically as a positive correlation of 0.744.

*RALs are exploitative in that they are issued most frequently in regions with concentrated pockets of poverty*

In North Carolina, geography matters, too. We see that RALs are used most often in the poorest communities across our state. In Rich Square, North Carolina, RALs are almost exclusive are product for low income filers. Of the 126 RALs made in Rich Square in 2004, 119 went to low income filers and 104 went to recipients of the Earned Income Tax Credit. It is not a unique story. See the following table.

City	Median Inc.	% minority	Returns	RALs	Low Inc RALs	EITC RALs	% RALS	% Low Inc. RALs	% EITC With RALs
Wadesboro	\$23,302	58.6	1,140	<b>489</b>	452	383	42.9%	92.4%	78.3%
Ahoskie	\$22,769	65.0	740	<b>313</b>	291	257	42.3%	93.0%	82.1%
Rich Square	\$22,656	67.0	316	<b>126</b>	119	104	39.9%	94.4%	82.5%
Rockingham	\$26,574	35.4	395	<b>156</b>	135	101	39.5%	86.5%	64.7%
Raeford-Fayetteville	\$31,306	48.1	112	<b>44</b>	40	36	39.3%	90.9%	81.8%
Charlotte	\$46,975	41.7	3,934	<b>1,518</b>	1,441	1,214	38.6%	94.9%	80.0%
Williamston	\$22,925	60.3	96	<b>37</b>	35	34	38.5%	94.6%	91.9%
Whiteville-Lumberton	\$22,455	39.8	112	<b>43</b>	36	34	38.4%	83.7%	79.1%
Charlotte	\$46,975	41.7	11,899	<b>4,517</b>	4,234	3,572	38.0%	93.7%	79.1%
Jacksonville	\$32,544	35.9	1,157	439	421	344	37.9%	95.9%	78.4%

*2004 returns, Median Income from Summary File 3, Census 2000, table P53. Percent minority from Census 2000, SF3, Table p6*

This table describes a strong tendency for communities with many low income filers and EITC recipients to witness a lot of RALs. Moreover, the habits are ingrained in poor locations regardless of the urban or rural setting of the community. Charlotte is a large urban area with many financial institutions. Whiteville, Rich Square, Ahoskie, Wadesboro and Rockingham are all very small communities. Fayetteville and Jacksonville are medium sized cities. Both are locations for large military bases.

Interestingly, Charlotte is probably one of the places in North America with the greatest array of financial providers. Somehow, the presence of alternatives is not as effective in practice. The solution might be instead found in preventing bad alternatives (RAL providers).

*RALs are exploitative in that they are concentrated in LMI neighborhoods*

There appears to be a peer effect in the decision to use a RAL. Poor people living in rich communities use RALs much less often than do poor people living in very poor communities. To show that, we banded zip codes into ten different groups by median household income. The next table shows the difference in RAL use in the poorest and richest zip codes.

Percent of RAL use by the poor in upper and lower-income communities

Income	Among EITC users	Among Low-Income filers
Very Poor – bottom ten percent	46.2 percent	27.7 percent
Very Rich – top ten percent	26.8 percent	9.0 percent

Income is ranked according to median household income by zip code

What is interesting here is that these findings separate the income of a community from the income of a tax filer. In this viewpoint, we are comparing the choice to use a RAL among poor (EITC or Low Income) filers in both rich and poor places.

It matters where you live. Poor filers are more likely to use a RAL if they live in a poor place. EITC users living in a very poor zip code are almost twice as likely to utilize a RAL as are EITC filers in a rich zip code. Low income filers living in a very poor zip code are more than three times as likely to utilize a RAL as are low income filers living in a rich zip code. Whatever the cause, such as a higher concentration of tax preparers in lower income communities or targeted marketing of RALS, the effect is detrimental to low income communities.

RALs are disproportionately marketed to low-income taxpayers, earned income tax credit (EITC) claimants, and communities with high concentrations of minority taxpayers. This predatory targeting of economically vulnerable communities, done largely by tax preparers, is so outrageous that at least one state has taken legal action to stop these practices on the basis that they violate human rights law. Specifically, the New York Division of Human Rights filed complaints against Jackson Hewitt, Inc. and JTH Tax, Inc. in January of 2008 which allege that both companies “disproportionately target[] and sell[] these abusive products to communities of color and communities with a high concentration of military families, in violation of the Human Rights Law.”<sup>6</sup> By making it

<sup>6</sup> *New York State, Division of Human Rights v. Jackson Hewitt, Inc. and Jackson Hewitt Tax Service, Inc.* Verified Complaints, available at [http://www.dhr.state.ny.us/pdf/Division%20vs.%20Jackson%20Hewitt\\_Complaint.pdf](http://www.dhr.state.ny.us/pdf/Division%20vs.%20Jackson%20Hewitt_Complaint.pdf) and *New York State, Division of Human Rights v. JTH Tax, Inc. and Subsidiaries, d/b/a Liberty Tax Service*, available at [http://www.dhr.state.ny.us/pdf/Division%20vs.%20Liberty%20Financial\\_Complaint.pdf](http://www.dhr.state.ny.us/pdf/Division%20vs.%20Liberty%20Financial_Complaint.pdf). Filed January 17, 2008.

less attractive and more difficult for tax preparers to market RALs to vulnerable populations and communities, the anticipated rule is expected to significantly reduce the economic exploitation of these communities through the abuse of the tax refund process.

Attached is the Community Reinvestment Association of North Carolina 2007 report, *The High Cost of Refund Anticipation Loans in North Carolina*, which further discusses our research on the exploitative nature of RALS.

**2) RALS are exploitative in that they are administered inconsistently without adequate explanation or understanding by consumers.**

The Community Reinvestment Association of North Carolina conducted mystery shopping of tax preparers for the administration of Refund Anticipation Loans. The results are important in that RALS are often made 1) without full disclosure that the RAL is a loan 2) without consumers understanding the cost and terms of the loan 3) without disclosure or explanation of alternative choices to receiving a tax refund including direct deposit.

For example:

- Three of ten testers were not informed that the RAL is a loan.
- Only one in ten testers had alternatives to RALs and RACs explained.
- At RJ's Business Services (810 Fayetteville, Durham, NC) and Gift Store, filer was offered a RAL but not asked if he had a bank account.
- Liberty Tax Service 12845 (1837 Martin Luther King, Durham, NC) (affiliate of Santa Barbara Bank & Trust) did not ask about bank accounts. When applicant was turned down for a RAL, they issued a refund anticipation check (RAC). Filer got three coupons to refer a friend (each with a \$20 credit for filer and for new customer).
- At Jackson Hewitt (Durham, NC) the preparer did not ask if filer (a student) had a bank account, if he wanted to file electronically, or if he wanted direct deposit.

Our surveys show that RAL consumers are often confused by the whole process. There are a number of fees with similar sounding names. Respondents often indicated that preparers were too rushed to adequately explain their choices. The comments of one filer, a female filing at H&R Block, summarized it well:

She did not introduce herself formally, but I did see her name tag. She completed the info for me on the screen, she even googled my daycare address for me because I did not know it off the top of my head. When it came time to end the procedure, she asked a co-worker, who had just come in, about some of the fees that I may or may not incur with the different options for refund receipt. Overall, she was very, very nice, but I left feeling a little confused and when it comes to money, that's not the way you want to feel.

Confusion is a common picture of the situation in these offices. It is not just that preparers often do not introduce themselves or focus more on the computer screen than on the taxpayer. It is more bizarre. At some locations, tax preparation is a secondary service to gift shops, consumer loans, or other products. One respondent indicated that it was hard to hear the preparer because at another desk there was a person yelling loudly while trying to collect bills.

In general the mystery shopping program supports the notion that consumers do not fully understand their options and that this is in part due to actions of the tax preparer. The use of RALS under these conditions is exploitative.

### **3) RALS incentive fraudulent behavior**

The Community Reinvestment Association of North Carolina (CRA\*NC ) strongly encourages the Treasury Department and the IRS to commence a rulemaking process to restrict the use of taxpayer information in connection with the marketing of refund anticipation loans (RALs) by tax preparers. Specifically, CRA\*NC agrees that, at a minimum, regulations should be promulgated to ban tax return preparers from obtaining a taxpayer's consent to disclose or use their tax return information for the purpose of soliciting taxpayers to purchase RALs. We favor the proposed rulemaking, and the “de-linking” of the tax preparation business from the RALS lending industry because it will help correct the perverse incentives currently connected to RALS, including targeting vulnerable taxpayers, encouraging deceptive and manipulative tax preparation practices, and expediting the benefits from filing fraudulent tax returns.

In addition to helping to limit the economic exploitation of vulnerable taxpayers, a rule that prohibits tax return preparers from obtaining a taxpayer's consent to disclose or use their tax return information for the purpose of marketing RALS to will have the significant effects of limiting fraud and promoting tax compliance. There are at least two ways in which such a rule will accomplish these important objectives.

First, as the National Taxpayer Advocate has noted, the majority of RALS borrowers are EITC claimants or other low-income taxpayers, many of whom are overly reliant on the advice of tax return preparers.<sup>7</sup> As numerous lawsuits and settlements indicate, tax preparers are often accused of engaging in deceptive, manipulative and fraudulent practices designed to induce such taxpayers to enter into RALS transactions. The annual RAL report produced by the National Consumer Law Center and the Consumer Federation of America describes the history of such misleading and fraudulent tactics on the part of large, national tax preparers.

For example, H&R Block, over a decade, attempted to avoid advertising RALS as what they are—high cost loans—instead using euphemistic terms, such as “rapid refunds” or

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<sup>7</sup> National Taxpayer Advocate FY 2007 Objectives Report to Congress, vol. II, *The Role of the IRS in the Refund Anticipation Loan Industry*, at 18 (June 30, 2006).

“instant tax refunds.”<sup>8</sup> The Federal Trade Commission and various state courts, in multiple suits, found these practices were misleading and fraudulent.<sup>9</sup> In 2002, the Federal Court of Appeals for the Fourth Circuit had “little trouble concluding that . . . [H&R] Block acted maliciously, willfully, deliberately, and in bad faith in conducting [its] advertising campaign.”<sup>10</sup> Though private litigation cooled after 2004 because of the frequent use of arbitration clauses in RALs contracts, the California Attorney General brought suits against H&R Block and Jackson Hewitt for misleading statements in the promotion of RALs in 2006.<sup>11</sup>

Jackson Hewitt settled for \$4 million in consumer refunds and \$1 million in penalties and costs.<sup>12</sup>

Please see **Attachment A**, RALs Reports Litigation Excerpts 2002-2007, which was taken from the National Consumer Law Center and Consumer Federation of America’s yearly report and outlines major litigation against tax preparers like H&R Block and Jackson Hewitt.

As the Treasury Department and the IRS state in the Advanced Notice of Proposed Rulemaking (the “ANPRM”), the current regulatory framework likely creates economic incentives for preparers to engage in fraudulent and deceitful practices in order to induce as many of their clients as possible to obtain RALs. To correct this perverse incentive, the Treasury Department and the IRS should promulgate a rule banning tax return preparers from obtaining taxpayer consent to disclose their information in connection with the marketing of RALs. Such a rule would significantly reduce the economic incentives tax return preparers currently have to aggressively market RALs to vulnerable and unsophisticated taxpayers. Eliminating these incentives should lead to a decrease in the amount of misrepresentation, deceit and fraud of which the industry is so frequently accused.

Second, CRA\*NC fully concurs with the assessment made by the Treasury Department and the IRS in the ANPRM with respect to the apparently causal correlation between RALs and the filing of fraudulent tax returns. As discussed below, there is ample case law to strongly support this position—RALs clearly create an economic incentive for tax preparers to manipulate tax return positions in order to inflate the size of a refund and, thus, the associated RAL.

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<sup>8</sup> See National Consumer Law Center/Consumer Federation of America’s 2002 RAL Report discussing H&R Block’s attempts to market RALs as “instant tax refunds” or “rapid refunds” at 25–27.

<sup>9</sup> *Id.*

<sup>10</sup> *JTH Tax v. H&R Block Eastern Tax Services*, 28 Fed. Appx. 207, 214 (4th Cir 2002) (unreported).

<sup>11</sup> Complaint, *People of California v. H&R Block, Inc.*, (Cal. Supt. Ct. San Francisco Feb. 15, 2006), available at [http://ag.gov/newsalerts/cms06/06-013\\_0a.pdf](http://ag.gov/newsalerts/cms06/06-013_0a.pdf); *People of the State of California v. Jackson Hewitt*, Case No. 070304558 (Cal. Supt. Ct. Alameda Cty Jan. 3, 2007), available at [http://ag.ca.gov/cms\\_pdfs/press/2007-01-03\\_Jackson\\_Hewitt\\_Settlement\\_Judgment.pdf](http://ag.ca.gov/cms_pdfs/press/2007-01-03_Jackson_Hewitt_Settlement_Judgment.pdf)

<sup>12</sup> See Complaint, *Hood v. Santa Barbara Bank & Trust*, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara march 18, 2003), available at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation).

This not only harms vulnerable and unwitting taxpayers, but undermines overall tax compliance. For example, in one case charging fraud by tax preparers who used RALs as a key element of their scheme, the defendants allegedly garnered nearly half a million dollars through the filing of fraudulent claims.<sup>13</sup>

Many tax preparers rely upon the current regulatory structure to market RALs to clients to extract exorbitant fees or defraud the government. In a representative case, Donnella Anderson, operating a tax service from her home prepared tax returns for clients and marketed RALs to these same clients. As part of her scheme, she had the IRS deposit the refunds directly into her account. The court found that, “Anderson knowingly filed 25 fraudulent income-tax returns on behalf of her clients. Anderson altered or created false W-2s to increase the amount of income her clients earned, and listed fraudulent deductions and credits, all with an eye toward increasing the refund she would receive.”<sup>14</sup> She claimed more than \$114,375 in false refunds in one five month period.

Though no rule can completely eliminate the possibility for tax related fraud or misrepresentation, CRA\*NC believes that the anticipated rule would make such schemes much less immediately profitable and much more difficult to perpetrate. Thus, the incidence of such schemes should be reduced.

There are numerous cases in which a perpetrator of tax fraud, who may be a tax preparer, will file or assist with the filing of fraudulent tax returns and then enter into RALs on behalf of their “clients” (who may or may not be knowledgeable participants in such schemes), in order to quickly profit off of fraudulent returns, grossly inflated fees, and charges associated with the RALs. The case of *United States v. Okoronkwo* typifies this scheme. As the court described: “Members of this conspiracy would recruit people to file tax returns and assist them in filling out fraudulent returns. . . . These returns were usually filed electronically through the rapid refund system at an office called Tax Sense. When the refund check arrived, conspirators would drive the filer to the bank to cash it, then collect the conspiracy's share of the refund.”<sup>15</sup> To effectuate this scheme, the conspirators “claimed refund anticipation loans [RALs] just under \$3,000, the maximum refund anticipation loan [RAL] a taxpayer could receive through the electronic filing system. . . . The conspirators were not generous: ordinarily, a filer would get to keep only \$200 out of a \$3000 refund.”<sup>16</sup> This is just one example of many such cases.

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<sup>13</sup> DOJ case against Tommie Lee Brown and Leonard Groomes for recruiting people to file fraudulent tax returns filed at H&R Block and requires a RLS from Household Bank FSB through H&R Block. Brown and Groomes filed approximately 74 false returns worth \$466,011.00. DOJ attorney Gregory G. Lockhart. Press Release: [http://www.usdoj.gov/tax/usaopress/2004/txdv04ohs40121\\_1.html](http://www.usdoj.gov/tax/usaopress/2004/txdv04ohs40121_1.html).

<sup>14</sup> In *U.S. v. Anderson*, the defendants got nearly half a million dollars in fraudulent returns. 251 Fed. Apprx. 365, 367 (7th Cir. 2007).

<sup>15</sup> 46 F.3d 426, 430 (5th Cir. 1995).

<sup>16</sup> *Id.*

For your convenience, CRA\*NC has provided, in **Attachment B** Annotated List of RALs Litigation, copies of numerous reported cases, current complaints, and other actions related to RALS. Clearly, there is ample evidence to justify the proposed rulemaking and, subsequently, a new rule that bans tax return preparers from obtaining a taxpayer's consent to disclose or use their tax return information for the purpose of soliciting taxpayers to enter into RALs. By de-linking tax preparers from the RALs lending industry, such a rule will remove the incentives that preparers currently have to exploit vulnerable taxpayers and to engage in fraudulent activities in order to enrich themselves through fees paid in connection with the marketing and provision of RALs to taxpayers.

It is clear that any such rule would have a tremendous impact and completely eliminate or greatly reduce exploitative, deceptive, and fraudulent practices. We applaud the Treasury Department and the IRS for issuing the ANPRM and looking seriously at how the rules related to the disclosure of taxpayer information can be improved to protect citizens, the public investments made in vulnerable communities through the EITC and other programs, as well as the integrity of the tax system more generally.

Such rules would make sense for the IRS to act because it recognizes that RALs can increase the volume of fraud that goes on in the process of filing returns. It is very logical to see how the fee structure of RALs leads to fraud. Preparers who issue RALs are able to extract larger fees as the amount of the refund increases. EITC credits increase when filers have more children. At the same, the likelihood that a filer will seek a RAL is greater when he or she has children<sup>17</sup>. This had the undesirable effect of incentivizing preparers to understate tax liabilities.

In spite of the empirical evidence demonstrating a link between RALs and fraud, policy continues to support their use through the debt indicator. The debt indicator helps RAL providers to do their business. Without the complicit help of the debt indicator, RALs would be more risky. At one point, some argued that the debt indicator would lead to cost savings to consumers. This has not played out over the long run. Chi Chi Wu of the National Consumer Law Center, writes that “the debt indicator has helped boost RAL profitability. The IRS terminated the debt indicator in 1994 due to RAL fraud, and the price of RALs rose significantly, from \$29-\$35 to \$29-\$89. The IRS reinstated the debt indicator in 1999 partly to lower RAL prices. RAL prices dipped for a year in 2000, but have gone back up to pre-indicator levels. Meanwhile, the amount of RAL fraud has multiplied since the debt indicator was reinstated.”<sup>18</sup>

*Preparers earn margins on RALs, and this reduces their reliance on the core competency of tax preparation*

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<sup>17</sup> Elliehausen. 2005. pg. 56

<sup>18</sup> Wu, Chi Chi. 2005. “Corporate Welfare for the RAL Industry: The Debt Indicator, IRS Subsidy, and Tax Fraud.” The National Consumer Law Center. From a PDF published online at [http://www.consumerlaw.org/news/content/Debt\\_Indicator\\_White\\_Paper.pdf](http://www.consumerlaw.org/news/content/Debt_Indicator_White_Paper.pdf). June 2005.

To some extent, tax preparers must offer RALs in order to remain competitive. It is a classic race-to-the-bottom scenario. Offering a RAL is an important device for getting business. It is also a major portion of the fee structure for tax preparers. Since there is very little risk to issuing a RAL when there is a debt indicator, RALs represent high margin business. This gives preparers more room to compete on price for tax prep. The use of coupons (get \$20 for referring a friend, for example) is a price competitive device.

The result is that tax prep is often not very good. Our own survey of the experiences of a group of RAL filers included several incidents that demonstrate how the interests of preparers working with RALs go against the interest of both taxpayers and the IRS. This example is not meant to demonstrate fraud so much as it serves to exemplify the lack of skill in tax preparation.

In one example, a local student brought in a return with a capital gain on the sale of some ING stock. The student expected that the income would be reported. The preparer was not familiar with this kind of event and did not know how to handle it. The filer worked for an independent tax preparer – National Financial, Incorporated – on 3808 Guess Road in Durham, North Carolina. The preparer’s initial reaction was to classify the sale as a dividend. Then the student indicates that she made a new interpretation.

After sitting in the office for an hour or so, she said that there was a problem that she did not know how to handle. The problem was there was a \$5000 “dividend” that we must pay taxes on. With the dividend, our return would only be \$100. If was to ‘ignore’ it, then we would receive \$3000 in returns. She then called her ‘tax people’, whom (sic) told her that we do not need to report the dividends and just ignore it.

The preparer decided to classify the sale of stock without incorporating a cost basis. This artificially increased the income of the filer by almost five thousand dollars. The student decided to not file his return with National Financial because it was too risky. He was invoiced \$117. He does not want to pay.

#### *RALs lead to harmful marketing*

Marketing plays a significant role in the decision among consumers to utilize a RAL. This comment noted how reports have shown that in North Carolina that there is a peer effect in RAL use. We see that low income filers are more likely to use a RAL when they live in a neighborhood with other low-income filers than are low-income filers who live in a non-low income neighborhood.

We can trace this to specific marketing techniques popular among RAL providers. The use of coupons like the ones at Liberty Tax Service (“Send a Friend to Liberty and Get \$20”) would be concrete evidence to buttress this explanation. Jackson-Hewitt emphasizes the same word-of-mouth network through the wording in the second paragraph of the return letter it prints. Jackson Hewitt, it says, will pay \$20 through its “Refer-A-Friend” program.

The coupon strategy is not limited to getting people to bring in their friends from the neighborhood. Other coupons seek to get people to bring in friends from work. Liberty Tax Service at Northgate Mall in Durham, NC offers half off on prep fees to all workers at the Northgate Mall. Mall workers mostly consist of low-wage workers – busboys, food court attendants, part-time department store sales clerks. It is a promotion that advertises high cost interest rate products to low-income workers.

We did not see evidence of strong marketing of audit insurance. This is probably evidence of the success of the agreement worked out by H&R Block with 42 attorneys general in 2003<sup>19</sup>.

#### **4) RALs do not offer safeguards to tax filer privacy**

There are significant concerns about privacy.

Under the way that RALs are currently designed, it is not possible for a tax payer to get a RAL and maintain privacy over his or her tax payer information. This is a problem that becomes clearer by looking at the step-by-step process of RAL issuance.

This matters because it violates the principles of the law. The goals of Section 6103 of the IRS Code are undermined by RALs. The Code states that “return and return information shall be confidential.”<sup>20</sup> Return information includes facts about the nature of a taxpayer’s liabilities. In spite of that rule, RAL providers are able to access information about outstanding tax liens, about child support, about unsatisfied student loan debts, and other liabilities. Those same RAL providers are then able to share those findings with corporations.

We believe that an analysis of privacy and RALs should examine each step that data is released in the course of a RAL. Here are the steps

- Consumer discloses confidential data to tax preparer
- Tax Preparer discloses same data to bank partner. Data disclosed is not limited to what is answered in the debt indicator, but instead includes other information as well that is available from a return.
- Bank partner takes data from tax preparer and transmits it to the IRS to see if there are any outstanding government debts. This is the debt indicator.
- Bank partner communicates back with the tax preparer to advise on the suitability of the filer for a RAL.
- Filer is given a RAL, or perhaps a RAC, or turned down.

If the sequence of data transmission was different, then there would be more privacy. If, for example, the tax preparer communicated with the IRS about the existence of

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<sup>19</sup> Meyer, Gene. “H&R Block Pays \$3.3 million to Settle ‘Peace of Mind’ Dispute.” Kansas City Star. April 25<sup>th</sup>, 2003. Business.

<sup>20</sup> 26 U.S.C. § 6103.

government debt, it would be different. In that scenario, the preparer would provide the bank partner a nominal “thumbs up” or “thumbs down” answer. The bank partner would have no private information.

This would be very different from the current arrangement. Now, bank partners get a rich cut of personal data through the RAL process. Notably, because of the sequence, there is no way for a filer to both get and RAL and keep his or her taxpayer information between the filer and the preparer.

Let us consider the value the opportunities that exist to a bank partner that participates in the RAL process, and also notice the lack of accountability that they are held to for filer privacy. Bank partners get more information than just a “yes” or “no” on the presence of government debt. They get discrete private data that is the basis for creating or adding to a database. We know that they get access to at least one social security number for this process, although they have other information remaining: name, marital status, children and their ages, health expenditures, job, salary, education, address, phone, income, assets, liabilities, charitable contributions including gifts to religious institutions, and other information.

It is not very hard to use this information in ways that undermine consumer interests. With the right databases and appropriately talented managers of information systems, this data can be appended to other sources of information.

Unfortunately, in the current regulatory framework, once bank partners have this information that can use the data however they wish. They are only constrained by their own privacy policies. A brief survey shows that the ones working as bank partner in RALs have policies that include sharing data with:

- other banks in its corporate family
- credit agencies
- Companies with marketing relationships for the sale of life insurance, credit cards, and consumer loans.

These practices are made more opaque by the lack of disclosure in privacy policies among banks. They do not say what companies they have marketing relationships with. Also, because data is stored electronically in databases, there is most likely no expiration of the vulnerability of data to future transmission. And no rules are likely to be available for the next set of unnamed non-affiliate partners who determine how and where the tax payer information is stored or transmitted.

CRA-NC believes that this system has no real safeguards. We believe that a balance can be struck, though. Certainly, consumers must disclose tax payer information. Nonetheless, if safeguards do not exist in the subsequent transmission of data, then there is no tax payer privacy with RALs.

We believe that the best standard would be to limit transmission of tax payer data to only groups that would demonstrate accountability for its security. That appears to be among tax preparers and the IRS. This means that consumers maintain the right to give consent to disclose their information. However, it also means that tax preparers cannot disclose tax payer information.

Examples from current practice underscore our assertion that there is no guarantee that disclosures to third party groups will remain confidential. Consider the example of Liberty Tax Service. They disclose tax payer information to their RAL partners at Pacific Capital Bank, also known as Santa Barbara Bank & Trust. On the disclosure form of the RAL given to consumers, it states that “if you apply for a bank product such as a refund anticipation loan, your information will be shared with the lending bank upon your express authorization and the bank’s use of that information and any other information received by or about you will be covered by the bank’s privacy policy.”

This means that once the transmission of information has been made, that Santa Barbara decides how it will safeguard that information. Following over to look at the privacy policy at Santa Barbara, it shows that unless a consumer opts out, that SBBT will share customer information with other banks in the Pacific Capital franchise as well as with Morton Capital Management.

It goes on. Santa Barbara also indicates that it will disclose information to companies with whom it maintains a joint marketing or servicing agreement. The examples they offer on their web site are companies that offer “expanded products and services, such as securities, credit cards, or life insurance.”

The information trail is no longer traceable. We do not know what kind of privacy safeguards are in place among the marketing companies that Santa Barbara has made agreements with for sharing customer information.

There is a popular movie out right now where a character has a secret that he knows he should not tell, but that he wants to tell. The movie is “Horton Hears a Who.” Horton is an elephant. This is not insignificant to our comparison. Like any computerized database, Horton has a long memory.

In the movie, Horton runs into a group of friends that he would like to share a secret with. Horton is conflicted. Like the RAL providers and the banks, he knows he should keep his story secret. Horton tells his friends that the information cannot get around -- that they should keep it “confidential.” Horton’s friends promise that they won’t tell anyone. Then, they amend it. His friends, much like the non-affiliate third parties (life insurance, credit cards, auto clubs, et al), indicate that if they do pass on the story, they will ask those groups to promise not to tell anyone.

The joke works in the movie because even a child can see that it is not smart to trust someone else to keep your secrets confidential, just because they say that they will.

Unfortunately, that is what is going on here. Except it is a lot more serious. The secrets are taxpayer information. The friends are multinational financial corporations. With HSBC, the transmission is going to a bank operating under the laws of a different country.

With Horton's friends, or with the RAL partnerships, there is no accountability for keeping taxpayer data private. This Horton story is a characterization of the kind of safeguards that are in place with tax payer information and RAL providers.

Liberty Tax and Santa Barbara Bank & Trust are not unusual in their lack of concern about privacy. HSBC, which works with H&R Block, has essentially the same policy rules. It is more explicit in identifying the kinds of "non-affiliates" with whom it discloses consumer information. They share the information with travel, auto and shopping clubs. The information is extensive, too. HSBC lists the following items that it will transfer to non-affiliates:

- Social security numbers
- Telephone numbers
- Email addresses
- Name
- Physical address
- Internet usage
- Credit card usage
- Income or credit reports (except in Vermont)
- assets

This represents an example of a privilege being used in ways that go well beyond the narrow purpose that the IRS originally intended for RAL providers. Internet usage and credit card data would not be within a RAL application, although it could exist on other electronic forms and be appended to a consumer's file through a common unique identifier. The social security number is an excellent unique identifier.

Certainly this information is more than enough to give bank partners the ability to run credit checks on filers. They would want to do that, in order to control risk on products that they offer. Consumers will have no protection or redress. In an extreme example, consider this example. Filers who apply for RALs could subsequently be vulnerable to increases in the premiums they pay for life insurance if they have evidence of high medical deductions.

To review, the standard of explicit transmission paths of taxpayer data would make the most sense in this age of electronic databases. We believe that if the debt indicator is going to remain in operation, that it should only receive taxpayer information from preparers.

### **Conclusion**

The proposed rule-making would not allow tax preparers to release tax payer information to third parties. It would have a tremendous impact if, as suggested by the analysis by the Duke Law Clinic, it would serve to de-link tax preparers from RAL lenders.

This matters because RALs counteract public efforts to relieve poverty. RALs work at economies of scale that are only possible through the availability of the Earned Income Tax Credit. No one wants to get rid of the EITC – it is a good program. Ronald Reagan said that the Earned Income Tax Credit was America’s most effective means of social welfare. In that spirit, the EITC represents a powerful opportunity for families to build assets.

This is one reason why policy makers examine the relationship between the EITC and RALs. Again, while less than 8 percent of households claimed a refund anticipation loan in 2005, almost 18.5 percent of filers that received the EITC also got a RAL. That is a disparity of 2.34 times<sup>21</sup>.

The fees sap the EITC. Take an example from one North Carolina refund, one that is not an extreme example.

- Earned Income Tax Credit (EITC) of \$4,716, with \$281 in tax prep fees, \$95 in RAL fees, and \$30.95 in account handling fees to set up a checking account.
- Federal EITC of \$1,850, with \$189 in tax prep fees and \$70.56 paid in RAL fees, refund account fees, and check processing fees. (HR Block/HSBC)
- Federal EITC of \$1,624, with \$194 in tax prep fees and \$80.03 in RAL fees

The RAL fees and the tax prep fees, in most cases, are not necessary. VITA sites could probably have done these returns for free and direct deposit on electronic filing takes less than two weeks.

We appreciate the concern of the Department of Treasury and the Internal Revenue Service. We hope that you will serve to advance the interests of consumers by adopting the changes in the APNRM.

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<sup>21</sup> Elliehausen. 2005. p. 63.