

# REFUND ANTICIPATION LOANS

Y 4. B 22/1:103-132

Refund Anticipation Loans, Serial N... 1

BEFORE THE  
SUBCOMMITTEE ON  
CONSUMER CREDIT AND INSURANCE  
OF THE  
COMMITTEE ON BANKING, FINANCE AND  
URBAN AFFAIRS  
HOUSE OF REPRESENTATIVES  
ONE HUNDRED THIRD CONGRESS  
SECOND SESSION

APRIL 14, 1994

Printed for the use of the Committee on Banking, Finance and Urban Affairs

Serial No. 103-132



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## REFUND ANTICIPATION LOANS

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THURSDAY, APRIL 14, 1994

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE,  
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10 a.m., in room 2222, Rayburn House Office Building, Hon. Joseph P. Kennedy [chairman of the subcommittee] presiding.

Present: Chairman Kennedy, Representatives Flake, McCandless, Castle, Pryce, Linder, and Sanders.

Chairman KENNEDY. The subcommittee will please come to order.

This morning the subcommittee meets to examine the growing popularity of the so-called rapid refunds. In truth, they aren't refunds at all. They are loans offered at interest rates that can make a loan shark blush, and consumers are often not being told the truth about what they are getting into. These loans, known as tax refund anticipation loans, have grown tremendously in the last few years with the rise of electronic tax filing. Three years ago, 125,000 Americans filed their taxes electronically. Last year, the number jumped 100 times, to 12.5 million. Of these, nearly 9 million consumers opted for a tax refund loan.

H & R Block, which I should add declined our invitation to testify this morning, dominates the market, taking credit for 7 million of these loans. While electronic filings may well become the change of the computer age, tax refund loans are simply potholes on the information highway. Essentially, they are nothing more than short-term loans, usually no longer than 2 or 3 weeks, made by lenders to consumers with the help of tax preparers. They have the benefit of putting money into consumers' hands in 2 days instead of the 2 to 4 weeks that they have to wait to get the money from the IRS, yet the cost of this convenience is staggering.

By charging fees ranging from \$30 to \$120 per loan, lenders and tax preparers are really sticking it to consumers with interest rates that can top 100 or even 200 percent. One lender in the New York City area charged \$30 for a 10-day loan on a \$500 refund, which translates into an annual interest rate of 225 percent. Another lender was found in a survey to be consistently charging over 110 percent for their tax refund loans.

Consumers are often kept completely in the dark about the cost of these loans. One way is by deceptive advertising. H & R Block, for instance, has been sued in each of the last 4 years by the New York City Consumer Affairs Department for failing to tell consum-

ers that their rapid refunds were really loans and what the interest rates on these loans actually were.

Another way to trip up consumers is to hide the true interest rates from them until the last minute. Due to a loophole in the law, consumers don't have to be told the interest rate when they apply for the tax refund loan. They only have to be told prior to endorsing the loan check. By then, many consumers feel that it is too late to withdraw their application.

This practice of hiding interest rates was confirmed by subcommittee staff who visited a half dozen tax preparation offices. Not one of those offices would tell the staff the effective interest rates on their tax refund loans unless an application was completed and approved.

Few would argue that tax refund loans have caused consumers grievous harm. In fact, some consumers may be willing to pay sky high interest rates because of an urgent need to pay medical, housing, or other bills. However, for many working families, every dollar they lose to usurious tax refund loans is one less dollar for a child's food or clothes or some other housing or household need. We should not be ignoring the harm that they suffer as a result of these practices. I believe that there are three basic steps that can be taken to ensure that tax refund loans don't gouge consumers.

First, we should ensure that consumers receive full disclosure of the true interest rates on their loans. Second, this disclosure should be made at the time consumers apply for the loans, not just when they endorse the loan check. Maybe then consumers will realize that there are other cheaper sources of short-term credit, like credit cards.

Finally, we should cap the rates on loans like these that are secured by Federal tax refunds. The Federal Government should not let its refunds be used by unscrupulous private firms as vehicles of usury, and banks should not be able to evade State usury laws just because they are headquartered in another State.

With that, let me turn the microphone over to Mr. McCandless for an opening statement.

Mr. McCANDLESS. Thank you, Mr. Chairman. I am going to ask that my opening statement be entered into the record in the interest of time, and thank our witnesses for appearing here this morning.

Chairman KENNEDY. Without objection, so ordered. Thank you.

Mr. Castle.

Mr. CASTLE. Thank you, Mr. Chairman. I wasn't really thinking in terms of a prepared opening statement, but what you said triggers some thinking, and I don't know the right answer to all this, but the one thing I do know is I have spoken to a number of people who believe that an RAL is an advantage to them, they like it, and I think they look upon what they pay as a fee as much as they do an interest rate. That is sort of the impression I get. I am not talking people who are paying \$100 but some of the people who are paying the lesser amounts.

Also, I don't know the statistics on this, but my understanding is the use of RALs has increased fairly dramatically in recent years, which means the consumers, as a whole, seem to like them. I think IRS, if I am not wrong, is actually encouraging this. They



want this kind of filing, the electronic filing, if you will, because it eases their burden and some of their costs.

You make some valid points, but I think there are also some valid points on the other side that need to be developed so we can determine what is the best legislative solution to some of the issues which are raised. I look forward to the hearing and hopefully these things can be brought to light.

Chairman KENNEDY. We will look forward. I am sure that Gary Perkinson and others will have some comments about the issues that you have raised, and we look forward to hearing from our witnesses this morning.

There being no further opening statements, we will proceed with our panel of witnesses. I would ask the panel to please provide all of your written statements for the record, and I would ask you to please limit your oral statements to 5 minutes and summarize your testimony in the interest of time.

I would encourage you to try and keep your opening statements to 5 minutes so that we can have a good back and forth in terms of the kinds of questions that might arise from the comments that you make.

Our first witness is Margot Saunders, who is the managing attorney of the National Consumer Law Center in Washington, DC. Her work has focused on consumer credit issues that face low-income people.

Ms. Saunders, it is a pleasure to have you with us this morning testifying before the subcommittee, and please proceed with your testimony.

**STATEMENT OF MARGOT SAUNDERS, MANAGING ATTORNEY,  
NATIONAL CONSUMER LAW CENTER**

Ms. SAUNDERS. Thank you, Mr. Chairman, and thank you, members of the subcommittee, for inviting me to testify today.

The National Consumer Law Center is a legal services backup center that represents low-income consumers around the country. We receive requests from legal services attorneys and pro bono attorneys all over the country for help with their consumer credit and other consumer matters, so we are very familiar, we think, with the issues facing low-income consumers across the country.

Refund anticipation loans are essentially unregulated loans with very few disclosures required. You will receive written testimony from Randolph Barnhouse, who is the executive director of DNA Legal Services in Arizona, which details one of the worst abuses we have heard about in connection with RALs. He will tell you in writing unfortunately that it is standard practice for the Navajo Indians to be subjected to abusive advertising of RAL loans so that they are charged 15 percent of their earned income tax credit to be returned to them as a loan fee. On a standard \$2,000 refund, they may be charged \$300. That is a lot of money for what amounts to a 2-week loan.

In my written testimony we have many other examples of the most abusive practices, but I think what brought us here today was not these high end, most outrageous practices, but the typical, standard, reputable tax preparer giving a RAL through a national bank. Those too, as you know, have serious problems. They lack

adequate disclosures, they don't show the true cost of the loan, and what disclosures are made are not made at the appropriate time.

What happens with an RAL is the customer goes in, talks to the tax preparer, is told of the advantage or supposed advantage of the RAL, and applies at that time for the RAL. Several days later he is called back in by the tax preparer and given a check. On the back of the check is what few disclosures and what few terms the taxpayer will ever receive.

Chairman KENNEDY. What do you mean by an RAL?

Ms. SAUNDERS. Refund anticipation loan, I am sorry. That is what we call it.

Chairman KENNEDY. That is fine.

Ms. SAUNDERS. So we have a problem with the timing of the disclosures and the disclosures themselves.

Truth in lending law could require, and actually we believe should require, that the annual percentage rate be disclosed based on what the actual practice is, and when we are talking about whether this is a fee or whether it is an interest rate; that is, Congressman Castle, as you noted, a matter of opinion, but nevertheless, truth in lending has traditionally required that if any charge to the borrower is charged as a part of an extension of credit, it should be disclosed as an annual percentage rate.

The only reason that national banks or that any lenders are able to avoid the actual disclosure of the annual percentage rate in RALs is because they are fictitiously terming RALs "demand notes" and because they are calling them demand notes, then under truth in lending laws they don't have to disclose the actual percentage rate, except as based on what the loan would bring in over a year. But because all of the RALs actually have a term of 2 to 3 weeks, we have a different actual cost.

On page 3 of my testimony, I have laid out some examples of what typical annual percentage rates are based on a \$35 fee. Thirty-five dollars is the fee charged for an extension of credit over a 2-week period. A \$500 loan with a \$35 fee would yield an effective annual percentage rate of 193 percent; even a \$2,000 loan would yield an effective annual percentage rate of over 45 percent over the same time period.

There is an easy way for this subcommittee to solve this problem, and that is simply to instruct the Federal Reserve Board to require truth in lending disclosures to be made on RALs based on what the actual practice of the lender is, not on the fictitious determination that they are demand notes.

But the most serious problem facing low-income consumers across the country, we believe, is not the lack of adequate disclosures, it is the fact that RAL loans are completely, as I said, unregulated.

There is a case out of South Carolina that is on appeal into the Fourth Circuit called the *Cade* case that I have discussed extensively in the testimony. What this case stands for, unfortunately, is that a national bank in one State can go into another State and completely ignore all the consumer protection laws in that other State.

Five States attorneys general were so alarmed by the Beneficial National Bank's activities in South Carolina regarding RALs that they entered into an amicus brief appealing this case.

I know I don't have much time and I have already extended, beyond my 5 minutes, but I would urge the subcommittee to carefully consider the effects of interstate banking preemption deregulation that RALs are just the foothold in the door. I will be glad to answer any questions.

[The prepared statement of Ms. Saunders can be found in the appendix.]

Chairman KENNEDY. Thank you very much, Ms. Saunders.

Our next witness is Gary Perkinson, who is the senior vice president for government relations at Beneficial Management Corp. Mr. Perkinson is in charge of all of Beneficial's government relations at both State and Federal levels, and we welcome Mr. Perkinson here this morning. We look forward to your testimony. Please proceed.

#### **STATEMENT OF GARY PERKINSON, COALITION OF ELECTRONIC FILERS OF AMERICA**

Mr. PERKINSON. Thank you, Mr. Chairman. I appreciate the subcommittee's invitation, and I would like to point out that I am here as coordinator of the Electronic Filing Coalition, which is a group of corporations and associations formed to help combat fraud associated with the filing of individual tax returns for refund anticipation loans.

Mr. Chairman, in the interest of time, I have submitted my full testimony and will give a brief opening statement here responding particularly to the questions you asked in your letter of invitation.

Since 1987, the financial institutions that comprise the coalition—Banc One, Beneficial National Bank, Greenwood Trust Co., and Mellon Bank, each a State or federally regulated institution of national standing and reputation—have participated in the RAL Program.

To make it clear, a refund anticipation loan is a loan made to taxpayers eligible for a tax refund. A participating bank makes a loan to the taxpayer in the amount of the taxpayer's anticipated tax refund minus the lender's service fee of typically \$29 to \$34, regardless of the amount of the loan.

Representatives of these lending institutions and of the tax preparers and IRS-approved electronic return originators, referred to usually as EROs, with whom they are affiliated are meticulous about disclosing to consumers all the facts concerning the RAL Program, the most fundamental of which is that the RAL is, in fact, a short-term loan for which the customer pays a fee.

By law, the fee must be disclosed in terms of an annual percentage rate. Each customer is required to complete a formal bank loan application that clearly discloses that fact. The loan is repaid to the lender when the refund is transferred by the government to the customer's account established for that purpose at the bank extending the RAL. That, by definition, is a refund anticipation loan.

As I said, I would like to just briefly respond to the four questions you laid out in your letter of invitation. Your first question, what are the pros and cons of RALs, should they be encouraged or discouraged by the Federal Government?

I have already said how the RAL works. Let me also point out that in 1993, over 9.5 million taxpayers applied for a RAL. This number is up from 8.9 million in 1991. I would like to show you just a few of the many ways these millions of customers greatly benefit from using a RAL.

First, RALs provide taxpayers fast use of their tax return money. Remember, 9.5 million taxpayers last year used a RAL to have immediate use of their refund money in order to satisfy financial obligations that could not be met by traditional means.

A recent survey by the Roper organization indicates that nearly half of all RAL customers have no banking relationship outside of the RAL Program, and only a small fraction of these customers would qualify for any kind of credit card or equity line of credit. RAL lenders can step in to help these individuals pay off a broad spectrum of financial obligations. Many RALs are used to pay tuition, many for medical bills, car repairs, outstanding utility bills, the rent, and so forth. The fact is a large population in this country has no financial cushion and depends on the immediate availability of tax refund money.

Second, the process of applying for and receiving a RAL educates many customers about and provides access to the earned income tax credit. As you know, EITC is a government-sponsored program to help the working poor. Congress chose the income tax return as the vehicle to get the EITC money directly into the hands of qualifying taxpayers in order to avoid additional government bureaucracy. Many RAL borrowers choose to have their taxes prepared by a professional preparer, and in doing so are achieving access to the earned income tax credit and the financial benefit it provides.

In addition to contributing to the effectiveness of programs like the EITC, RALs also greatly benefit the IRS and the Federal Government in other ways. As part of this tax system's modernization program, the IRS has committed to increasing the number of electronically filed returns from its current level of 12 million to 60 to 80 million by the year 2000. Statistics clearly show the RAL Program has become the driving force behind the IRS's electronic filing program.

Third, as many residents of high crime neighborhoods in this country can tell you, the traditional printed tax refund checks used by the IRS are systematically pilfered from taxpayers' mailboxes. Criminals easily recognize the Federal Government's familiar brown tax return envelopes holding refund checks, and victims readily report that getting a lost or stolen check replaced by the IRS can be a long, time-consuming process.

Question two, to whom are the RALs principally marketed? In your view, are these taxpayers aware of the effective annual percentage rate of these loans?

RALs are marketed to taxpayers who are eligible for a tax refund and who find economic advantage in receiving their tax refund quickly.

Our experiences indicate that the average RAL borrower has a total household income of approximately \$25,000, is 34 years old and is employed full time. Because the RAL is a loan, we fully disclose interest rates and other information in compliance with Federal truth in lending regulations.

The regulations require that the fee be disclosed as an annual percentage rate. We have chosen to base the APR on the average loan maturity of only 14 days. Because it is calculated over such a short time period, the APR associated with RALs appears high when compared to APRs on more traditional demand loan products calculated over a longer maturity.

Our RAL APR, however, is based on a fixed fee amount for the service that customers overwhelmingly agree is fair and reasonable, so fair and reasonable, in fact, that according to a 1993 Roper survey, 88 percent of repeat users and 80 percent of first-time users felt the RAL Program was a good value. Eighty-seven percent of borrowers clearly understood that the RAL was a loan. Of the 13 percent who said they were not aware it was a loan, half of them said it would not have mattered in the first place.

Question three, please describe to the extent possible specific cases in which taxpayers could be affected adversely by RALs.

In our opinion, Mr. Chairman, there are just two ways taxpayers might be negatively affected by a RAL, including unanticipated price increases from year to year. Please keep in mind that the coalition lenders, and we do over 90 percent of the RAL loans, I should point out, have consistently been able to bring the price of the RAL down over the past several years because of economies of scale, experience, and constant improvements in technology. Further, the coalition is concerned about a current IRS proposal which would impose an additional \$8 fee on individuals who electronically file and request direct deposit of their refund.

Another way consumers would be adversely affected is if regulated RAL lenders were no longer able to offer the product. We could easily see the return of unscrupulous discounters who preyed on military personnel and other taxpayers who needed quick access to their refunds by charging as much as 50 percent of their total refund.

Last, question four, what steps, if any, do you believe should be taken by lenders, tax preparers, and/or public officials to protect customers, consumers who may wish to use RALs?

We believe the IRS could do a more thorough screening and licensing of EROs who are the principal contact with the taxpayers. Coalition banks make extra efforts to ensure that the electronic return originators with whom we deal are from reputable businesses run by creditworthy individuals. We ask each ERO applicant for bank and trade references, review credit reports of the principals, and check past history of electronic filing.

In conclusion, Mr. Chairman, let me assure you that the industry appreciates your efforts to raise the level of attention of this important area, and I pledge our continued cooperation with the subcommittee.

Chairman KENNEDY. Thank you very much, Mr. Perkinson. We appreciate your testimony and I also appreciate some of the steps that Beneficial, in particular, has taken to clean up some of the abuses that have taken place in the industry, and look forward to some questions about some of the other companies that haven't been as responsible.

Mr. PERKINSON. Thank you.

[The prepared statement of Mr. Perkinson can be found in the appendix.]

Chairman KENNEDY. Our final witness is Cynne White Wolf, who is a tax preparer affiliated with the National Association of Enrolled Agents. Ms. Wolf has been in this business for over 18 years and started out with H & R Block back in 1975.

Ms. Wolf, thank you very much for being here this morning. We look forward to your testimony before our subcommittee. Please proceed for 5 minutes.

**STATEMENT OF CYNNE WHITE WOLF, ENROLLED AGENT,  
NATIONAL ASSOCIATION OF ENROLLED AGENTS**

Ms. WOLF. Good morning. Thank you. My name is Cynne White Wolf. I have really been in business for about 20 years, but I wanted to say that I am accompanied by Janet Bray, the executive vice president of National Association of Enrolled Agents; and Phyllis Borghese, director of our government relations.

I don't know if you know very much about enrolled agents. I was asked on the phone when you all called me 2 days ago, what is an enrolled agent. At present, we have 8,300 members, and we represent more than 4 million taxpayers. We have expertise in doing taxation, we are licensed by the Treasury, and in order to be an enrolled agent with the National Association of Enrolled Agents, we have to have 30 hours of CPE each year.

That aside, and the fact that we don't have any written testimony, and I will get you some when it is not the tax season after tomorrow, I would like to get into what I wanted to talk about.

A 1991 IRS research study found that RALs were the taxpayers' primary motivation for electronic filing. The study also showed household income of those getting RALs were less than \$30,000; more than 40 percent of the electronic filers were due earned income credit.

In 1992, about 79 percent of electronic filers filed either 1040 As or 1040 EZ. This means that less than a quarter of the electronic filers use the more complex 1040 A. This would lead one to believe that the cost of the electronic filing and RALs are largely borne by the low-income taxpayer. The increase in earned income credit is leading to an upward surge in electronic filing while the IRS's real cost savings in electronic filing is the more complicated form 1040, and these taxpayers are not filing in large numbers.

In IRS's enthusiasm to encourage electronic filing, they have continued to make it easy for electronic filing and do not have enough safeguards in place to prevent ongoing problems. The driving force behind electronic filing is the RALs. If IRS were to curtail RALs, it would impede IRS's electronic filing program, but on the other hand, taxpayers who can least understand the full ramifications of what they have undertaken are the ones fulfilling IRS's efforts.

I polled as many EAs as I could across the country in the 2 days that I had and got some input as to their problems and whether they liked it, did not like it. In one case I was told by a preparer, an enrolled agent in Washington State, that she had just reported a case of fraud, so I mean we are getting all aspects of the RALs and electronic filing.

Some of the pros to it is the taxpayer enjoys the fact that the fees can be taken out up front. They don't have to actually take money out of their pocket and give it to the preparer, transmitter, whoever; they can have it taken out of the check they are getting. They are essentially paying for getting their own money.

IRS encourages the RALs by acknowledging if a taxpayer is on an offset list. If you don't know what an offset list is, it is the list IRS has of who owes back taxes, who owes child support, and so forth. This would be an indication that they would not get their refund. Therefore, they are not eligible for an RAL because the bank would not be paid back.

Banks have high interest rates on low-risk loans, and so this is wonderful for the banks. This is a very good way of making money. Also, the banks have the opportunity to turn down loans that IRS have said that they are all right, they are going to get their money back.

The transient population I was told by one person in Florida, they have a large transient population, and because of that they say that these RALs are very beneficial to them.

Until the IRS technology catches up, I can't see where there will not be a demand for this type of electronic filing and other sources. Taxpayers are in a dire need for food, for shelter, for medicine, for drugs, whatever. They need their money yesterday.

Now I, personally, have a problem with that because your tax money comes once a year and it may solve a problem this instant, but what about the next? I have had clients come in, say they need it for their rent money or they are going to be living with their three kids in the car this month right now if they don't get it right now. Fine. What are they going to do next month? So we have to look into that.

Some of the cons I have heard about and I have dealt with are the high cost of getting one's own money, and we have had a lot of talk here about the APR. The APR is on the bank fees only.

People don't look at the fact that there is actually as much as four different fees on that refund. There is, if they have their return prepared, which in a lot of instances they have to because they can't understand the earned income tax laws in order to even compute that, so there is a tax preparation fee. There is a transmission fee to electronically transmit. There is a loan application fee that the transmitter charges them for filling out the loan papers, and the bank's fee. So there is actually, you know, three or four other fees and they are not figured into that APR, so really the APR is a lot higher, I feel, than it is showing.

Unreasonable fees are being charged. I have heard anywhere from \$350 to \$1,000. Now, if these people are preparing these tax returns fraudulently so that they can get large refunds and then charging these people a portion of it, that may be where some of those are coming from. Those, I hope, are the rare instances, but we have had some and some of our enrolled agents have turned these, when they have heard about these, turned them into IRS.

Taxpayers are unfamiliar with the annual percentage rates. Like I said, the banks don't base it on, totally on those fees.

I brought along with me an APR form that is given out by Greenwood Trust just to give you an idea of what it looks like. To some-

one who is low income and maybe unsophisticated, this is an extremely intimidating piece of paper, but it is very informative. They are not reading it. They have no intention of reading it. It is either going in the trash can or with their tax return files. It is not being read.

There are a lot of cases of fraud. I was at a meeting with IRS not too long ago and they didn't even want to talk about the cases of fraud. My question regarding that is the savings that IRS has in electronic filing, is that cost being overrun by the fraud that it is costing us in the long run? So I think that is something that is very important and should be looked into.

There have been cases reported to me of discrimination, there have been cases where taxpayers, they are really forced to be loan officers. A lot of your low-income people cannot cash the RAL checks, Beneficial Bank, Greenwood, Banc One, they go to a local bank and try to cash it, and they either cannot cash it, the transmitter has to guarantee it, or they pay a percentage of their refund to get it cashed.

Now, they don't have this problem with the government check. Some large companies have tried to monopolize areas. I have a problem with that. Practitioners and transmitters can be liable for the debt if that IRS check erroneously goes not to the bank to repay the loan.

Poor monitoring by IRS in advertising and transmitters. Now, some of the marketing techniques for quick, fast instant, or rapid refunds on TV, I mean, you have really got to look quick at the fine print at the bottom of the screen to be able to see that this is really a loan. When it says "rapid refund," you think you are getting your refund just quicker, that the IRS is getting it to you quicker, you don't realize that this is a loan. In print it is very fine print when they advertise it.

Misleading advertisement. Taxpayers believe refunds are being processed faster, that they are receiving their money—they don't realize that it is a loan.

Marketing to low-income people. Earned income credit is used as a selling technique, and I have seen this done numerous times. People are told, hey, I can get you a bigger refund, the government is giving money away free, meaning earned income credit, and we will take your fees out up front, it won't be any money out of your pocket, and you can have it in a day or two.

I think this is bad because they are entitled to the earned income credit, they are entitled to every penny of it. Most taxpayers do not understand all aspects of borrowing. If they had to go into a bank, you know, they would be totally lost. Most disclosure statements are intimidating, most low-income taxpayers do not have the experience in reading them.

You asked for some possible ways of correcting it other than totally doing away with RALs. You could improve the monitoring by IRS of transmitters; you can monitor more of the advertising that is done; the disclosure, of course. You could also possibly separate the transmitter from the loan. In other words, the transmitter cannot process a loan if a taxpayer transmitted their tax return and then had to go into a financial institution to get their loan, then they might have second thoughts about it.



Thank you very much.

[The prepared statement of Ms. White Wolf can be found in the appendix.]

Chairman KENNEDY. Thank you very much, Ms. White Wolf, for your testimony.

I want to thank all three of the witnesses for your testimony this morning. Like Mr. Castle, when I first heard of this issue, I noted the difference between the interest rate, the annual APR rates, which Ms. Saunders indicated were in the 100 or 200 percent range, and then you look at the actual fees that are charged of \$30, and you say, well, wait a minute, is this some game that we are trying to somehow make what appears to be a reasonable fee into a high cost loan, and therefore there isn't any serious violation of the consumer taking place here?

I have—it would be easy to dismiss this as a fee and not get into what, in fact, seems to be occurring. We see companies, as I understand, Mr. Perkinson, at least from the article in the newspaper here, that Beneficial last year made a profit of \$56 million on these loans last year alone, and the question then becomes whether or not the same money would be made available to consumers at much lower rates, if for instance, you put it on your credit card.

We have had hearings, as Mr. McCandless and others can tell you, about the fact that we think credit card interest rates are too high, but can you tell us whether or not if you were a consumer and you filed your taxes electronically, whether you think you would be better off borrowing money from your credit card, knowing that you are going to get a check back 2 to 4 weeks later from the IRS, than you would going through the average companies that are in this line of work?

Mr. PERKINSON. Let me say first, you are correct on the \$56 million last year.

Would I—the RAL loan is not for everybody, quite clearly. If you don't need a RAL loan, if you have other available sources of money, certainly you would have to think twice about taking it.

Frankly, I personally looked last week and talked to some credit card companies because someone suggested that you would be better off taking an advance on a credit card and paying it back after 4 to 6 weeks, but actually you wouldn't be, because traditionally among banks there is a \$10 to \$15 transaction fee for an advance, plus a typical rate, as you just mentioned, Mr. Kennedy, of 18 percent on the credit card. Without going through all the arithmetic, if that loan was outstanding, a credit card loan of \$1,500 for 2 months would cost about \$45; and that is another problem because most people if they got their average \$1,500 return, had put it on a credit card, if they are like my daughters at least, they will say, well, I will pay \$500 of that and take the other \$1,000 and do something else with it.

Chairman KENNEDY. But in fairness to the comparison, let's go apples to apples, in other words, if you are going to make the delay 2 months on the credit card loan, let's make the delay 2 months on the loan—

Mr. PERKINSON. That is a good point. My only point is that most people never pay the credit card until they get the statement in the

second month, and then if they don't pay the full thing, but if, the fact if they paid the full thing off—

Chairman KENNEDY. It is a fairly simple question. Is the rate of interest substantially more charged by Beneficial or H & R Block or someone like that, than it would be if you put the bill on your credit card?

Mr. PERKINSON. The APR would be higher, yes.

Chairman KENNEDY. About how much higher?

Mr. PERKINSON. It would depend.

Chairman KENNEDY. Give me a—

Mr. PERKINSON. We clearly—it is interesting from the earlier testimony, we show on ours the chart of a 14 day, the least possible, the most—the least positive for us, we show a 14 day on our application, and we show amounts, \$500, \$750, \$1,000, but the fact is—

Chairman KENNEDY. What are those interest rates?

Mr. PERKINSON. One hundred fifty-one percent on \$500; 101 percent on \$750. This is the APR. These are not interest rates; the APR.

Chairman KENNEDY. Annual percentage rate of interest?

Mr. PERKINSON. Extended out. If we could—on the law, we could extend it out as a demand note.

Chairman KENNEDY. The whole issue on that, Mr. Perkinson, is that Ms. Saunders is trying to suggest that while you are characterizing or while the banks are characterizing it as a demand note, that that is how we could clean up this—

Mr. PERKINSON. But we are not.

Chairman KENNEDY. I understand that, so I am not accusing you of doing this, but I am just saying that while the banks are characterizing this as a demand note, this is something that the banks have the discretion to do at the moment, and what Ms. Saunders in her testimony was suggesting is that one way to really clean this up is to simply have the Federal Reserve or the other bank regulators simply suggest that you cannot do this as a demand note and that that in and of itself would then create the kind of reduction in interest rates.

The real question in my mind is whether or not, getting back to again Mr. Castle's point, I don't think anybody is interested in disallowing consumers the advantage of being able to get paid in a very short-term fashion. The question is whether or not that is being utilized by these particular companies as a way to gouge the consumers and do it in such a fashion that it doesn't appear gouging because the price tag of the gouge doesn't appear to be that much in comparison to the amount that you are borrowing in terms of a loan. I don't think what we want to do is paint over the 151 or 100 percent interest rates that you are talking about here when in fact there would appear to be ways of providing the same amount of benefit to the consumer at a greatly reduced cost to the consumer.

Ms. Saunders, do you have a comment about that?

Ms. SAUNDERS. Yes. I don't want it misunderstood, we are not here today to say that RALs are necessarily a bad thing, and although I think in the abstract a 150 or 180 annual percentage rate is terrible, and I don't want to ever say on the record I think it is

good, what I would like to concentrate on is when the charge to the consumer is \$400 or \$300 for a 2-week loan. That is abusive, whatever the resulting annual percentage rate is. I mean, if we are talking about \$35 on—it is not a big deal. When we are talking about 15 percent of an earned income tax credit return of \$2,000, that becomes a big deal.

The abstract idea of annual percentage rate is very useful. It was a terrific law that Congress passed, but by itself it should not, in our opinion, be the focus of this subcommittee's considerations. I think what this subcommittee needs to focus on are the abusive situations, and that is 15 percent being charged, a fee in this instance, \$35 for a 2-week loan. Perhaps it should be \$20. Perhaps it should be \$15, but that is nickels and dimes; \$400 is much too much.

And our recommendation in the testimony is that this problem be addressed. The way you can address it is to say simply, here is a maximum fee that can be charged on loans extended, secured by tax refunds from the Federal Government, and you set it at \$35 or \$40 or something like that.

Chairman KENNEDY. I appreciate that.

Again, I want to thank Mr. Perkinson for some of the reforms that have taken place by the company that he in particular represents, and by being up front about what these interest rates really are, but I think that maybe there is some difference between what our experience as a subcommittee was in terms of sending our staff out to check with six or seven offices in the last week or so to area offices in the Washington, DC, metropolitan area to determine whether or not when an application is made whether we get, in fact, those interest rates disclosed, and in fact none of our staff ever got the disclosure even though they asked for it in every instance. That was something that Miss Saunders raised as an issue as well.

Do you have a comment about that, Miss Saunders?

Ms. SAUNDERS. I think I addressed it. I think the way to deal with that is to instruct the Federal Reserve Board to mandate that these loans be treated as they are in practice rather than as demand notes. I am not that familiar exactly with what Mr. Perkinson's association does. I am sure—

Chairman KENNEDY. I was referring to Beneficial, not to the association.

Mr. PERKINSON. May I just say the four banks that represent our association—Mellon, Banc One, ourselves, and Greenwood Trust—all disclose on the 14-day, as Miss Saunders is recommending. None of us shows disclosure based on the full year demand note.

Chairman KENNEDY. But do any of you disclose it when you make the application?

Mr. PERKINSON. We do, as a matter of fact.

Chairman KENNEDY. I think some of the ones we went to are in fact—

Mr. PERKINSON. You are dealing with probably—and I have discussed with your staff some of the store-front-type organizations that you visited, and there are problems. There are problems—I think it is outrageous, the example that Miss Saunders gives of a 15-percent up front fee on the tax return in an earned income tax

credit. Frankly, the IRS has regulations prohibiting that, and they ought to be informed that that is happening to the Native Americans there because it is not legal for them to do it.

Chairman KENNEDY. Although, to tell you the truth, I was on a television show earlier this morning on this issue, and a woman who worked at the television station told us that she was eligible for an earned income tax credit and that she had had this exact same experience, so I don't think it is just on Indian Reservations. This is a person who worked right here in Washington, DC, and certainly wasn't an Indian.

Mr. PERKINSON. There are fraudulent problems all over the country, Mr. Chairman.

Chairman KENNEDY. Yes, I appreciate it.

Did you want to make a comment?

Ms. WOLF. I wanted to go back to your credit card issue about using the credit cards. I don't think that would be viable because most of these low-income people don't have credit cards, so I don't think that is a viable answer.

Chairman KENNEDY. Thank you very much. Mr. McCandless.

Mr. MCCANDLESS. Thank you, Mr. Chairman.

After the Tax bill last year, I would like to have some money returned. I had to go out and find new money to pay for that new tax return.

Chairman KENNEDY. Big Al, in all that money you are going to make next year, things should go well.

Mr. MCCANDLESS. Then they tell me I have to pay a 110 percent estimate or I am going to be charged a 7 percent penalty next year. I think we ought to have the Internal Revenue Service up here rather than these people.

That is quite an experience, ladies and gentlemen, when you plan your year, and you have planned it for years and years, and then all of a sudden you are found with not only having to go out and get money in addition to what you saved, but you also carry forward for 2 years what was retroactive in the Tax bill. We are talking here about another subject, but since you asked me to speak, it is relevant to the issue.

Chairman KENNEDY. Well, I will ask you to be quiet, too, if that will help.

Mr. MCCANDLESS. Well, I am concluding my 24th year in public service as an elected official, and when we get to one of these periods of activity, such as we are now in, it reminds me of something somebody told me who had been in this type of activity for many years prior to me, "McCandless, you cannot legislate morals," and so people are paying 99 cents for a quart of milk somewhere, six blocks away they can get it for 69 cents. Is that right? Well, it is a matter of question, but let's get back to the subject here.

Miss Saunders, I had an opportunity to look at an application for a real estate loan the other day. We had the credit check and we had the processing fee, and we had a number of other things that all added up to a considerable amount of money, and the points for the loan, and I kind of was thinking there might be a little parallel here and I would like you to respond.

The electronic filing is not free; there is a charge for the processing itself, irrespective of the individual involved or how much is

going to be charged ultimately. There is a charge for processing this. There is a charge for the credit check. Somebody has to pay these particular charges. You said in your concluding remarks in your last answer to the question that you thought that \$30 was a little too high on a \$500 refund, if I understood you correctly, that it should be somewhere around \$20.

Ms. SAUNDERS. No, I said that is debatable. I said what I was really concerned about was the \$400 on \$2,000.

Mr. MCCANDLESS. Let's play what if. Mr. Perkinson, you chime in here. What if we approached this from another direction similar to that of a loan on a piece of real estate and said, well, we are going to charge you \$30 for this service, of which \$6.35 is the transmission of the electronic aspect of this. Now, we have a young lady over here who has a computer, and she is going to have to type up a number of things in order to get you your money, and that will cost \$4.75, and there is a credit check, and the credit check from another period in our history here cannot be more than \$8 or whatever it was we had, so we will use the figure \$8 for the credit check, and the balance is for the service involved. All of a sudden that APR becomes not an APR but simply a list of charges necessary to complete what it is that you have come to us.

Chairman KENNEDY. If the gentleman will yield just briefly, on this issue there is no need for a credit check. The fact is that they don't do credit checks on these transactions.

Mr. MCCANDLESS. The statement of one of our witnesses said that there is a credit check.

Chairman KENNEDY. I don't believe on these loans there is a credit check.

Mr. PERKINSON. No, there isn't generally a full credit check; there isn't time. It is a 1- or 2-day turnaround. There are administrative costs.

Mr. MCCANDLESS. We check to see your last filing, we check to see this, we check to see that, strike the words "credit check," and we will just say there is a check required or they perform a check which has a cost attached to it. Ms. Wolf.

Ms. WOLF. What you might be misconstruing is the offset list that the IRS checks to let the banking institutions know if their loan will be repaid. That might be what you are thinking about.

Mr. MCCANDLESS. I was quoting one of you who said there was some check involved.

Mr. PERKINSON. The check is a thorough check, for example, of previous loans made, RAL loans made, and it is a form of a credit check, but it is not a formal credit application type that you would see on a normal loan because there simply isn't time to do that, but there are various administrative costs, including marketing to the providers. We pay a fee to H & R Block for marketing on this out of our \$29.

Mr. MCCANDLESS. What would you say, from your experience, would be your cost on a \$500 RAL?

Mr. PERKINSON. Out of the \$29 that we charge, Beneficial National Bank charges a flat \$29 fee, the cost is, before taxes, approximately \$20. We probably end up in the neighborhood of \$9 clear before State and Federal taxes, so it is a \$20 fee to get the thing together, the cost of money, origination of the loan, market-

ing fees, and all the rest that you mentioned, so there is at least \$20 out of the \$29 is clearly for these costs.

Mr. MCCANDLESS. I guess, Miss Saunders, what I am trying to point out here is that you cannot in all good conscience apply an APR to what we have here and I tried to illustrate it by using real estate loans as an example. I don't know if you wish to comment on that or not.

Ms. SAUNDERS. Yes, sir, I do. As in the real estate loan, a new real estate loan situation, all of those charges are included in the amount financed. Unless they are actually received by the lender, they would not be included in the finance charge so that they would not go into the calculation of the annual percentage rate. Just as in the real estate loan situation, in the RAL situation, the tax preparation fee, the transmission fee, and the application fee are all also outside of or in addition to this \$29 or \$35 fee. So we have got, as Ms. White Wolf pointed out, as many as possibly four fees, only one of which is determinative of the annual percentage rate. When you actually add all the costs to the taxpayer of an RAL, it might be even higher, it will be even higher than this perceived annual percentage rate. But Mr. McCandless, I agree with you that by focusing just on the annual percentage rate we are missing the main abuses here.

Mr. MCCANDLESS. I need a clarification. I was under the understanding that you had a basic charge for preparing the tax form, then you had the charges for the electronic processing. Now, you are saying that the electronic processing is separate from the preparation fee and the transmission fee?

Ms. SAUNDERS. Yes.

Ms. WOLF. There are actually four fees being charged.

Mr. MCCANDLESS. Give me an idea of your experience here. How much would they be on what?

Ms. WOLF. It depends. The abusive cases like she has been talking I think are charged primarily by your transmitter, not so much by the banks. They are charged when they come in to have their tax return prepared. Then they are charged again an additional fee for the transmission of that return.

Mr. MCCANDLESS. Can you give me an example that might hold water here?

Ms. WOLF. I can give you an example of some of the fees I have charged in the past. An average tax return would be about \$80 for the preparation fee; I would charge about \$10 to transmit the tax return; and I would charge another \$5 to fill out the loan papers, and then whatever the banks charge, you said \$29, some are \$31, some \$35, some \$40, whatever they charge were on top of that.

Now, I tried to charge very low fees because I knew the type of people I was dealing with, but there are a lot of abuses, just in my area we have pizza parlors, we have car dealers, we have pawnshops that are essentially doing the same thing, and they don't know the tax laws but yet they are transmitting tax returns and charging exorbitant fees.

Mr. MCCANDLESS. Miss Saunders made the comment that we ought to notify the regulators or have the regulators reclassify these loans so that they would fall under existing laws as it relates to APR. Then that would indicate to me that if this were to take

place, the maximum a bank could charge on this hypothetical case would be the maximum APR for any loan in this kind of category; is that where you are coming from?

Ms. SAUNDERS. No, sir. The Federal laws governing truth in lending simply require disclosure. They do not in any way affect the maximum rates that lenders can charge under State law. So that if there is a State law that a State regulator might argue would be applicable and limit the interest rate that can be charged, that wouldn't be affected in any way by that truth in lending.

I think that you can deal with one of the problems that has been targeted by this subcommittee, which is the inaccurate disclosures made in some instances, apparently not by Mr. Perkinson's group, but in many instances that we have seen of the inaccurate disclosures being made based on a year. One way to deal with that is to instruct the Fed that—Federal Reserve Board to require that these loans be disclosed as in actual practice. That does not in any way limit the amount that can be charged, although I think that you should do that also, but it wouldn't do that.

Chairman KENNEDY. The gentleman's time has expired. Mr. Flake.

Mr. FLAKE. Thank you very much. Mr. Chairman, let me ask one question, the fee for preparation, is that not charged back by the taxpayer on the next year? Doesn't that come back from their return?

Mr. PERKINSON. If they do a long form.

Ms. WOLF. If they itemize, then it is subject to 2 percent of their adjusted gross income, so it is very rare that they can take the deduction, the people that we are talking about, the low-income people.

Mr. FLAKE. This particular issue is a two-edged sword in that I wish my father was alive and sitting over there as a witness because I am not sure that he would not have preferred this process to the process that he experienced during most of his life. As a janitor raising 13 children, come tax time, he desired to have the money as quickly as possible without thinking about the next month, deal with next month when next month comes. I realize there are some abuses here, but I also realize that there is probably some value for those persons who do not have to do what he did then, and that was prepare a tax return, go across town somewhere and find a Beneficial or Household or whoever, make the loan based on what he anticipated that return to be, and then pay for the loan during the course of the whole year as opposed to having the loan and the prep fees and all being paid within a 14-day period.

On the one hand, I can see value in this process given my historical background of my growing up experience. On the other hand, I realize that there are great possibilities for abuse, great possibilities for scandal, and of course, we have to address those. I am not sure we can solve Miss Saunders' problem just by mandating certain policies for the Fed, because if you are talking about Household, Beneficial, or GEC or whomever, they are not regulated by the Fed, so the catch-22 for us here becomes the majority of these loans, I suspect, and you can correct me if I am wrong, are not being done by banks, they are in fact being done by nonbank

banks, and I don't think we solve the problem or get to it just by dealing with the Fed on this particular issue. You may respond.

Ms. SAUNDERS. There are several problems. One is the disclosures that are required under the Federal truth in lending law. The truth in lending law is regulated by the Federal Reserve Board. The Federal Reserve Board can change its commentary such that everybody who makes an RAL has to disclose the annual percentage rate, as Mr. Perkinson's group already does. That would solve the disclosure problem.

Second, you are right, obviously, the Federal Reserve Board does not regulate national banks. In our testimony, we have recommended that you give the Office of the Comptroller of the Currency authority to regulate national banks on this issue, so that to the extent there are any abuses or any complaints, the OCC can deal with that.

Third, we think that you need to come up with a wholesale method of dealing with the abuses which are being perpetrated on low-income people. The lenders that are victimizing the woman in Washington, DC, that Chairman Kennedy talked about, and our clients on the reservations in Arizona and New Mexico, that I was mentioning before, are not banks.

The way to deal with that on a national level is simply to set a flat maximum fee or something like that, so we have a series of recommendations to deal with the series of different problems.

Mr. FLAKE. I think we would be prepared to look at all of them. I think all of us are concerned about abuses. I think we also understand, though, that even the check itself becomes a target for abuse in a community like the one I serve where you take that check in to a bank that rejects the check, and you wind up going to a check-cashing place that takes off the top 20 percent of that check.

To the question of credit cards, my dad and mother died without ever having a credit card or checking account, and I tend to think that there are a lot of poor folk in this country who still don't have those, so I don't think it is a simple solution of charging it to the credit card. It would perhaps be easier, but I don't think that that is an option for a whole lot of people, so, again, it is kind of a mixed bag in terms of the approach.

I think one thing we can all agree on, the abusive situations have to be dealt with, and perhaps as Beneficial and others have demonstrated some leadership, we can depend on them to help try to clean it up, because I believe that there are poor people who basically benefit by the RAL Program in ways that they would not if they had to deal directly with the loan, lending institutions themselves, and they are trying to live hand to mouth, and the issues for them are quite different than the issues we may address here in this House.

I yield back, Mr. Chairman.

Chairman KENNEDY. Thank you very much, Mr. Flake. Mr. Castle.

Mr. CASTLE. I will try to be brief, and hopefully, get brief answers, we have to vote in 7 or 8 minutes. I tend to agree with what Mr. Flake has just said, in the realm of consumer ripoffs this one appears to be much lower than some of those, such as the lending-to-purchase type things and some of the others where the consumer



simply in my mind has no idea what they are dealing with. In fact, in all candor, I think if I were dealing with this I probably wouldn't pay a lot of attention to the interest rates either, I would look at the dollar amounts I was being charged and say is it worth \$29 to me and whatever the filing fees are, the \$5 and \$10 extra to get the \$400 early or whatever it may be, and you never really get into the interest rates. That is why the fee-type situation, which is apparently the direction the Beneficial and the other banks you represent, Mr. Perkinson, are going and what Miss Saunders recommends is sort of the sense of where you are going, and it is a benefit, people really want the electronic filing, it is growing, it is a good field.

My question to you, Mr. Perkinson, is what percentage do the four banks which apparently are major players in this Banc One, Mellon, Greenwood Trust, and Beneficial that you represent here today, besides your own representation of Beneficial, what percentage of these transactions are you involved with, is that group involved with?

Mr. PERKINSON. Upward of 90 percent of the RALs.

Mr. CASTLE. Who makes up the other 10 percent? Are they other large players or do they generally get to be a little different?

Mr. PERKINSON. No, they are not. They are much smaller players and they are scattered across the country. They operate under procedures laid down by the IRS and hopefully abide by the disclosures that Miss Saunders rightfully points out should be followed. They don't always do that. There are problems in the industry, particularly in the type of organizations that Mr. Kennedy mentioned, but ours, we fully comply with everything that Miss Saunders pointed out as far as disclosure is concerned. We agree with her on the 15 percent or any percentage charges, they are wrong, and as a matter of fact—

Mr. CASTLE. The contingency, the trial lawyers contingency fee basis of biting into the situation is wrong, is what you are saying. Do any of your four banks do that at all? Is it all straight charge?

Mr. PERKINSON. No. Straight charge. We do not participate in the other fees that were discussed, preparation, transmission, none of that.

Mr. CASTLE. That is debatable, too. I wish I could prepare my own taxes. I can't do it. I had to pay a preparation fee this year, a lot of us do that, and you make your decisions on that. But what are the fees that you are involved in? You said you charge \$29. What is the range of, not just you?

Mr. PERKINSON. \$29 dollars to \$34 among our group, that is the range.

Mr. CASTLE. OK. Because of time I am going to have to defer asking any more questions. I think it has been an interesting presentation, though. I think there is more common ground than not in this instance, to tell the truth. We are not that far apart in whatever the resolutions may be. I yield back.

Chairman KENNEDY. First of all, I want to thank all of our witnesses. I do believe that there are enough instances that warrant us not glossing over this. I suppose we could issue some directives up here at some levels, and the trouble is that when you get down to the street level, it doesn't take, and it doesn't get implemented.

Right here, we have got one in this area for refund anticipation loans in a matter of days for \$79. The *Baltimore Sun* just did a survey of the RALs in the Baltimore area that came out between \$30 and \$120 in that area. That was just a newspaper trying to get a sense of it.

You have the individual cases that Ms. Saunders has indicated take place on Indian Reservations. Let's be clear that what really takes place here is that the loan is fully guaranteed because you turn over the basic check that you are going to get from the Federal Government, so what happens is when we have circumstances like the advent of the earned income tax credit coming down the line, I think we have to make certain that the kinds of abuses that are potentially available and are in fact taking place in circumstances around the country are ended, and if we can do that by policies in terms of controlling the underlying interest rate policies, controlling the way these are determined in terms of demand notes versus loans trying to get the Federal Reserve and the OTS to concentrate on some of the abusive practices, then it seems to me we can clean up an industry and make certain that there aren't the kinds of problems that I am sure Mr. Perkinson and everybody else associated with it want to avoid.

So we want to thank all of you for the information that you have provided us. We look forward to working with you and trying to fashion a response to those circumstances where abuses have taken place, and thank you all very much.

There being no further questions on behalf of the subcommittee, I want to express my appreciation to all the witnesses who shared their views with us today, and I would like to ask unanimous consent that the record be kept open for a period of 4 weeks from today so that additional views may be submitted.

Hearing no objection, so ordered.

The panel is excused. The subcommittee is in recess.

[Whereupon, at 11:12 a.m., the hearing was adjourned.]

APPENDIX

April 14, 1994

JOSEPH P. KENNEDY II, MASSACHUSETTS, CHAIRMAN  
 HENRY B. GONZALEZ, TEXAS  
 LARRY LARGOCCO, IDAHO  
 LUIS V. GUTIERREZ, ILLINOIS  
 BOBBY L. RUSH, ILLINOIS  
 LUCILLE ROYAL-LALAND, CALIFORNIA  
 THOMAS M. BARNETT, WISCONSIN  
 ELIZABETH FURIE, OREGON  
 NYDIA M. VELAZQUEZ, NEW YORK  
 ALBERT R. WYNN, MARYLAND  
 CLEO FELES, LOUISIANA  
 MELVIN WATT, NORTH CAROLINA  
 MAURICE HINCHY, NEW YORK  
 PAUL E. KANJORSKI, PENNSYLVANIA  
 FLOYD W. FALK, NEW YORK  
 MARLENE WATERS, CALIFORNIA  
 CAROLYN B. MALONEY, NEW YORK  
 PETER DEUTSCH, FLORIDA

ALFRED A. MCCANDLESS, CALIFORNIA  
 MICHAEL CASTLE, DELAWARE  
 PETER KING, NEW YORK  
 DEBRAH PRYCE OHIO  
 JOHN LINER, GEORGIA  
 JOE KNOLLBERG, MICHIGAN  
 DOUG BERGLER, KANSAS  
 CRAIG THOMAS, WYOMING  
 RICK LAZO, NEW YORK  
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U.S. HOUSE OF REPRESENTATIVES  
 SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE  
 OF THE  
 COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ONE HUNDRED THIRD CONGRESS

ROOM 604 O'NEILL HOUSE OFFICE BUILDING  
 WASHINGTON, DC 20515

Opening Statement

by

Representative Joseph P. Kennedy II (D--MA)

April 14, 1994

THIS MORNING THE SUBCOMMITTEE MEETS TO EXAMINE THE GROWING POPULARITY OF SO-CALLED "RAPID REFUNDS". IN TRUTH, THEY AREN'T REFUNDS AT ALL. THEY'RE LOANS OFFERED AT INTEREST RATES THAT COULD MAKE A LOAN SHARK BLUSH. AND CONSUMERS OFTEN ARE NOT BEING TOLD THE TRUTH ABOUT WHAT THEY'RE GETTING INTO.

THESE LOANS -- KNOWN AS TAX REFUND ANTICIPATION LOANS -- HAVE GROWN TREMENDOUSLY IN THE LAST FEW YEARS WITH THE RISE IN ELECTRONIC TAX FILINGS. THREE YEARS AGO, 125,000 AMERICANS FILED THEIR TAXES ELECTRONICALLY. LAST YEAR, THE NUMBER JUMPED 100 TIMES TO 12.5 MILLION. OF THESE, NEARLY 9 MILLION CONSUMERS OPTED FOR A TAX REFUND LOAN. H&R BLOCK -- WHICH, I SHOULD ADD, DECLINED OUR INVITATION TO TESTIFY THIS MORNING -- DOMINATES THE MARKET, TAKING CREDIT FOR 7 MILLION OF THESE LOANS.

WHILE ELECTRONIC FILINGS MAY BE A WELCOME CHANGE OF THE COMPUTER AGE, TAX REFUND LOANS ARE SIMPLY POTHoles ON THE INFORMATION HIGHWAY. ESSENTIALLY, THEY ARE NOTHING MORE THAN SHORT-TERM LOANS -- USUALLY NOT LONGER THAN 2 OR 3 WEEKS -- MADE BY LENDERS TO CONSUMERS WITH THE HELP OF TAX PREPARERS. THEY MAY HAVE THE BENEFIT OF PUTTING MONEY INTO A CONSUMER'S HAND IN 2 DAYS, INSTEAD OF THE 2 TO 4 WEEKS THEY'D HAVE TO WAIT TO GET THE MONEY FROM THE IRS. YET, THE COST OF THIS CONVENIENCE IS STAGGERING. BY CHARGING "FEES" RANGING FROM \$30 TO \$120 PER LOAN, LENDERS AND TAX PREPARERS ARE REALLY STICKING CONSUMERS WITH INTEREST RATES THAT CAN TOP 100 OR EVEN 200 PERCENT.

ONE LENDER IN NEW YORK CITY CHARGED \$30 FOR A 10-DAY LOAN ON A \$500 REFUND -- WHICH TRANSLATES INTO AN ANNUAL INTEREST RATE OF 225%. ANOTHER LENDER WAS FOUND IN A SURVEY TO BE CONSISTENTLY CHARGING OVER 110% FOR THEIR TAX REFUND LOANS.

CONSUMERS ARE OFTEN KEPT COMPLETELY IN THE DARK ABOUT THE COST OF THESE LOANS. ONE WAY IS BY DECEPTIVE ADVERTISING. H&R BLOCK, FOR INSTANCE, HAS BEEN SUED IN EACH OF THE LAST 4 YEARS BY THE NEW YORK CITY CONSUMER AFFAIRS DEPARTMENT FOR FAILING TO TELL CONSUMERS THAT THEIR "RAPID REFUNDS" WERE REALLY LOANS, AND WHAT THE INTEREST RATES ON THOSE LOANS WERE.

ANOTHER WAY TO TRIP UP CONSUMERS IS TO HIDE THE TRUE INTEREST RATES FROM THEM UNTIL THE LAST MINUTE. DUE TO A LOOPHOLE IN THE

LAW, CONSUMERS DON'T HAVE TO BE TOLD THE INTEREST RATE WHEN THEY APPLY FOR A TAX REFUND LOAN. THEY ONLY HAVE TO BE TOLD PRIOR TO ENDORSING THE LOAN CHECK. BY THEN, MANY CONSUMERS MAY FEEL THAT IT IS TOO LATE TO WITHDRAW THEIR APPLICATION. THIS PRACTICE OF HIDING INTEREST RATES WAS CONFIRMED BY SUBCOMMITTEE STAFF, WHO VISITED A HALF DOZEN AREA TAX PREPARATION OFFICES. NOT ONE OF THOSE OFFICES WOULD TELL STAFF THE EFFECTIVE INTEREST RATES ON THEIR TAX REFUND LOANS, UNLESS AN APPLICATION WAS COMPLETED AND APPROVED.

FEW WOULD ARGUE THAT TAX REFUND LOANS HAVE CAUSED CONSUMERS GRIEVOUS HARM. IN FACT, SOME CONSUMERS MAY BE WILLING TO PAY SKY-HIGH INTEREST RATES BECAUSE OF AN URGENT NEED TO PAY MEDICAL, HOUSING, OR OTHER BILLS. HOWEVER, FOR MANY WORKING FAMILIES, EVERY DOLLAR THEY LOSE TO A USURIOUS TAX REFUND LOAN IS ONE LESS DOLLAR FOR A CHILD'S FOOD OR CLOTHES. WE SHOULD NOT BE IGNORING THIS HARM.

I BELIEVE THAT THERE ARE THREE BASIC STEPS THAT CAN BE TAKEN TO ENSURE THAT TAX REFUND LOANS DON'T GOUGE CONSUMERS. FIRST, WE SHOULD ENSURE THAT CONSUMERS RECEIVE FULL DISCLOSURE OF THE TRUE INTEREST RATES ON THESE LOANS. SECOND, THIS DISCLOSURE SHOULD BE MADE AT THE TIME CONSUMERS APPLY FOR THE LOANS, NOT JUST WHEN THEY ENDORSE THE LOAN CHECK. MAYBE THEN, CONSUMERS WILL REALIZE THAT THERE ARE OTHER, CHEAPER SOURCES OF SHORT-TERM CREDIT -- LIKE CREDIT CARDS. FINALLY, WE SHOULD CAP THE RATES ON LOANS SUCH AS THESE THAT ARE SECURED BY FEDERAL TAX REFUNDS. THE FEDERAL GOVERNMENT SHOULD NOT LET ITS TAX REFUNDS BE USED BY UNSCRUPULOUS PRIVATE FIRMS AS VEHICLES OF USURY.

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Testimony of the National Consumer Law Center

on

Tax Refund Anticipation Loans

before the

Subcommittee on Consumer Credit and Insurance

of the

Committee on Banking, Finance and Urban Affairs

April 14, 1994

by

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Testimony of the National Consumer Law Center on  
Tax Refund Anticipation Loans before the  
Subcommittee on Consumer Credit and Insurance  
of the  
Committee on Banking, Finance and Urban Affairs

April 14, 1994

Mr. Chairman, Members of the Committee, thank you for your invitation to testify today on behalf of the clients of the National Consumer Law Center, regarding Tax Refund Anticipation Loans ("RALs") and their impact on low income consumers.

The National Consumer Law Center is a national support center for legal services attorneys and pro bono attorneys representing low income consumers around the country. On a daily basis these attorneys request our assistance with the analysis of credit transaction to determine appropriate claims and defenses these clients might have.

SUMMARY OF PROBLEMS WITH TAX RALS.

As RALS are essentially unregulated loans made with little or no meaningful disclosures, they provide great potential for serious abuse of consumers. Indeed there are a number of cases around the country which illustrate these abuses. One example is the scam currently being perpetrated on Native Americans in Arizona.<sup>1</sup> On the reservations, it is *standard practice* for taxpayers to be maneuvered into agreeing to RALS in which 15% or more of their **Earned Income Tax Credit** is taken as a fee. These *fees* can often amount to \$400 or more for a completely secure loan of only two to three weeks in duration.<sup>2</sup>

These abuses must be addressed. However, it is likely that it is not these high end abusive situations which brought RALS to the attention of this committee. Instead, it is the lack

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<sup>1</sup> See testimony to be provided this Committee by Randolph Barnhouse, Executive Director of DNA - Peoples Legal Services of Window Rock, Arizona.

<sup>2</sup> The case of *Income Tax Buyers, Inc. v. Steven W. Hamm, Administrator, S.C. Department of Consumer Affairs*, (Court of Common Pleas, Richland County, S.C., CJA No. 91-CP-40-3193), is another example. In this case the plaintiff (ITB) was engaged in the business of tax refund discounting. According to the court, ITB solicited customers by advertisement in newspapers, had customers bring their state or federal tax returns to ITB's office, had customers sign documents purportedly selling the right to the refunds of those tax returns, and had customers sign power of attorney forms in favor of ITB, authorizing ITB to sign endorsements on refund checks. ITB then gave customers checks or money in the amount discounted from the total refund between 35% and 50%.

of meaningful regulation and disclosures in the *typical RAL* which has generated sufficient concern to precipitate this hearing.

The problems with the typical RAL made by a national bank through a reputable tax preparer's office include:

- Lack of adequate disclosure - of
  - the true costs of the loan,
  - the effects of non-payment of the loan,
  - the availability of electronic filing (and thus the ability of the taxpayer to receive the tax refund within two weeks, with no extra fee charged).
- Inappropriate timing required for the disclosure. Disclosures should be made at the time of *application* for the loan, not *receipt* of the loan.

However, the single most terrible aspect to RALs is their potential to open the door to completely unregulated consumer lending in all types of loans throughout the nation. This possibility is not just hysterical hyperbole. It is, in fact, the manifest result of the recent decision of the federal district court in *Cade v. H & R Block and Beneficial National Bank*,<sup>3</sup> as predicted by five states attorneys general.<sup>4</sup> Indeed, the defendant, Beneficial National Bank has apparently already made it clear that it intends to seek this result.<sup>5</sup>

#### PROPOSALS TO RESOLVE PROBLEMS CAUSED CONSUMER BY TAX RALS.

1. Impose a Ceiling for RAL Fees. The simplest, easiest, and by far the most effective method of resolving all of the problems that consumers are experiencing with RALS, is as follows:

- for Congress to impose a maximum amount for the fee that can be charged for the extension of credit secured by a tax refund owed by the United States Government.

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<sup>3</sup> Civ. No. 4:92-1454-21 (D.S.C., Jul. 16, 1993) (Order granting partial summary judgment).

<sup>4</sup> West Virginia, Michigan, Kentucky, Connecticut, and Arkansas.

<sup>5</sup> See brief of *Amici Curiae* in Support of Appellees, page 7.



A flat fee, set by law, will put a dead stop to the most abusive situations, such as those being perpetrated on Native Americans in Arizona.<sup>6</sup> A flat fee will settle with clear resolve, Congress' intent not to allow the further diminution of state's consumer laws under the guise of the National Banking Act, and a flat fee will allow uniform disclosures to be made with ease by tax preparers.

2. Instruct the Federal Reserve Board to clarify that the Truth In Lending law requires proper disclosure of annual percentage rates. Disclosure of the true costs of credit is a basic right of any consumer borrowing money. Since 1968, when the federal Truth In Lending Act was first adopted, borrowers have been given the information about the actual cost of credit in terms of an Annual Percentage Rate (APR).

Consumers typically get their money in about 4 days through an RAL, while the average time to process an electronically filed return is about 18 days. Thus, the borrower, in effect, gets a 14 day loan. For this the taxpayer commonly pays a \$35 fee to open a deposit account at a participating bank. If the average refund for electronically filed returns is about \$1,100, with a RAL fee of \$35, the APR on a 14-day loan of \$1,100 is 82.85%. (This APR excludes the impact of the extra charge for electronically filing the tax return, which averages \$20.)

The following are examples of actual APRs on RALs with a \$35 fee and a loan period of fourteen days:

\$ 500 loan - 193.55% APR  
 \$ 750 loan - 125.88% APR  
 \$1,000 loan - 93.26% APR  
 \$1,500 loan - 61.43% APR  
 \$2,000 loan - 45.80% APR

However, currently most RAL lenders are taking advantage of a loophole in the Truth In Lending law and are not disclosing true APRs. RAL lenders are calling these loans "demand notes," notes to be based on an assumed maturity of one year. Thus, in the case of the \$1,100

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<sup>6</sup> See testimony of Randolph Barnhouse, Executive Director of DNA - Peoples Legal Services of Window Rock, Arizona.

refund described above, the *disclosed* APR might be only 3.29%. Disclosures like this do not tell the consumer the true cost of the credit.

RALs are not really demand notes, but rather a loan the payment of which is contingent on a future event. Given this fact, disclosures on RALs should be made on the basis of estimates as to the actual repayment period, or 14 days in the example used above.

In 1990, the Commentary to the Truth In Lending Act was amended specifically to deal with the disclosures for refund anticipation loans (RALs).<sup>7</sup> The Commentary now states that Truth In Lending disclosures on RALs must be based on the estimated time of receipt of the refund *only if there is a legal obligation to repay at that time.*<sup>8</sup> Whether there is a "legal obligation" to repay at that time is determinable by reference to state or other applicable law, not, according to the Commentary, whether it is the creditor's *practice* to demand repayment of the loan when the refund is received.<sup>9</sup> This reasoning is circular and provides no relief to consumers.

This problem can be remedied by a direction to the Federal Reserve Board to require that RALs be treated as the *practice* of the lender indicates - as non-demand notes. Although, RAL lenders will strongly object to this, there is little excuse not to require that these lenders conform to all of the requirements that all other lenders follow. Consumers have a right to know the real cost of the money they are borrowing.<sup>10</sup>

3. Require the disclosure of the effects of non-payment. Most RAL lenders try to determine the actual availability of the tax refund before extending credit. Nevertheless, occasionally after the loan will be made the IRS will find that the refund must be applied to overdue child support, a delinquent student loan, or back taxes due from another year. In this case, the taxpayer-borrower ends up owing the amount of the loan, plus the fees, to the RAL

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<sup>7</sup> Official Staff Commentary § 226.17(c)(1)-17, published 55 Fed. Reg. 13103 (April 9, 1990).

<sup>8</sup> The staff based that interpretation on Reg. Z §226.17(c)(1), which states that the disclosures shall reflect the terms of the legal obligation between the parties. Supplementary Information, 55 Fed. Reg. 13103, 13106 (April 9, 1990).

<sup>9</sup> Official Staff Commentary §226.17(c)(1)-17, published 55 Fed. Reg. 13103 (April 9, 1990).

<sup>10</sup> In fact, Maine requires disclosure of a realistic APR based on the bank's actual practice, Maine Stat. T. 9-A § 8-106.

lender. The possibility of this happening, and the resulting debt, due immediately, must be fully and thoroughly disclosed to the taxpayer.

Additionally, other issues which would arise in the event of non payment of the tax refund to the lender should be fully disclosed. For example, What are the consequences of non-payment? Would any interest be charged on these loans? Are there terms available for installment payments?

4. Require the disclosure of the availability of electronic filing. According to the IRS, a refund from an electronically filed return should be sent to the taxpayer within three weeks. This fact should be disclosed to taxpayers so that they understand that through an RAL they are getting their money only about two weeks sooner than if they simply had their return electronically filed.

5. Require that disclosures be made at the time of the solicitation for the RAL. Typically, tax preparers offer taxpayers an RAL at the time the tax return is prepared. On that date, or one soon after, the taxpayer signs an application for a RAL. No information relating to the loan is given to the borrower until several days later when a check, representing the amount of the loan, is given to the taxpayer. The borrower's endorsement of the check is his/her acceptance of the terms of the loan. The only disclosures ever given to the borrower are given at the same time the check is handed over. This is too late.

As these loans are a relatively new product on the market, few borrowers really understand their costs and how they work. The limited information given to them at the same time as the check is given does not give the borrower the opportunity to make an informed choice about the real costs of Refund Anticipation Loans.

At the time the taxpayer applies for the RAL he/she should be given information about 1) the probable cost of the loan in terms of an Annual Percentage rate; 2) the possibility that the anticipated refund will be diverted by the IRS and the effects on the taxpayer of this; and 3) the availability and savings involved by simply electronically filing the tax return.

6. Prohibit the sale of insurance or the taking of other security on RALs. RALs are short term notes. There is very little risk, and small cost in the extension of this type of credit. No

insurance is necessary; neither is any other intangible product unrelated to the preparation and filing of the tax return, and the establishment of the deposit account for the RAL. RAL lenders should be clearly prohibited from selling these other products and from taking any security on the loan other than the contents of the deposit account.

7. Establish clear penalties for violations of both the law, and the promises made to consumers. One of the major complaints consumers make about RALs is that the money is not delivered to them within the promised time periods. If this failure is due to the fault of the lender, there should be some way to enforce these commitments.

8. Provide the Office of the Comptroller of the Currency with the authority to regulate national banks in practice of making RALs across state lines. Most lenders of RAL loans are national banks. They generally claim to be exempt from the consumer laws and interest rate limits of the states in which they make their RAL loans (see discussion below regarding interstate banking). The OCC regulates national banks. The OCC should be given the authority to oversee the practices of national banks relating to RALs. In this way, unconscionable rates would be limited, and unfair practices prohibited.

#### RALs REQUIRE CONGRESS TO RECOGNIZE DANGERS OF UNLIMITED INTERSTATE BANKING

By virtue of the National Banking Act,<sup>11</sup> one state cannot limit the interest charged by a bank operating out of another state.<sup>12</sup> The maximum interest rate that can be charged is limited only by the home state in which the national bank is chartered. As interstate branching is not currently allowed,<sup>13</sup> a national bank in one state has limited access to consumers in other states.<sup>14</sup>

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<sup>11</sup> National Bank Act of 1864, Ch. 106, § 30, 13 Stat. 108 codified at 12 U.S.C. § 85.

<sup>12</sup> See *Marquette Nat'l Bank of Minneapolis v. First Omaha Service Corp.*, 439 U.S. 299 (1978), and *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1978).

<sup>13</sup> Although as the members of this Committee are well aware, interstate branching is currently being considered by this Congress. See, e.g. H.R. 2235, 103rd Congress, § 102 (introduced by Rep. Vento, D. Minn.)

<sup>14</sup> The McFadden Act, Ch. 191, § 7, 44 Stat. 1224, 1228-9 (1927) codified at 12 U.S.C. §36, prevents national banks from establishing branch operations across state borders, unless state laws permit such branching.

To date the primary way that consumers have been made aware of the effect of the allowed exportation of interest rates by national banks is through credit cards. A bank in Georgia which provides a credit card to a consumer in North Carolina may charge the North Carolina consumer those rates which are allowed by Georgia's law, rather than be limited to those allowed under North Carolina's law. The rationale for this is that when interstate commerce is the mechanism by which the loan is made a state cannot limit the interest rates charged by the foreign state's bank. The issue of exactly which terms of the loans are subject to the home state of the national bank, or to the state in which the consumer resides has been hotly contested.<sup>15</sup>

Most everyone on all sides of the deregulation debate has agreed that - with the exception of home mortgage lending - a state should be allowed to regulate the consumer loans, and set the consumer protection laws, for loans made within the state borders. Indeed, until the *Cade*<sup>16</sup> case interpreting RALs, no court case has ever held that a bank or its agents with offices located across state lines could impose the out-of-state laws on interest rates, except in the limited situation of credit cards. If a bank operates out of state and makes loans in state by use of instrumentalities of interstate commerce, the bank can use its home state's interest rates. However, if the bank operates and distributes loan proceeds from an office in the consumer's home state it would be subject to the consumer's state interest rate limits.

However, the *Cade* case goes much further. It holds that a bank in one state, may operate - using its home state's interest rate caps - in another state *simply by virtue of the presence of an agent* in the consumer's state. (In this case Beneficial National Bank argued that by virtue of the presence of its' agent, H & R Block, in South Carolina, it could make loans *not* subject to South Carolina's interest rate laws.<sup>17</sup>)

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<sup>15</sup> See, e.g., *Greenwood Trust Co. v. Massachusetts*, 971 F. 2d 818 (1st Cir. 1992); *Tikkanen v. Citibank*, 801 F. Supp. 270 (D. Minn. 1992); *Hill v. Chemical Bank*, 799 Supp. 948 (D. Minn. 1992); *Nelson v. Citibank*; 794 F. Supp. 312 (D. Minn. 1992).

<sup>16</sup> Civ. No. 4:92-1454-21 (D. S.C., Jul. 16, 1993) (Order granting partial summary judgment).

<sup>17</sup> The pattern of RAL loan making in the *Cade* case is typical of RAL loans across the nation. As set out in the brief of *Amici Curiae*:

\*A tax refund anticipation loan generally works like this: Tax preparer, e.g., H & R Block office, is set up to file tax return electronically. Pursuant to an agreement between an out-of-state/Delaware based bank and the tax preparer (in this case, Beneficial National Bank, and H & R Block) local consumers are solicited for a RAL loan and given a loan application for the out-of-state bank/Delaware based bank. As part of the application the consumer agrees to establish an account at the out-of-state bank and authorizes the IRS to send his/her refund to that account (the consumer has no real access to

The potential evils which would result from a prevailing decision in the *Cade* case (which is currently on appeal to the Fourth Circuit Court of Appeals) unless specifically overruled by Congress are depicted in the *amici curiae* brief of live attorneys general:

- The decision "ignores that federal law leaves the decision as to whether banks may operate branches across state borders almost entirely in the hands of the states. . . . Second, it conflicts with the understanding presently being promoted in Congress in furtherance of legislation facilitating interstate branch banking. Congressional proponents of interstate branch banking have drafted their legislative proposals so that state consumer laws will apply to such branches, and have even provided a mechanism by which states can opt out of permitting interstate branching."(citations omitted)<sup>18</sup>
- "Another pernicious . . . result of the lower court's decision is that the expanded preemption would eviscerate state laws licensing and regulating small consumer loan companies. Many states, including each of the *amici* states to this brief, have laws permitting certain licensed loan companies to make small loans for consumer purposes. These laws usually allow for a higher rate of interest to be imposed by the qualified licensees. Federal law grants national banks parity in making such loans. . . . However, [national banks] cannot, we contend, make consumer loans at a higher APR than allowed under state law by asserting that they were merely acting as agents for their Delaware affiliate, .... If that were permitted our state small loan laws would be open to wholesale evasion."<sup>19</sup>

If the deregulation permitted by the *Cade* case is allowed to proceed to its natural conclusion, a finance company in West Virginia could make small loans to consumers in West Virginia *without complying with the consumer protections established by the West Virginia legislature* simply by saying that the actual lender was a national bank affiliate.<sup>20</sup>

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this account). The consumer fills the application out, the tax preparer sends it electronically to the out-of-state/Delaware based bank. The bank makes sure no tax liens exist, notifies the tax preparer office that the loan is approved, and transmits the funds to the tax preparer's office electronically through a linked printer where the check is printed for the tax preparer to distribute to the consumer. The tax preparer's office, acting as the bank's agents and per its agreement, distributes the loan proceeds (which equals the tax refund, minus the tax preparer's fee, the fee for electronic filing, and the loan fee) to the consumer. When the IRS sends the tax refund owed to the consumer's out-of-state/Delaware based bank account, the bank, using its right of set-off, immediately takes the money in satisfaction of the RAL loan upon its arrival. BNB, an out-of-state/Delaware based bank, is thus acting through agents to both solicit deposits and make loans through offices located in the South Carolina consumer's home state." *Brief of Amici Curiae in Support of Appellees*, pages 10, 11. \_\_\_\_

<sup>18</sup> *Amici* brief, page 4.

<sup>19</sup> *Amici* brief, pages 6, 7.

<sup>20</sup> *Amici* brief, page 7.

As the alarmed AGs from five states put it:

In short, if tax refund loans involving the solicitation of deposits and lending of monies by out-of-state national banks is permissible, and such loans can be made without reference to the usury laws of the states where the agents' businesses offices are located and loans are made, then where does it end? Why cannot Bank One of West Virginia act as agents for Bank One of Delaware to make car loans to West Virginia consumers at usurious rates and accept car loan payments at the consumer's account set up at the Delaware affiliate? . . . .<sup>21</sup>

If the plaintiffs and the AGs are unsuccessful in their appeal of the *Cade* decision, the parade of horrors that are depicted in the *Amici* brief will become fact throughout the nation, unless Congress stops it.<sup>22</sup>

Deregulation of interest rates is a loose cannon which has spun out of control. Unless stopped by Congress, under its guise, all consumer protections under state law are threatened with mortality.

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STATEMENT OF  
GARY J. PERKINSON  
BEFORE THE SUBCOMMITTEE ON  
CONSUMER CREDIT AND INSURANCE ON  
TAX REFUND ANTICIPATION LOANS (RALs)  
APRIL 14, 1994



**RAL Industry Group Congressional Testimony**  
**The Refund Anticipation Loan**

**Introduction**

Mr. Chairman and Members of the Committee, I am Gary J. Perkinson. I appreciate the Committee's invitation to testify today on Tax Refund Anticipation Loans (RALs). I am coordinator of the Electronic Filing Coalition. The Coalition is a group of Corporations and associations formed to help combat fraud -- through detection and prevention -- associated with the filing of individual tax returns for Refund Anticipation Loans.

In the eight years since its inception, the Refund Anticipation Loan (RAL) program has been an overwhelming success, both among consumers who depend on its convenience, security and timeliness, and among advocates of increased government efficiency.

RALs have proven to be the single most important factor in encouraging individuals to file their tax returns electronically, which is a goal for the IRS and the U.S. Government. Electronic filing is critical to

the IRS if it is to achieve the ambitious efficiency, cost-reduction and fraud-detection goals of its Tax System Modernization program. The 9.5 million RAL-driven electronic filings will be the foundation of future electronic filing efforts.

Since 1987, the financial institutions that comprise the Coalition of Electronic Filers of America -- Banc One, Beneficial National Bank, Greenwood Trust Company and Mellon Bank -- each a state- or federally-regulated institution of national standing and reputation, have participated in the Refund Anticipation Loan (RAL) program. Since then, many institutions and individuals have benefitted tremendously from the program. Among them are the IRS, the federal government and, above all, millions of American taxpayers who want their money fast, as well as those who don't have the luxury of alternative sources of credit or who lack sufficient resources to carry them through the 8-10 week period it often takes to receive a refund check by mail.

Roughly 50 percent of all taxpayers use the service of a professional tax preparer to prepare their tax returns. For those RAL customers who need professional tax assistance to properly prepare their tax returns and lack the money to pay the fees, the RAL program enables them to directly deduct the tax preparation fee, and the electronic filing fee, from the amount of the RAL check, and thus avoid any out-of-pocket expense.

For consumers, the RAL program is a fairly priced, convenient and secure way to participate in the tax system in a way that best suits their needs and the demands of their daily lives.

Short-term loans made against anticipated tax returns are nothing new. Long before reputable -- and regulated -- financial lending institutions entered the business in 1987, unscrupulous "discounters" provided short-term loans against anticipated tax refunds to taxpayers in need of immediate income. Preying on military personnel near their bases and on other consumers from store-fronts, liquor stores, pawn shops and gas stations, the price a typical discounter might charge for making such a loan was often up to one-half of the total refund amount. On the average refund today of \$1,400, that amounts to a "fee" of \$700.

Despite these usurious "fees," people went to the discounters. Some even continue to go, though in greatly reduced numbers. This is because individuals who need -- or want -- access to the tax refund money within days rather than weeks or months, now have an affordable, convenient and secure alternative.

#### What Is A Refund Anticipation Loan?

A Refund Anticipation Loan is a loan made available to taxpayers eligible for a tax refund. A participating bank, regulated by state or federal banking authorities, makes a loan to the taxpayer in the amount of the taxpayer's anticipated tax refund, minus a service fee of

\$29-\$34, regardless of the amount of the loan. Representatives of these lending institutions and of the reputable tax preparers and IRS-approved electronic return originators with whom they are affiliated, are meticulous about disclosing to consumers all the facts concerning the RAL program -- the most fundamental of which is that the RAL is in fact a short-term loan for which the customer pays a fee (sample RAL application attached). By law, the fee must be disclosed in terms of an annual percentage rate (APR). Each customer is required to complete a formal bank loan application that clearly discloses that fact.

The loan is repaid to the lender when the refund is transmitted by the government to an account established for that purpose at the bank extending the RAL. That, by definition, is a Refund Anticipation Loan.

But for the people who depend on it, a RAL goes beyond a short-term loan for which they pay a fee.

The average income of the RAL program participant is approximately \$25,000. For them and their families, the RAL is a short-term loan they can use to pay off outstanding utility bills, the rent, or bills left over from Christmas. For many of our customers, the RAL is how you get your car out of the shop or how you pay your tuition. For some, it's how you pay for that vacation you've been working towards for

so long.<sup>1</sup> The fact is, there is a large population in this country that has no financial cushion and thus depends on the immediate availability of tax refund money.

As a matter of public policy, consider the customer who depends on a RAL to pay off accumulated bills. The longer that person has to wait for his or her refund check -- perhaps as long as 8-10 weeks for tax returns filed through the mail, and longer if it should be lost or stolen -- the more financing charges accumulate on those bills. The more charges, the harder it is, and the longer it takes to regain a sound financial footing. And the longer that takes, the weaker the credit history. The weaker the credit history, the more difficult it becomes to begin reversing the cycle of personal economic decline.

Consider the hard-working couple who decide they want to start an independent trucking company but to do so they need the money quickly to make a down payment on the small business. In their case, for about \$29 they can get their refund within a week and get to work. That's 6-10 weeks of being in business, earning a meaningful income they may otherwise have been deprived of.

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<sup>1</sup> As documented in the "RAL Customer Interviews" video submitted to the IRS in May 1993.

That's what a Refund Anticipation Loan is for our customers. And that's why in a recent survey by the Roper Organization of 500 randomly selected RAL customers, fully 84% indicated that they would use the service again.

The RAL program is also critical to the attainment of several key goals of the IRS and the federal government including greater efficiency and lower processing and administrative costs.

### Who Uses RALs

As revealed in the Roper Survey, the RAL customer profile cuts across almost all demographic strata.

On average the RAL customer has a total household income of approximately \$25,000 and is 34 years old. Seventy-three percent are employed full-time, 9% are employed part-time, 1% are retired, and 17% are not employed. Of those employed, 39% have white-collar jobs, 37% have blue-collar jobs, and 18% are service workers. Fifty-seven percent of RAL customers rent their homes; 40% own them.

Characterized by level of education, fully 87% of RAL customers have completed high school, and more than a third have attended college. Specifically, 52% of RAL customers completed their formal education with a high school diploma, and another 22% also completed some college education without receiving a degree. Beyond that, 10% are

college graduates, while 3% have gone beyond college, either to postgraduate work or to technical and professional schools.

#### Cost Of The RAL Program To Consumers

The RAL is a loan. As such, federal and state truth-in-lending regulations require that the fixed \$29-\$34 RAL fee be disclosed as an annual percentage rate (APR). The APR is based on the average loan maturity of 14 days. Because it is calculated over such a short time period, the APR associated with RALs appears high when compared to APRs on more traditional demand loan products calculated over a longer maturity. That APR, however, is based on a fixed fee amount for the service that customers overwhelmingly agree is fair and reasonable.

According to the 1993 Roper Survey, 88% of repeat users and 80% of first-time users felt the RAL program was a "good value." Eighty-seven percent of borrowers knew that the RAL was a loan. Of the 13 percent who said they did not know it was a loan, half acknowledged that it did not matter in their decision.

The usual lenders' fee for RALs is a flat fee between \$29 and \$34, regardless of the amount of the refund. The fee covers a number of services provided by the RAL lender, including the printing and clearing of the check, electronic transmission and data processing costs, establishment of a bank account, a very large customer service staff,

the absorption of RAL loan losses and collection costs, and the operation of the Fraud Services Bureau, discussed later in more detail.

The lenders' RAL fee, standing alone or combined with the Electronic Return Originators' average electronic filing charge of \$25 to \$35, can be compared to a fee for a money transfer. For example, a Western Union money transfer costs \$75 for amounts from \$1000 to \$1500, the range of the average tax refund loan. Certainly, no one questions the value that Western Union provides to people who need their money in a hurry. One significant difference between the two, however, is that while the money transfer is a no-risk transaction for Western Union, the RAL lender -- not the customer, the IRS or the U.S. government -- bears the risk of the Refund Anticipation Loan.

More important, while demand for the RAL service has increased dramatically over the past five years, the price of RALs has dropped almost 33% on average. And as long as the current structure of the program with the IRS remains intact, further reductions in the price of RALs are likely. The growth of RALs provided by professional and reputable financial institutions will reduce the market share of the discounters who have a vastly inferior product at a grossly inflated price.



### Benefits To The Consumer

Fifty-nine percent of RAL customers agree that they need their tax refund as soon as possible, and 51% said that they need their refund every year in order to pay bills or for living expenses. The ability of the RAL program to provide almost immediate cash in hand is clearly a welcome benefit to these people.

The RAL satisfies other needs as well, even for those people who don't need their money immediately. Apart from the speed and reliability with which customers receive their refunds, the RAL provides the added benefits of convenience and security.

As many residents of high-crime neighborhoods of this country can tell you, tax refund checks are systematically pilfered from mailboxes. Criminals can easily recognize those distinctive brown, government, tax-return envelopes holding refund checks that usually arrive on Saturday. Victims readily report that getting a lost or stolen check replaced by the IRS can be a long, time-consuming process. For many of our customers, the peace of mind and security that comes with knowing that they will be able to pick up their check in person from a safe and convenient location -- that it cannot be lost or stolen -- is worth the \$29 cost of the service on its own.

To be sure, RALs are not for everyone. Those who are not in immediate need of the amount of their tax refunds or have alternative sources of credit may not benefit significantly from the product.

However, industry surveys indicate that nearly half of all RAL customers have no banking relationships outside of the RAL program. Moreover, only a small fraction of all RAL customers would qualify for any alternate credit card or equity line of credit. Without any financial reserves to look to, RAL customers are greatly disadvantaged in meeting their financial obligations if they could not have quick access to their refunds.

RALs help to drive the Earned Income Tax Credit (EITC), a government-sponsored program to help the working poor, by providing and encouraging access to tax services that previously had been unavailable to low-to-moderate income consumers. It should be pointed out that the Administration and the U.S. Congress chose the income tax return as the vehicle to get EITC money directly into the hands of taxpayers without having to first pass through myriad other government agencies. Because of the complexity of even the most simple tax forms, many RAL customers need help with their tax returns and prefer to have them prepared by professional tax preparers. If they get a RAL, those tax preparation costs, as well as the electronic filing charge and RAL fee, can be deducted from the amount of the RAL check so the taxpayer need not pay anything out of pocket for those services. This is often a significant factor in their decision whether or not to file a tax return at all.

In fact, for many of our low-to-moderate income customers with only intermittent employment, the RAL program renews their contact with the IRS tax system. Many of these individuals unwittingly exclude themselves from the benefits of the EITCs by not filing a tax return. Rather than take themselves out of the system, further damaging their economic prospects, these individuals gain access to refunds and expanded EITCs they would not have received otherwise.

#### Benefits To The IRS And Federal Government

The IRS has committed to increasing the number of electronically filed returns from its current level of 12 million in 1993 to 60-80 million by the year 2000; the centerpiece of its Tax Modernization System program.

Statistics clearly show that the RAL program has become the driving force behind the IRS's electronic filing program. In 1993 alone, 12.4 million people filed their returns electronically. Of those, approximately 9.5 million -- over 75% -- chose RALs.

Without the RAL, the number of taxpayers who file electronically would decline dramatically. A survey of 800 professional electronic filers published in the Winter 1993 edition of Electronic Filing Digest showed professional electronic filers estimating a decline in electronic filing of more than 66% without the availability of RALs. RAL consumers went even further. According to the Roper survey, 75%

of those who filed electronically and received a RAL would not file electronically again if the RAL were not available to them.

That would be a very unfortunate, giant step backward.

Electronic filing is faster, less expensive and more accurate than paper returns filed by mail. In fact, according to the General Accounting Office, each electronically filed return costs \$1.62 less to process than a paper return. Conservative estimates are that the IRS's electronic filing program saved U.S. taxpayers many millions of dollars in processing costs for tax returns since the inception of the program, including \$17.7 million in 1992 alone, with the potential for much greater savings in the future.

In significant measure, the RAL program is directly responsible for increased electronic filing, decreased processing and administrative costs, a broadened tax base and increasing numbers of deserving recipients of the Earned Income Tax Credit being brought into the mainstream tax and banking systems.

#### Electronic Filing Coalition

The member banks formed the Coalition in 1992 to address areas of shared concern. Chief among those concerns is fraud. Since the RAL lender -- not the U.S. Government -- must absorb any losses from fraud or abuse detected by the IRS before the loan is repaid (usually 14 days after filing), the industry has a very strong self-interest in identifying instances of possible fraud in electronically filed returns to protect itself

against such losses. In the process, the interests of all taxpayers -- and the U.S. Treasury -- are served.

The Coalition established the Fraud Service Bureau (FSB) in 1993. Costs associated with the FSB, including start-up costs, have amounted to more than \$4 million. The FSB is a clearing house for RAL lenders that uses sophisticated computer technology to measure electronically filed RAL applications and their associated tax returns against a profile of fraudulent applications from prior years. Using artificial intelligence technology, the software actually improves its performance each year as it recognizes evolving patterns of fraud.

In 1993, the RAL banks provided the IRS with names of 13,000 RAL applicants whose loans were denied on the basis of FSB data. This in no way means the application is fraudulent, only that it warrants closer examination.

This effort by the RAL Banks has:

- Provided an effective check on fraudulent applications and electronically filed tax returns; and
- Given the IRS important data for identifying criteria to use in future IRS screening programs.

The FSB is just one example of ways in which good business, good government and good public policy can be one and the same.

As this testimony demonstrates, the Refund Anticipation Loan program is another such example.

Conclusion

Yes, the RAL program is good business. It is a good business because it is an excellent and much-needed product. And we strongly believe that as a matter of good government and good public policy, it should be supported by this Committee and expanded to reach all those who can benefit from it.

In summary, the RAL program is:

- Affordably priced;
- A service highly valued by consumers; and
- A boon to IRS and U.S. Government efforts to improve efficiency, reduce costs and bolster fraud detection.

**PERSONAL LOAN APPLICATION, AUTHORIZATION AND CERTIFICATION FOR A REFUND ANTICIPATION LOAN**  
 A Refund Anticipation Loan Program Offered By Beneficial National Bank In Association With H&R Block

**1. INFORMATION**

Applicant \_\_\_\_\_ Spouse (if joint return) \_\_\_\_\_  
 Home Phone # (\_\_\_\_\_) \_\_\_\_\_ (Required) Home Phone # (\_\_\_\_\_) \_\_\_\_\_ (if different)  
 Work Phone # (\_\_\_\_\_) \_\_\_\_\_ (Required, if employed) Work Phone # (\_\_\_\_\_) \_\_\_\_\_  
 Date of Birth \_\_\_\_\_ (Must be 18 or older)  
 Social Security # \_\_\_\_\_ Social Security # \_\_\_\_\_

**2. NAME, SOCIAL SECURITY NUMBER VALIDATION AND APPLICANT QUALIFICATION (Obtain name & SSN from IRS label whenever possible; ELECTRONIC RETURN ORIGINATOR ("ERO") MUST INITIAL APPROPRIATE BOX.) If multiple surnames on I.D. presented, only items 1, 3 or 5 are acceptable.**

1  Current IRS Mailing Label Check Digits \_\_\_\_\_ 2  Current Social Security Card # \_\_\_\_\_ 3  Current Military ID # \_\_\_\_\_ 4  1992 Tax Return \_\_\_\_\_ 5  CURRENT RAL PRIORITY CARD  
 Enter below the Primary Taxpayer Name and SSN exactly as they appear on the document indicated above.  
 Primary taxpayer \_\_\_\_\_ SSN \_\_\_\_\_  
 If box 2 or 3 is initialed: Did taxpayer file a return in 1992?  Yes  No Is taxpayer eligible for earned income credit?  Yes  No  
 Check box if 1993 income is solely from Schedule C or C-EZ  (See Certification.)

**3. AUTHORIZATION: IF THE 1993 TAX RETURN IS A JOINT RETURN, THE PRONOUNS "I" AND "MY" SHALL BE UNDERSTOOD TO INCLUDE BOTH SPOUSES AND SHALL THIS BE READ AS "WE" AND "OUR," RESPECTIVELY, WHEREVER USED. BY SIGNING BELOW, I HEREBY AGREE TO THE FOLLOWING:**

A. On the date I sign this application, I hereby authorize and request H&R Block to disclose to Beneficial National Bank and its agents ("BNB") my federal income tax return for tax year 1993, my and all other information contained on such tax return, all information supplied to H&R Block in connection with the preparation of such tax return and all other information contained in this form. I authorize and request such disclosure for the purpose of enabling BNB to determine whether or not to make a Refund Anticipation Loan ("RAL") to me in response to my application for such loan which is a part of this form. I further authorize the ERO, BNB and its affiliates or agents, to confirm information on this application and any necessary employment information. H&R Block may not use or disclose such tax return information or such other information for any purpose not otherwise permitted under Treas. Reg. Sec. 301.7716-2) other than as stated herein, except that BNB or its affiliates may use such information to conduct system testing of the RAL program to update such system and keep it operational.  
 B. I authorize H&R Block, Mellon Bank (IR) N.A., Greenwood Trust and Bank One, whichever I have received RALs from previously, to disclose to each other information about their respective credit records concerning my present and prior RALs. If I have any delinquent RALs from prior years with H&R Block, Mellon Bank (IR) N.A., Greenwood Trust and Bank One, that have not been discharged in bankruptcy, by signing below, I authorize and instruct BNB to deduct from the proceeds of my RAL, or any account at BNB or another entity to the balance owed on delinquent RALs and to pay such amount to BNB, Mellon Bank (IR) N.A., Greenwood Trust and Bank One, as the case may be, to pay off the delinquent RALs. In addition, if I have a delinquent RAL with BNB, the proceeds of my secured CARD with BNB may be used to offset such delinquent RAL.  
 C. I understand that the information which will be disclosed to BNB by H&R Block will be part of my application for a RAL. I authorize the use of such information by BNB, or its affiliates, in connection with the solicitation, approval, and collection of such a RAL as well as any other products or services any of them may offer. See also Section 3(E) below.  
 D. I hereby authorize and request BNB to establish an account in my name at BNB to receive payment of my tax refund from the Internal Revenue Service ("IRS"), and I authorize BNB to deduct funds from the proceeds of either my RAL, or my account at BNB and pay H&R Block any fees or charges for the preparation and/or filing of my tax return which I have authorized.  
 E. I authorize and instruct BNB to request and receive credit information about me from any credit reporting agency or third party and submit such information to BNB's affiliated Credit Service Bureau. BNB is affiliated with other Beneficial companies ("Affiliates"). While I understand that the following authorization and instruction is not a requirement to qualify for a RAL, in order that I may learn about the credit or other offerings of Affiliates or their agents, I authorize and instruct BNB to provide in Affiliates or their agents my credit information about me that I have provided on this application or that BNB obtains from any credit reporting agency or third party. I understand that if I am not willing to authorize and instruct BNB to provide such credit information to Affiliates or their agents, I may advise BNB by calling toll-free at 1-800-524-6628. Operators are available 9:00 a.m. to 5:00 p.m. Eastern time on weekdays. If I wish to insure that no such credit information is provided to Affiliates or their agents, I will call within 10 calendar days after the date of this application. BNB may begin to provide such credit information to Affiliates or their agents if I do not call within those 10 days. At any time thereafter, however, I may call the above telephone number and, upon my request, BNB will promptly cease any further provision of such credit information to Affiliates or their agents. However, depending on when in a given month I call, I may receive one solicitation after I call.  
 F. If for any reason any part of the anticipated refund is disallowed or offset by the IRS, or if I should receive a refund check in the mail from the IRS, I agree to advise BNB and promptly pay off my RAL with BNB. I acknowledge, understand and agree that, notwithstanding anything else to the contrary contained either herein or in any other document relating to this transaction, my signing of this Loan Application, Authorization and Certification for a Refund Anticipation Loan and the IRS Transmittal Form 4433 constitutes an irrevocable transfer to BNB of all of my rights, title, and interest in the proceeds of my tax refund to the extent of my RAL and any delinquent RALs made in previous years.  
 G. I understand and agree that BNB may assign its rights relating to my RAL and I further understand and agree that this agreement is governed by Delaware law and applicable Federal law.

**Please Note:** If I have a prior year delinquent RAL, I understand that BNB may be acting as a debt collector hereunder within the meaning of the Fair Debt Collection Practices Act and may use the authorization and instruction in section B above to collect a delinquent RAL debt I owe to the other RAL lenders noted above.

**4. SECURED CARD ACCOUNT:** By checking this box,  I hereby apply for a secured credit card from Beneficial National Bank USA or an add-on to such existing account. I am requesting a credit line of \$\_\_\_\_\_. \*OFFERED ONLY AT PARTICIPATING LOCATIONS.

**5. CERTIFICATION:** By initialing this box, \_\_\_\_\_, I hereby certify that the following information is true with respect to the RAL. I am certifying: (1) I am not a first time filer of a federal income tax return. (2) I do not owe any tax due and/or any tax liens from prior tax years, nor have I previously filed a 1993 Federal Income Tax return. (3) I do not owe any delinquent child support, alimony payments, student loans, V.A. loans or other Federally sponsored loans. (4) I do not have a petition (whether voluntary or involuntary) presently filed, or anticipate filing, under any state or Federal bankruptcy or insolvency laws. (5) I have not had a RAL with BNB, or any other RAL lender, from a prior year that has been discharged in bankruptcy. (6) I have not paid any estimated tax and/or did not have any amount of my 1992 refund applied to my 1993 tax return. (7) The 1993 income I have reported is not solely from Schedule C or C-EZ (Profit or Loss from Business). (8) I do not have a Power of Attorney presently in effect or on file with the IRS to direct my Federal Tax Refund in any Third Party. (9) Everything that I have stated in this Application, Authorization and Certification is correct.

**6. ACKNOWLEDGEMENT/AGREEMENT:** By signing below, I acknowledge and agree that the FINANCE CHARGE for my RAL is \$\_\_\_\_\_ and I further acknowledge and agree that I have read and understand the important disclosures above and on the reverse side of this Loan Application Form including Section 3B above relating to debt collection.

Witnessed \_\_\_\_\_ Signed \_\_\_\_\_ Witnessed \_\_\_\_\_ Signed \_\_\_\_\_ Date \_\_\_\_\_  
 (Initial) (Primary Taxpayer) (Initial) (Spouse, if Joint Return)

NOTE: Electronic Return Originator must witness at least one of the signatures above.  
 I certify that I have received my Refund Anticipation Loan check from Beneficial National Bank \_\_\_\_\_ Date \_\_\_\_\_  
 (If check is mailed to client indicate mailed) \_\_\_\_\_ Client Signature \_\_\_\_\_

**DO NOT SIGN THIS LOAN APPLICATION UNTIL YOU HAVE READ THE IMPORTANT INFORMATION, AUTHORIZATIONS AND DISCLOSURES ABOVE AND ON THE REVERSE SIDE**  
 RTM-0701 (01/94)

### BENEFICIAL NATIONAL BANK REFUND ANTICIPATION LOAN DISCLOSURE STATEMENT

The FINANCE CHARGE on your RAL\* is set forth in section 6 on the front side. Fees are also charged for the completion and electronic filing of your income tax return by your tax preparer/electronic filer. You are responsible for these fees and the repayment of the loan whether or not your tax refund is paid in whole or in part.

Your income tax return can be filed electronically without obtaining a RAL, and the average time within which you can expect to receive a refund if you file electronically and without a RAL is two to three weeks. Alternatively, if you elect to obtain a RAL the loan proceeds will be made available to you within approximately two to five days of your loan approval.

The usual duration of a RAL is approximately two weeks. The following are examples of the ANNUAL PERCENTAGE RATES for hypothetical RALs of varying amounts, having a RAL FINANCE CHARGE of \$29.00 or \$34.00, with 14 day maturity periods.

Hypothetical Loan Amount	RAL - \$29.00 FINANCE CHARGE ANNUAL PERCENTAGE RATE	RAL - \$34.00 FINANCE CHARGE ANNUAL PERCENTAGE RATE
\$ 500.00	151%	177%
\$ 750.00	101%	118%
\$1,000.00	76%	89%
\$1,500.00	50%	59%
\$2,000.00	38%	44%
\$3,000.00	25%	30%

\*Maximum RAL amount offered—\$3,300/minimum RAL amount offered—\$300. Checks in amounts in excess of \$3,300 will be issued by Beneficial National Bank upon receipt of the tax refund received from the IRS.

#### IMPORTANT INFORMATION REGARDING YOUR Refund Anticipation Loan

In this section, the term "You" and "Your" mean the person(s) signing the application.

After you have signed your Loan Application, Authorization and Certification for a Refund Anticipation Loan, H&R Block will electronically transmit (1) your tax return to the IRS and (2) a loan request to Beneficial National Bank. Upon IRS acceptance of your tax return for electronic filing and Direct Deposit and Beneficial National Bank's approval of your loan application, your check for the equivalent of your anticipated tax refund (minus the bank processing fee and any additional authorized fees or charges due H&R Block) will be issued by Beneficial National Bank.

Upon approval of your Refund Anticipation Loan by Beneficial National Bank an account is opened in your name at Beneficial National Bank. This account is established to receive the Direct Deposit of your Federal Tax Refund from the IRS. When you endorse the Refund Anticipation Loan check you have authorized Beneficial National Bank to withdraw the amount deposited into this account by the IRS and apply this amount to your Refund Anticipation Loan balance. If your IRS refund is greater than your RAL, a check in such excess amount will be sent to you shortly after the bank receives your refund.

\*\*\*\*\*

SHOULD ANY OF THE FOLLOWING SITUATIONS OCCUR, IMMEDIATELY CONTACT H&R BLOCK AND CALL BENEFICIAL NATIONAL BANK AT OUR TOLL-FREE NUMBER 1-800-524-0628.

... If you receive a refund check directly from the IRS.

This should not happen since you have chosen Direct Deposit of your refund to your Beneficial National Bank account. However, if it does happen, you must endorse the check made payable to BENEFICIAL NATIONAL BANK, and forward it promptly to: BENEFICIAL NATIONAL BANK, ATTN: BENEFICIAL TAX MASTER'S, 200 BENEFICIAL CENTER, PLAZACK, NEW JERSEY 07077

... If you should receive any correspondence from the IRS regarding your Federal Income Tax Return.

... If the amount of your refund turns out to be less than anticipated.

This could occur if your tax liability is adjusted by the IRS causing your refund to be less than anticipated. If this does occur you will receive a notice from the IRS. You will, of course, be responsible for paying Beneficial National Bank directly any additional amount needed to satisfy your loan. Notify H&R Block and call Beneficial National Bank.

\*\*\*\*\*

... If your Refund Anticipation Loan is declined.

Your Refund Anticipation Loan may be declined if the IRS does not accept your tax return for Direct Deposit. This should not happen since you have signed a certification to the effect that you do not have any outstanding liabilities or you are not a first time filer of a federal income tax return which could cause this decline. Should you have any back tax liens, delinquent child support, delinquent student loans or other Federally sponsored loans which are delinquent, the IRS will mail your refund, if any, to you.

The IRS makes no guarantee with respect to the date the tax refund will be issued or the amount of such refund.

California residents: Applicant, if married, may apply for a separate account.

Ohio residents: The Ohio law against discrimination requires that all creditors make credit equally available to all creditworthy customers, and that credit reporting agencies maintain separate credit histories on each individual upon request. The Ohio Civil Rights Commission administers compliance with these laws.

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Neither the negotiability of this check nor our obligation to pay it is affected in any way by the Loan Agreement below.

\_\_\_\_\_  
First Borrower's Signature and Endorsement

(Seal)

\_\_\_\_\_  
Second Borrower's Signature and Endorsement

(Seal)

NOT VALID UNLESS SIGNED BY EACH PAYEE NAMED  
ON THE REVERSE SIDE OR IF ALTERED IN ANY WAY.

**TRUTH-IN-LENDING DISCLOSURES CONTINUED FROM REVERSE SIDE:**

**Demand Feature:** This loan is payable on demand or when the anticipated refund from the Internal Revenue Service is electronically deposited into your account, whichever occurs first.

**Payment Schedule:** We estimate that a single payment in full will be due approximately 14 days from the date of the accompanying Refund Anticipation Loan ("RAL") check, noted on the reverse side.

**Security Interest:** You have provided us with a security interest in your tax refund payable by the IRS and in the account where it is deposited.

**Late Charge:** If the RAL is not paid in full within 35 days from the date of our demand for repayment, you must pay us an additional 1.5% of the outstanding principal balance of the RAL. You must pay us a like amount for each additional month the RAL is not repaid in full.

**Prepayment:** If you pay off early, you will not be entitled to a refund of part or all of the Finance Charge.

Refer to the Loan Agreement and the Loan Application, Authorization, and Certification for any additional information about non-payment, default, any required prepayment, in full before the scheduled date, any prepayment, refunds and penalties.

\* AMOUNT PAID TO BENEFICIAL NATIONAL BANK FOR PRIOR YEAR UNPAID RAL.

\*\* AMOUNT PAID TO YOUR BENEFICIAL NATIONAL BANK DEPOSIT ACCOUNT TO SECURE YOUR BENEFICIAL NATIONAL BANK USA CREDIT CARD ACCOUNT.

\*\*\* COMBINED AMOUNTS OF \* AND \*\* ABOVE.

NOTICE: Language relating to the Refund Anticipation Loan ("RAL") below and on attached stub does not apply if you have selected our Refund Anticipation Check Product.

**BENEFICIAL NATIONAL BANK LOAN AGREEMENT**

In this Loan Agreement which includes the Truth-in-Lending Disclosure Statement on the attached check stub, the words "you", "your" and "yours" refer to the payee(s) named on the reverse side to whom this check is issued. The words "we", "us" and "our" refer to Beneficial National Bank ("BNB"), the lender named on the reverse side, which issued this check.

By endorsing the check above, you promise to pay us the amount set forth in the "Total of Payments" section on the attached check stub on demand or when the anticipated refund from the Internal Revenue Service ("IRS"), is electronically deposited into the account described below, whichever occurs first. You further agree to each of the terms of this Loan Agreement and the Loan Application, Authorization, and Certification which are incorporated in and hereby made a part of this Loan Agreement.

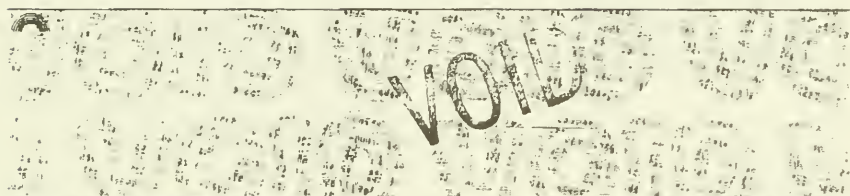
**Security:** You hereby grant us a security interest in (1) the anticipated refund to be paid to you by the IRS for the tax year on which this check is issued, (2) the account described below and (3) all the funds deposited in such account.

You agree that an account is hereby opened in your name at BNB to receive payment of your refund from the IRS. You further agree that we may withdraw any and all amounts in such account from time to time to repay any amounts under this Loan Agreement due us or any BNB affiliate to which your loan is assigned.

**Choice of Law:** The terms and provisions of this Loan Agreement and the Loan Application, Authorization, and Certification are governed by Delaware and Federal Law.

**Late Charge:** If the Refund Anticipation Loan ("RAL") is not repaid in full within 35 days from the date of our demand for repayment, you must pay us an additional 1.5% of the outstanding principal balance of the RAL. You must pay us a like amount for each additional month the RAL is not repaid in full.

VOID



FOR CHECK VERIFICATION CALL 1-800-226-0528 CHECK IS VOID IF COLORED BACKGROUND IS ABSENT NOT VALID WITHOUT MICRONELL SECURITY PAPER

## TRUTH-IN-LENDING DISCLOSURES CONTINUED FROM REVERSE SIDE:

**Demand Features:** This loan is payable on demand or when the anticipated refund from the Internal Revenue Service is electronically deposited into your account, whichever occurs first.

**Payment Schedule:** We estimate that a single payment in full will be due approximately 14 days from the date of the accompanying Refund Anticipation Loan ("RAL") check, noted on the reverse side.

**Security Interest:** You have provided us with a security interest in your tax refund payable by the IRS and in the account where it is deposited.

**Late Charge:** If the RAL is not paid in full within 35 days from the date of our demand for repayment, you must pay us an additional 1.5% of the outstanding principal balance of the RAL. You must pay us a like amount for each additional month the RAL is not repaid in full.

- \* AMOUNT PAID TO BENEFICIAL NATIONAL BANK FOR PRIOR YEAR UNPAID RAL
- \*\* AMOUNT PAID TO YOUR BENEFICIAL NATIONAL BANK DEPOSIT ACCOUNT TO SECURE YOUR BENEFICIAL NATIONAL BANK USA CREDIT CARD ACCOUNT.
- \*\*\* COMBINED AMOUNTS OF \* AND \*\* ABOVE.

INV. CONTROL NO. 222520

Neither the negotiability of this check nor our obligation to pay it is affected in any way by the Loan Agreement below.

\_\_\_\_\_  
First Borrower's Signature and Endorsement (Seal)

\_\_\_\_\_  
Second Borrower's Signature and Endorsement (Seal)

NOT VALID UNLESS SIGNED BY EACH PAYEE NAMED ON THE REVERSE SIDE OR IF ALTERED IN ANY WAY.

NOTICE: Language relating to the Refund Anticipation Loan ("RAL") below and on attached stub does not apply if you have selected our Refund Anticipation Check Product.

## BENEFICIAL NATIONAL BANK LOAN AGREEMENT

In this Loan Agreement which includes the Truth-In-Lending Disclosure Statement on the attached check stub, the words "you", "your" and "yours" refer to the payee(s) named on the reverse side to whom this check is issued. The words "we", "us" and "our" refer to Beneficial National Bank ("BNB"), the lender named on the reverse side, which issued this check.

By endorsing this check above, you promise to pay us the amount set forth in the "Total of Payments" section on the attached check stub on demand or when the anticipated refund from the Internal Revenue Service ("IRS"), is electronically deposited into the account described below, whichever occurs first. You further agree to each of the terms of this Loan Agreement and the Loan Application, Authorization, and Certification which are incorporated in and hereby made a part of this Loan Agreement.

**Security:** You hereby grant us a security interest in (1) the anticipated refund to be paid to you by the IRS for the tax year on which this check is based, (2) the account described below and (3) all the funds deposited in such account.

You agree that an account is hereby opened in your name at BNB to receive payment of your refund from the IRS. You further agree that we may withdraw any and all amounts in such account from time to time to repay any amounts under this Loan Agreement due us or any BNB affiliate to which your loan is assigned.

**Choice of Law:** The terms and provisions of this Loan Agreement and this Loan Application, Authorization, and Certification are governed by Delaware and Federal Law.

**Late Charge:** If the Refund Anticipation Loan ("RAL") is not repaid in full within 35 days from the date of our demand for repayment, you must pay us an additional 1.5% of the outstanding principal balance of the RAL. You must pay us a like amount for each additional month the RAL is not repaid in full.



**NATIONAL ASSOCIATION OF ENROLLED AGENTS**

6000 Executive Boulevard • Suite 205 • Rockville, MD 20852-3813 • (301) 984-6232 • FAX (301) 231-8961

*Members Licensed to Represent Taxpayers Before the Internal Revenue Service*

STATEMENT OF CYNNE WHITE WOLF, EA

MEMBER, GOVERNMENT RELATIONS COMMITTEE

ON BEHALF OF THE

NATIONAL ASSOCIATION OF ENROLLED AGENTS  
(NAEA)

ON

TAX REFUND ANTICIPATION LOANS

BEFORE THE

SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U. S. HOUSE OF REPRESENTATIVE

APRIL 14, 1994

Statement of Cynna White Wolf, EA  
Member, Government Relations Committee  
on behalf of the  
National Association of Enrolled Agents  
(NAEA)  
on  
Tax Refund Anticipation Loans  
before  
Subcommittee on Consumer Credit and Insurance  
on the  
Committee on Banking, Finance and Urban Affairs  
U. S. House of Representatives  
April 14, 1994

Good morning! I am Cynna White Wolf, an enrolled agent with a tax practice in Fredericksburg, Virginia for the last 20 years.

Today, I am presenting testimony on behalf of 8300 members of the National Association of Enrolled Agents (NAEA).

Members of NAEA are professional individuals whose primary expertise is in the field of taxation. They have established this expertise by either passing the Internal Revenue Service's comprehensive, two-day examination on federal taxation or by serving as an IRS employees in an appropriate job classification for at least five years. NAEA members maintain this level of expertise by completing at least 30 hours of continuing professional education each year. Our members work with more than four million (4,000,000) individuals and small business taxpayers annually.

Currently, I am a member of the NAEA Government Relations Committee. Also, I am a trustee of the NAEA Education Foundation and I have previously served as its Chairperson of the Long Range Planning Committee.

On the State level, I am a Past President of the Virginia Society of Enrolled Agents (VSEA), the affiliate organization of NAEA. I have also served as VSEA President, Vics President and Secretary. In addition I have been Chairperson of the Government Relations Committee and a member of the Education Committee.

We would like to thank you for the invitation to appear before the Committee today. Attached is an outline of the various points I shall be addressing.

**TAX REFUND ANTICIPATION LOANS****I) RAL's****A) Pros**

- 1) Fees taken out up front
- 2) IRS encourages RAL by acknowledging if Taxpayer is on offset list
- 3) Banks have high interest rates on very low risk loans
- 4) Banks can turn down loans even if IRS accepts
- 5) Transient population needs money
- 6) Until IRS's technology catches up, there will be a demand
- 7) Taxpayers in dire need of money whether for food, shelter, medicine, or drugs

## B) Cons:

- 1) High cost of getting one's own money
- 2) Unreasonable fees being charged
- 3) Taxpayers unfamiliar with annual percentage rate (APR)  
APR based only on Bank fees not inclusive of total fees
- 4) Many cases of fraud
- 5) Cases of discrimination
- 6) Forcing tax practitioners to become loan officers
- 7) Problems in cashing BAL checks
- 8) Some large companies have tried to monopolize areas by locking in banks with their companies only
- 9) Practitioner/transmitter can be liable for debt if IRS check erroneously does not go to banks. (to repay loan)
- 10) Poor monitoring by IRS of advertising and transmitters



**II) Marketing Techniques****A) Quick/Fast/Instant/Rapid refunds**

- 1) Loan aspect is played down:  
On TV - must read quickly  
In print - fine print
- 2) Misleading advertisement - Taxpayer believes refunds are being processed faster - not that they are receiving a loan of their own money
- 3) Marketing to low income Taxpayers - Earned Income Tax Credit is used as selling technique - told free money given by Government and this can pay for fees up front
- 4) Most Taxpayers do not understand any or all aspects of borrowing
- 5) Most disclosure statements are intimidating - most low income Taxpayers do not have experience in making loans



COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D. C. 20224

April 13, 1994


The Honorable Joseph P. Kennedy II  
Chairman, Subcommittee on Consumer  
Credit and Insurance  
Committee on Banking, Finance and Urban Affairs  
Room 604 O'Neill House Office Building  
Washington, D.C. 20515

Dear Mr. Chairman:

I regret that I am unable to testify at the Subcommittee's hearing on April 14, 1994 on the subject of Refund Anticipation Loans. I appreciate your interest in this topic and share your concern that taxpayers be fully informed of the costs associated with these loans.

Responses to the specific questions you raised in your April 8, 1994 letter are attached to this letter. If you need any additional information, please let me know or have your staff contact Vince Wolfinger of the Legislative Affairs Division at 622-3740.

Sincerely,



for Margaret Milner Richardson

Attachment

## RESPONSES TO THE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

**Question:** What is your understanding of the relationship between electronic filing and RALs?

**Answer:** A Refund Anticipation Loan (RAL) is a private transaction between a taxpayer and a financial institution, by which the institution lends money to the taxpayer to be repaid with the taxpayer's income tax refund. The amount of the loan is generally the amount of the refund less the return preparer's fees and interest and charges on the loan. **The Service is not a party to these loans.** When a tax return is filed electronically, the Service will confirm that the taxpayer is eligible for a refund -- that is, there are no holds on the taxpayer's refund to repay delinquent taxes or other federal debt, such as a student loan. This confirmation, the Direct Deposit Indicator, does not indicate the amount owed or the exact nature of the debt.

**Question:** What has your agency done to ensure taxpayers receive full disclosure of the fees and terms for RALs, and that RALs otherwise conform to applicable federal consumer protection laws?

**Answer:** Revenue Procedure 94-11, Obligations of Participants in the Electronic Filing Program for Form 1040, U.S. Individual Income Tax Return, stipulates that any entity involved in the Electronic Filing Program has an obligation to every taxpayer who applies for a RAL to ensure that the taxpayer understands that a RAL is in fact a loan, and not a substitute for, or a quicker way of receiving, a refund. An Electronic Transmitter/Preparer may charge a flat fee for assisting the taxpayer to apply for the RAL, but the fee must not be related to the amount of the refund or RAL.

The Service may rescind the electronic filing privilege of any Electronic Transmitter/Preparer who violates any provision of the revenue procedure.

## RESPONSES TO THE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE

**Question:** What measures has the agency taken to assure compliance with the Anti-Assignment Act?

**Answer:** Taxpayers can receive their refund in one of two ways: a paper check issued to the taxpayer, or by a direct deposit into an account in their own name at a financial institution. Taxpayers who wish to have their refunds directly deposited into their savings/checking account must supply the following:

Account Name  
Account Number  
Name of Financial Institution  
Routing Transit Number (RTN) of the Financial Institution

This information is both transmitted with the tax return and entered on the Form 8453, which is the document the taxpayer signs. The account designated to receive the deposit must be in the taxpayer's name.

**Question:** Please indicate, to the extent possible, any specific actions your agency has taken or intends to take to prevent injury to consumers in connection with RALs and electronic filing.

**Answer:** In addition to the financial disclosure provisions cited above, Revenue Procedure 94-11 limits the taxpayer information an Electronic Transmitter may disclose to third parties. Tax information may be disclosed to the lending financial institution in connection with the application of a RAL only with the taxpayer's written consent as specified in section 301.7216-3(b) of the regulations.

We have rescinded electronic transmission privileges of transmitters/preparers who have used misleading advertising that did not clearly state that the RAL is a loan and not a tax refund.

**CONSUMER AFFAIRS**

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ALFRED C. CERULLO III  
COMMISSIONER

May 13, 1994

Honorable Joseph P. Kennedy II  
Chairman  
Consumer Credit and Insurance Subcommittee  
of the Committee on Banking, Finance and Urban Affairs  
U.S. House of Representatives  
1210 Longworth House Office Building  
Washington, D.C. 20515-2108

Dear Representative Kennedy:

I am submitting my comments on tax refund anticipation loans that were the subject of the April 14, 1994 hearing of the Consumer Credit and Insurance Subcommittee.

Thank you for your invitation to comment on this issue, and please do not hesitate to contact me if I can be of further assistance.

Sincerely,

Alfred C. Cerullo, III  
Commissioner

**CONSUMER AFFAIRS**

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ALFRED C. CERULLO III  
COMMISSIONER

COMMENTS OF ALFRED C. CERULLO, III  
COMMISSIONER, NEW YORK CITY DEPARTMENT OF CONSUMER ASFFAIRS  
TO THE SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE  
OF THE COMMITTEE ON BANKING, FINANCE AND URABN AFFAIRS  
UNITED STATES HOUSE OF REPRESENTATIVES  
FOR ITS HEARINGS ON  
TAX REFUND ANTICIPATION LOANS  
APRIL 14, 1994

Mr. Chairman and Members of the Subcommittee, my name is Alfred C. Cerullo, III., and I am the Commissioner of the New York City Department of Consumer Affairs. I am responding to your invitation to testify at the timely hearing you had scheduled for April 14, 1994 on Tax Refund Anticipation Loans ("RALs"), and to your request that I address four specific issues relating to such loans. They are:

1. Disclosure requirements for RALs.
2. Recent enforcement actions against H & R Block.
3. Actions taken to ensure fee disclosures to taxpayers and tax preparer compliance with applicable laws.
4. Reforms.

Under the New York City Charter, the Department of Consumer Affairs is responsible for enforcing all laws relating to the advertising and offering for sale and the sale of all commodities, goods, wares and services. As part of its responsibilities, the Department enforces the following laws and regulations that have a direct bearing on the RALs that are the subject of your hearing (copies are attached).

The New York City Income Tax Preparers Law (Administrative Code of the City of New York § 20-739 et seq.) and related regulations.

The New York City Consumer Protection Law (Administrative Code §20-700 et seq.) and related regulation that mandates compliance with federal, state and local laws governing the extension of credit under which the Department enforces the requirements of the federal Truth in Lending Act.

Based on the Department's enforcement experience, here is how I see the issues that you asked me to address.

1. Disclosure requirements for RALs.

The Department first raised the issue of disclosure requirements governing RALs in the suit it filed against Beneficial National Bank (a Delaware bank) on March 23, 1992 in New York State Supreme Court in New York County.

The Department's position in this and subsequent enforcement actions concerning RALs is that such transactions are subject to the disclosure requirements for closed-end loans (Subpart C of Regulation Z) that are payable on demand (§226.17 (c) (5) and note 17 of the Official Commentary and § 226.18 (1) of Regulation Z).

The Department's position, however, has also been that the

generally applicable 1-year maturity that may be presumed for the purpose of computing the annual percentage rate (APR) disclosure for demand loans does not apply to RALs. Such loans are, instead, governed by the more restrictive requirement governing demands loans which state an alternate maturity date for which the APR must be computed based on the alternate maturity date. The Department's contention is that a consumer's RAL obligation establishes a mechanism for determining such alternate maturity date by requiring that the loan be repaid from the proceeds of the income tax refund the consumer agrees to direct deposit in an account the consumer must establish with the lending institution. Since the lending institution "calls" the note upon receipt of the income tax refund, the date the refund is received is the alternate maturity date for the RAL. Note 17 of the Official Staff Commentary mentioned above makes plain that in such cases, the APR disclosures are to be based on the creditor's estimate of the time when refunds will be received.

The Internal Revenue Service currently estimates that for electronically filed returns, direct deposit refunds are received in the consumer's account within two weeks of the filing. The Department has, therefore, insisted that APR disclosures for RALs be computed based on a two-week maturity date rather than the one-year period lenders used, which vastly understated the true APR for such loans.

Since creditors making RALs typically charge a fixed finance charge for all loans within the range specified by the lender (usually not less than \$300 nor more than \$3,000), the maturity date used for computing the APR makes a huge difference in the rate disclosed to consumers. For example, with a fixed \$29 finance charge, the APR on a \$1,200 RAL for the typical 10-day maturity period works out to 90% rather than just the 2.5% which a lender had been disclosing based on the one-year maturity date.

The Department has also insisted in its enforcement actions that the requirement that TILA disclosures be furnished prior to consummation is, in the case of RALs, triggered by the submission of the signed loan application rather than when the consumer receives the check disbursing the loan. Providing the TILA disclosures just prior to disbursing the loan proceeds entirely subverts the purpose of TILA which is to require the disclosure of credit terms early enough in the transaction process so consumers can compare credit costs and make informed credit decisions.

## **2. Recent enforcement actions against H & R Block.**

In March 1993, the Department cited H & R Block in connection with confusing signs about RALs and its Rapid Refund program for electronically filed income tax returns. The confusion was created by two large signs that were juxtaposed at the company's 36 store-front locations throughout New York City, thereby creating the



impression that the company's Rapid Refund electronic filing program would result in a tax refund in two days. In fact, consumers could only receive a RAL in two days, not a tax refund.

These citations were resolved by an Assurance of Compliance the company entered into with the Department in May 1993. Under this assurance, the company specifically undertook to make disclosures that clearly informed consumers about the differences between RALs and the company's Rapid Refund electronic filing program, to make other disclosures to comply with the City's Consumer Protection and Income Tax Preparers Laws, and to pay a \$53,500 fine for violations plus \$1,500 for the cost of the investigation.

The Department had cited H & R Block and entered into Assurances concerning RAL disclosures for four consecutive years beginning in 1990 when such loans first came into widespread use in connection with the electronic filing of income tax returns.

The Department resolved the suit against Beneficial National Bank by entering into an Assurance with the bank. The Department thereafter also entered into Assurances involving RAL disclosures in 1993 with Bank One, Columbus, N.A. and Mellon Bank. Each of these institution has agreed to compute its APR disclosures based on an RALs estimated duration of 14 days.

### **3. Actions taken to ensure fee disclosures to taxpayers and tax preparer compliance with applicable laws.**

As provided by the City's Income Tax Preparers Law, the Department published the text of, publicized and provided to income tax preparers the "Consumer Bill of Rights" flyer that income tax preparers are required to furnish to consumers. The flyer informs consumers about their legal rights and about the obligations of tax preparers, including disclosures to be made about RALs (a copy of the flyer is attached).

During the 1994 income tax filing period, the Department conducted compliance inspections in response to a consumer complaint driven monitoring program.

### **4. Reform proposals to prevent consumer injury in connection with RALs.**

In the case of RALs, consumer injury results from unwisely entering into very costly loans because of confusion about the complicated series of transactions that occur when consumers file their income tax returns electronically to speed up tax refunds due from the IRS.

The confusion surrounding RALs surfaced in this region after the IRS initiated its electronic filing program in the New York

metropolitan area in 1990 for the 1989 tax year.

The refund speed-up is clearly the key feature that attracts tax payers to the electronic filing program. The turn-around time for receiving a refund for electronic filers is up to two weeks if the tax payer elects to have the refund direct-deposited in a checking/savings account or up to three weeks if mailed by check. By contrast, paper filers must wait for a refund for a minimum of four weeks if they file in January, and a minimum of eight weeks if they file in April.

The refund speed-up feature very effectively attracts the intended audience. According to data furnished by the Manhattan IRS District (which includes Manhattan, Staten Island, Bronx and Westchester county), more than 98% of all electronic filers are due income tax refunds. Of the electronic filers who are entitled to refunds, about 80% elect to have the refunds direct-deposited into a savings/checking account. The remainder elect the refund to be made by check. While no data is available about how many of the direct-depositors have obtained RALs, it is estimated that a significant proportion of the consumers who elect direct deposit refunds have taken out RALs. The estimate is undoubtedly close to the mark since the key repayment feature of RALs is that consumers must agree to direct deposit their refund into an account they must open at the financial institution which extends the RAL. The lending institutions then collect the loan by debiting the consumer's account upon receipt of the tax refund.

The key features of electronic income tax filings, rapid IRS refunds and RALs are so closely intertwined that they can easily be made to appear as services that are bundled up into a package that consumers can take only as a whole. It is this confusing impression that our enforcement actions have sought to dispel.

The key to eliminating the confusing picture tax preparers can create about these closely-linked transactions is to require that tax preparers clearly identify the different services that are involved, how the services can be coupled together, and what the cost of each service is when purchased separately or in a bundle.

Requiring that the following disclosures be made by the tax preparer and creditor who combine to offer RALs in connection with electronically filed income tax would minimize consumer confusion and enable consumers to make knowledgeable choices when taking out RALs.

#### APR disclosures and advertising.

Anyone who advertises or offers to make RALs in connection with electronically filed tax returns should be required to include in their advertising the APR for the RAL loans.

The APR disclosure for RALs that are repaid out of direct deposit tax refunds and for which a fixed finance charge is imposed should be required to be computed for the estimated average duration of such loans rather than a longer hypothetical time period. The law should make it unequivocally clear that APR disclosures must be based on such computations to relieve enforcement agencies from the lengthy proofs they may otherwise have to produce in court to establish that this requirement is already imposed under TILA.

Require that the required TILA disclosures be clearly and conspicuously made to consumers at the time they apply for such loans or when they initiate an electronic income tax filing.

Required disclosures about services and fees by tax preparers.

Tax preparers who are authorized to file electronic returns and who participate in arranging or offering RALs should be required to provide at least the following information about their services and fees on signs posted in their office and on flyers furnished to consumers.

Income tax preparation fee (with or without electronic filing).

Electronic filing fee (with or without income tax preparation).

The options for obtaining tax refund payments and the estimated time it takes to obtain the refund under each option.

The schedule of finance charges and the APR for each amount or range of RAL amounts not exceeding a specified increment for each range and how long it takes the consumer to obtain the loan from the time of the filing of the return.

Require that any signs or advertising that refer to the speed of refunds when made in connection with electronically filed income tax returns clearly distinguish between the electronic filing services and the preparer's RAL program. In addition, require that any stated time period for receiving funds that is shorter than the time during which the IRS makes refunds must be identified as the period for disbursing loan proceeds in print or type that is at least as large as the printing or type used to state the shorter time period.

Compliance with the proposed disclosure requirements should be made a condition for obtaining and maintaining a tax preparer's authorization to participate in the electronic income tax filing program of the IRS. The fact is that it is the combination of the

IRS electronic income tax filing and refund speed-up which attracts consumers to RALs and which makes it possible for preparers and creditors to team up to provide the services.

It would therefore be both reasonable and appropriate to impose on those who benefit from this program to be required to make disclosures that enable consumers to make informed choices when purchasing services that can only be provided in connection with the IRS program.

Thank you for this opportunity to participate in your timely hearings on RALs, and I only regret that I was unable to accept your kind invitation to address the subcommittee. Please do not hesitate to contact me if I could be of further assistance in this matter.

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RANDOLPH H. BARNHOUSE  
EXECUTIVE DIRECTOR

*Testimony of Randolph H. Barnhouse*

*Before the*

*House Subcommittee on Consumer Credit  
and Insurance*

*of the*

*Committee on Banking, Finance and  
Urban Affairs*

*On*

*Federal Income Tax Return  
Anticipatory Loans*

*April 14, 1994*

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**RANDOLPH H. BARNHOUSE**  
EXECUTIVE DIRECTOR

**TESTIMONY OF RANDOLPH H. BARNHOUSE  
BEFORE THE  
HOUSE SUBCOMMITTEE ON CONSUMER CREDIT  
AND INSURANCE  
OF THE  
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS  
ON  
FEDERAL INCOME TAX RETURN  
ANTICIPATORY LOANS**

*April 14, 1994*

**I. INTRODUCTION.**

*My name is Randolph Barnhouse. I am Executive Director of DNA-People's Legal Services. DNA is the largest of the Native American Legal Services programs funded by the Legal Services Corporation. We serve members of the Navajo Nation, the Hopi Tribe and the San Juan Southern Paiute Tribe. I would like to thank Chairman Kennedy and members of the Subcommittee for investigating anticipatory tax refund loan abuses, and considering action to remedy some of the more flagrant abuses.*

*Many of the problems with these loans that our clients experience are, no doubt, encountered by low income people from throughout the United States and are based on similar factors: lack of information; lack of access to other credit sources; lack of understanding of interest rates and "fees" not described as interest; pressing needs for financial resources; and similar considerations. Those factors are exacerbated in the communities we serve by cultural and language barriers, borrowers with little or no western-style education, borrowers who speak little English, and the relatively recent shift to a cash economy. I would like to share with the Committee some of the unique characteristics of our client community, and give a few examples of common abuses associated with these types of loans.*

## **II. CREDIT NEEDS OF THE CLIENT COMMUNITY.**

*Most of the people who come to us with problems connected with anticipatory tax refund loans are members of the Navajo Nation. The Navajo Nation is the largest American Indian tribe in the United States, with a total population of nearly 250,000. The Navajo Nation covers more than 17,000,000 acres in three states: Arizona, New Mexico and Utah. The counties in which the Navajo Nation is located are the poorest in all of the three states.<sup>1</sup> Approximately 56% of all members of the Navajo Nation live at or below federal poverty guidelines. Bureau of Indian Affairs (BIA) Labor Force Statistics indicate a much higher poverty rate. According to the BIA, nearly 90% of the Navajos living on or near the Navajo Nation earn less than \$7,000 a year.*

*Consumer loan rate limitations in Arizona, and similar considerations in Utah, combined with the lack of commercial centers in Utah, have led most anticipatory loan businesses to locate their operations in New Mexico. Even though the lenders primarily are located in New Mexico, their practices affect thousands of*

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<sup>1</sup> *McKinley County, New Mexico is the poorest in the state, with approximately 30.2% of its population living in poverty. Apache County, Arizona is the poorest in Arizona, and the eighteenth poorest county in the United States. Approximately 47.1% of the county's population lives in poverty, 94% of whom are Navajo.*

*Navajos in all three states. The convenience of larger commercial centers in New Mexico, combined with the lack of a strong private sector economy on the Navajo Nation, forces most Navajos to go to off reservation bordertowns in New Mexico to shop and bank. The lack of banks serving the Navajo Nation was discussed by Vice-President Marshall Plummer in his testimony before this Committee on October 21, 1993 and February 8, 1994. Because of the lack of banking facilities available to members of the Navajo Nation, people must rely on non-bank credit sources, including pawn shops, rent-to-own retail establishments, and consumer finance companies. Complicated land tenure issues and oppressive government regulation combine to deny Navajos the opportunity to own a home, or develop other assets that could be used as collateral for loans. The result is that obtaining credit becomes difficult, down payments are excessively high, interest rates are far above the norm, and loan repayment periods tend to be extremely short compared to those available to non-Native Americans. Unfortunately, one of the only available sources of collateral for many people is their income tax return.*

*The credit needs of the community are tremendous, and are exacerbated by the relatively recent move towards a cash economy. See, e.g., K. Kelley & P. Whiteley, Navajoland: Family, Settlement and Land Use, Navajo Community College Press, 1989. Cash needs are higher in winter when seasonal jobs are not available. Credit is needed to purchase reliable transportation to haul wood, water and other necessities in this very remote portion of the United States. Cash is needed to pay college tuition and purchase books, to buy or rent furniture, and to buy food, gasoline, propane, and other necessities of life. Income tax returns, coming as they do in late winter and early spring, are relied upon as a source of cash to help families through the winter. Because of this, many people use income tax deductions as a forced savings mechanism, ensuring an infusion of cash during the most difficult time of the year. People also receive large income tax returns because much of the available work is part-time or seasonal, which results in a lower annual income, lower taxes and, therefore, a return of all wages withheld when work was available.*



### III. PROBLEMS WITH INCOME TAX ANTICIPATORY LOANS.

#### (A) Unconscionable Interest Rates.

Because income tax anticipatory loans are one of the few credit sources available at a crucial time of year for many members of the community, those offering the loans often are able to force any requirement they desire on those seeking credit secured by their income tax return. What is extremely unfortunate is that by taking advantage of electronic filing, people could have their income tax returns in three weeks. Instead, they wait a few days, and borrow against their return. The "fee" for such a loan typically is 15% of the total return. Because the lender usually gets the tax return in four to six weeks (see attached article) the resulting annual percentage rate can be as high as 180%. If we only were talking about a \$45.00 fee on a \$500.00 return, that might not seem so outrageous. However, for the reasons discussed earlier, many people receive not only all of their withholdings from their seasonal work, but also qualify for the maximum earned income tax credit. For a family of four in tax year 1993, the maximum earned income tax credit is \$2,364.00. If that were the only money a taxpayer received in her return, her payment to a lender would be \$345.60. She would pay that only to get her money two weeks sooner than she could with electronic filing. It is hard to imagine that Congress, when establishing the earned income tax credit, intended that such a large portion of these payments be paid to consumer lenders.

#### (B) Difficulty in Communicating with the Internal Revenue Service.

One of the greatest problems encountered by consumers when using anticipatory tax loan services is the use by the lender of its own address in communications with the IRS on behalf of the taxpayer. The result is that the IRS uses the lender's address when writing to the taxpayer. That can result in taxpayers missing deadlines for challenging garnishment of income tax returns, never receiving information regarding audits and other reviews by the IRS, and related difficulties.

For example, Betty and Tully S. received an income tax refund anticipation loan for tax year 1992. In September of 1993, the Federal Food and

*Nutrition Service added New Mexico to the states authorized to experiment with the use of garnishing income tax returns to recover alleged food stamp overpayments. The regulations that allow the New Mexico Human Services Department to participate in this program require that a sixty day notice of intent to garnish be sent to the taxpayer at the address provided by the Internal Revenue Service. The only address the IRS had for Betty and Tully S. was the address of the company that gave them an income tax anticipatory loan in early 1993. Therefore, the sixty day notice was sent to the lender. When Betty and Tully went to have their 1993 taxes prepared, the tax service handed them the IRS notice. At that time, their opportunity to appeal the garnishment had expired. Betty and Tully have ten children, eight of whom are dependent. Tully works in construction part-time each year, and traditionally receives 100% of his income tax withholdings as a refund. That, combined with the family's earned income tax credit, would have provided them with much needed money this winter. They have a home with no furniture, and planned to use their income tax return to buy furniture so that their children would not have to eat and sleep on the floor. Not only are Betty and Tully not receiving food stamps, but they also will not receive an income tax return this year because of their inability to challenge the garnishment.*

(C) Tax Credit Cards.

*A local twist on the anticipatory loan is the "tax credit card" offered by certain of the lenders in this area. Taxpayers can use the cards only at retail outlets that accept the cards. The advantage for retailers is that people are limited in the number of places at which they can shop. In return for this advantage, retailers pay the issuer of the tax card a fee that ranges from 10% to 14% of the cost of items bought from the retailer using the cards. Although consumers do not pay a loan "fee" (interest) directly to the issuer, some retailers attempt to recoup the fee they pay by charging more for items bought using a tax "credit card." There have been other problems associated with the lack of any regulatory oversight of these businesses. For example, in 1987 Little Bear's, a local income tax anticipatory lender, filed*

*bankruptcy after issuing tax "credit cards". When Little Bear's filed bankruptcy, it had not paid retailers for tax card purchases. As a result, many clients were left not only without their income tax refund, but also owing money for the tax card purchases they had made. (See attached letter and newspaper article).*

*(D) Confusion with other Consumer Issues.*

*Carolyn P. came into one of our New Mexico offices in March of this year. Ms. P. had gone to a car dealer to purchase a truck. Located with the dealer was a tax preparation service. After having her taxes prepared, Ms. P. signed a Power of Attorney assigning her interest in her anticipated tax return to the car dealer as part of her down payment. Ms. P. purchased a 1973 Ford F-100 pickup truck with over 150,000 miles on it for a total sales price of \$3,396.00. She applied her anticipated \$1,200.00 tax refund to the down payment along with \$300.00 in cash. She borrowed the remainder of the funds for the purchase from the dealer at a 25% annual rate. Within days of purchasing the truck, it became apparent that the high mileage vehicle was totally inappropriate for Ms. P's needs and worth much less than she paid for it. Ms. P. had to replace the starter, the oil pump and have the fuel line cleaned within eight days of her purchase. Unfortunately, she was unable to revoke the power of attorney assigning her refund to the dealer.*

**IV. RECOMMENDATIONS.**

*It is difficult to make recommendations limited to anticipatory income tax loans given that this is only one small part of a failed financial system serving Native American communities. That failure forces many people to use this source of credit because nothing else is available. What is needed is in depth review and subsequent restructuring of the financial industry serving Native American communities. Absent that, adoption of a flat fee for income tax return loans, limiting the use of earned income tax credits to secure tax loans, enactment of usury limits, and similar measures could help regulate what is now a rogue industry. Other measures might include: 1) funding community organizations through the IRS to work with and*

*educate people on the availability of electronic filing; 2) expansion of the IRS's free volunteer clinics in rural, Native American communities; and 3) establishment of programs that pay for income tax preparation and education in rural, Native American communities.*

*Without comprehensive federal review of the unique credit needs of Native American communities, it is doubtful that the socio-economic standards of most Native American communities will dramatically improve in the near future. These communities will continue to remain among the financially poorest in the United States, with devastating unemployment and oppressive poverty continuing to be the norm.*

*I again thank Chairman Kennedy and all Subcommittee members for looking into this very important and neglected area of consumer lending. I will be happy to provide additional information if needed by the Committee.*

*Attachments*

## Tax cards free, cash advance fees costly

**GALLUP** — Although Gallup's unique tax cards have been around for more than 20 years, they are widely misunderstood by both natives and newcomers in the area.

The tax cards enable people to use their tax money before their IRS checks arrive. A common misconception is that they are a means for the interest rate to use the card at participating stores.

In fact, customers may use the tax cards completely free of charge. The credit line is available in the full amount of the project's cost and services are the only two companies in Gallup that offer the tax cards, along with a cash loan service.

People often confuse the tax card with the costly cash loan service because tax customers often use them in combination.

The cash loan service allows you to borrow a portion or all of your projected refund in "cash". This service costs tax customers money ranging 15 percent of the borrowed amount.

### Tax card: friend or foe

The tax card began as a courtesy to regular customers at trading posts, said Ellis Tanner, owner of Ellis Tanner Tax Service. The tradition continues today "to make money available to people during the tough winter months," he said.

Not only do tax cards take the Ellis Tanner tax card and more than 300 businesses accept the T & R card. Participating stores offer a wide range of services and merchandise including clothing, furniture, insurance, tires, cars, eye care and

food.

Although the cards are free to tax customers, merchants must pay a hefty 10 to 14 percent fee on the price of all merchandise purchased with the card.

Most credit cards such as Visa or MasterCard charge only 3 to 4 percent. Merchants who choose to use the tax cards end up with the higher processing fees.

"Basically it's the only game in town," said Loren Pula, tax card merchant and general manager of Fuha Auto Sales. "If you don't accept it, you don't get the business."

Colin Tanner, owner of T & R Tax Services, said his company files about 14,000 returns a year, giving business the chance to draw those 14,000 dollars into the winter time needs the business. It's an ideal opportunity," he said.

Ellis Tanner, Colin Tanner's cousin and toughest competitor, said he files about 6,000 returns a year.

### Merchant card abuse

Abuse of the tax cards by a handful of merchants has given the program "a black eye," Ellis Tanner said.

More than a dozen merchants have tried to blatantly pass the 10 to 14 percent processing fees on to their customers.

"I've taken off several merchants from the program because they were charging a fee for the card, which is a direct violation of my contract," Ellis Tanner said.

In his contract states: "The client shall be entitled, without prejudice to his or her rights, to sue for and recover damages for any services offered by MERCHANT to the general public."

Colin Tanner said he dropped two merchants last year due to this problem. "The beauty of the card is it doesn't cost the customer," he said. "I want to share in the merchant's profit, not gouge my customer."

Ellis Tanner, who has published a book titled "A New York Times editorial" last January by Dolph Burnhouse, executive director of DNA People's Legal Services.

In response to this editorial, Ellis Tanner said he mailed certified letters to all of his merchants family reminding them of their responsibility to follow the terms of their contract.

"I've had a tremendous response back from the letter," he said. "Some merchants are good, honest customers to be wary of extra charges and to report any suspicious merchants."

Colin Tanner said he warns his customers to be wary of extra charges and to report any suspicious merchants.

### Cash will cost you

To guarantee that you will receive the maximum return possible, Burnhouse recommends waiting to receive your IRS check before spending the money.

Filers who choose to borrow money from T & R or Ellis Tanner will pay a 15 percent fee on the amount of the loan. For example, a filer will pay a \$15 charge on \$100 and a \$300 charge on \$2,000.

Burnhouse calls this interest rate "outrageous." "I think a 100 percent rate with zero risk is excessive."

Ellis Tanner said the high-risk nature of this service justifies the loan fee. "I don't make any apologies for the 15 percent fee."



Adam D. Venon/Independent

Freddie and Irene Pelt of Blanding, Utah, discuss Ellis Tanner Tax Services. Ellis Tanner is one of two companies that offers tax cards to customers.

He said the government garnishes 12 to 13 percent of his clients' returns and the IRS usually takes the balance back from the filer's wages.

In cases, he said, he is usually not reimbursed for the cash loans or the purchases charged to the tax cards. Ellis Tanner said most of his customers ask for at least a portion of their refund in cash, in conjunction with using the tax card.

Colin Tanner said the majority of T & R's customers are men, and for their checks. He attributed this to his shortthree-week delivery time on IRS checks.

A price survey of the amount of the amount also added a \$90 flat fee to the "Rapid Return" program. Block of Gallup said it usually takes the filer's wages to get refunds to their employers. By using electronically shortens the waiting time to three to five days, but to \$45.

NMN, INC.  
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**MIDAS SERVICE CENTERS**

HOME OFFICE

1801 SAN JUAN BLVD., FARMINGTON, NEW MEXICO 87401 (505) 327-5373

August 27, 1987

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Dear Mr. \_\_\_\_\_

I regret to inform you that your tax refund has been one of many which the Little Bear's Tax Service did not pay off your charges on, as they have declared bankruptcy. I have enclosed a newspaper article which I feel will help you to understand everyone's point-of-view and position on the issue. Also enclosed, you will find a copy of the charges for services rendered by our company. Since you did sign for these charges and received service you are liable for the bill. I understand this is a surprise to you as it was to us. Therefore, I will be more than happy to help you attempt to get your income tax refund reimbursed from the Internal Revenue Service. Don't despair it may be possible. I will also work with you on setting up a payment plan suitable to your financial needs as I know you were not planning on this bill. Please stop by our office as soon as possible and I will be glad to go over the appropriate procedures and paperwork necessary to be filed with the Internal Revenue Service. This is a very important matter and should be taken care of immediately. Call and set-up an appointment or drop in any time within 10 days from the above date as we need to get the paperwork taken care of.

Sincerely,

Kandice Faver

# Little Bear's Files Bankruptcy

By George Jobst

Daily Times Staff

The owner of a Gallup-based credit service filed two petitions Monday for bankruptcy under Chapter 7 of the U.S. bankruptcy code.

The petitions, filed in U.S. bankruptcy court in Albuquerque, included one for Pasadena and Little Bear, and one for Little Bear's Inc., which operates credit service and schedule listing debts and assets filed with either petition.

Further checks issued.

A Little Bear's spokesman declined, however, that the firm was filing for bankruptcy. A few weeks later, some of the merchants had been paid, but others had not.

One of those is Basin Motor Co., which claims the tax credit service owes it almost \$70,000, and on July 2 Basin filed suit seeking treble damages.

Basin seeks treble damages because, according to the suit, Little Bear's violated the state Fair Practices Act by discriminating against Basin when it allegedly paid other merchants before paying Basin.

In the suit, Basin also alleges that officers of Little Bear's made a statement to the effect that Basin

would be the last to be paid reportedly because of checks issued by Basin.

Another Farmington business man said in July that if the auto dealership is not paid, then it will be forced to collect from customers who used Little Bear's credit vouchers when making a purchase with a major national tax prep firm, would prepare tax return for a fee. If a refund was due, Little Bear's issues a credit voucher and inform them that their down in the amount of the tax refund.

Little Bear's, with a branch in Farmington and in association with a major national tax prep firm, would prepare tax return for a fee. If a refund was due, Little Bear's issues a credit voucher and inform them that their down in the amount of the tax refund.

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