

RALs in Jeopardy After FDIC Warns Bank of Risk

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The end may be near for refund anticipation loans after the FDIC ordered one of the last underwriters of the products to stop backing the controversial loans.

The FDIC on February 10 told Kentucky-based Republic Bank & Trust Co. the loans are unsafe and unsound now that the IRS no longer offers banks its debt indicator, a tool loan providers used to determine whether a taxpayer had outstanding tax liabilities that could be garnished from a tax refund. The IRS stopped offering the indicator in August, a move many observers said would be the death knell for RALs. (For prior coverage, see *Tax Notes*, Aug. 9, 2010, p. 602, *Doc 2010-17498*, or *2010 TNT 151-2*.)

Republic, which finances RALs for Jackson Hewitt and Liberty Tax Service, has 60 days to contest the FDIC's assertion — and it plans to do so, Republic President and CEO Steve Trager told Tax Analysts. "I think we have a high regard for the FDIC, but this is just one of those issues that reasonable minds can disagree on," Trager said.

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The bank, which has offered the loans for 15 years, can continue to offer RALs for the remainder of the 2011 tax filing season, allowing Jackson Hewitt and Liberty Tax Service customers to avail themselves of the loans.

While refund anticipation loans are safe for this filing season, however, the future is much less clear. Within 60 days, bank officials will have to defend the loans at a hearing before an FDIC-appointed administrative law judge, who will make a recommendation to the FDIC board of directors for a final ruling. The board of directors then has 90 days to make a decision.

"Our feeling is that this is possibly the beginning of the end for RALs," said Adam Rust, research director at the Community Reinvestment Association of North Carolina.

Consumer advocates have long criticized RALs, saying the interest rates they charge are too high and hurt low-income taxpayers. Treasury statistics show that in 2008, the median annual income of an RAL customer was \$19,768. In 2009, RALs took more than \$600 million in interest and fees from the refunds of 7.2 million taxpayers, according to the National Consumer Law Center.

Taxpayers who want quick access to cash can take out a refund anticipation loan based on what they expect their income tax refund to be. Republic charges \$61.22 for a RAL of \$1,500. Adding in this fee plus other administrative fees, Liberty Tax Service charges a customer \$110 for a \$1,500 loan.

John Hewitt, CEO of Liberty Tax Service, defended these fees, saying RALs help deliver money quickly to people living paycheck to paycheck. If the loans weren't available, people would pursue other services with potentially higher interest rates. "Back before there was e-filing or RALs, they'd go to a pawn broker or a loan shark," Hewitt said. "People were getting reamed."

The RAL financing market has contracted sharply in recent years. In April 2010, JP Morgan Chase voluntarily stopped backing the loans. On December 24, the Office of Comptroller of Currency ordered HSBC to stop making RALs. HSBC backed the loans for H&R Block, the nation's largest tax preparation company. (For coverage, see *Tax Notes*, Jan. 3, 2011, p. 30, *Doc 2010-27413*, or *2010 TNT 248-1*.)

After H&R Block, Jackson Hewitt and Liberty Tax Service are the nation's second- and third-largest tax preparation companies, respectively. On December 24 H&R Block announced it would no longer offer the controversial loans.

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Critics of RALs argue that now that the IRS offers direct deposit of tax refunds often within 7 to 15 days, there should be less need for consumers to seek instant refunds. Treasury's new program offering tax refunds directly deposited onto prepaid debit cards should also decrease incentives for taxpayers to seek RALs, said Chi Chi Wu, staff

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