

Additional and Final Comments of the  
Community Reinvestment Association of North Carolina

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Regarding

**Advance Notice of Proposed Rulemaking  
Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain  
Other Products in Connection With the Preparation of a Tax Return**

**26 CFR Part 301**

**[REG- 136596–07]  
RIN- 1545–BH12**

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The Community Reinvestment Association of North Carolina submits these comments in support of the Internal Revenue Service issuing rules which prohibit the use of taxpayer information for the purposes of making Refund Anticipation Loans (RALs) because

***RALS exploit certain tax filers and facilitate tax fraud.***

The Community Reinvestment Association of North Carolina is a nonprofit agency that promotes and protects community wealth. The agency is a leader in promoting the use of the EITC and ending RALS at the local, state and national level. The agency has conducted extensive research on the RALS including data analysis, policy and legal research, as well as mystery shopping testing of RAL providers. The agency has met with the leadership of H&R Block, HSBC North America, JP Morgan Chase, Santa Barbara Bank and Trust and Republic Bank as well as the Comptroller of the Currency and Director of the Office of Thrift Supervision to discuss our concerns. This comment letter is based on an informed and active engagement in the issue of RALS and its impact on low income communities.

The Community Reinvestment Association of North Carolina recognizes that RALS are not exploitative to every consumer in every situation. We concede that RALS despite their high cost can be provided in a fair fashion to an informed consumer where exploitation does not take place. Yet the fundamental dynamics of the RAL applied to the majority of borrowers does not meet a standard of fairness and are exploitative.

Our comments will frame a definition of exploitation to examine how RALS exploit certain tax filers. The evaluation will include data analysis, legal proceedings and results of mystery shopping to show that companies providing RALS take advantage of tax filers by 1) using misleading marketing, 2) engaging in unfair lending practices, and 3) targeting and making RALS disproportionately to disadvantaged populations.

The majority of RALS are not involved in tax fraud. But RALS are key to many cases of tax fraud. Our comments will highlight an extended annotated list of legal proceedings which show that RALS facilitate tax fraud.

RALS as allowed by the current IRS rules are exploitative in that it allows a special interest to take advantage of persons, their characteristics or situation through unfair business practices. We urge the IRS to promulgate rules that prohibit the use of taxpayer information for making RALS to remedy these problems.

## **RALS Exploit Certain Tax Filers**

The Treasury Department and the Internal Revenue System generally “believe that taxpayers should have the ability to control the use of disclosure of their tax return information.” (ANPRM, pp. 5-6) and has codified this right in the Final Regulations, Guidance Necessary to Facilitate Electronic Tax Administration-Updating of Section 7216 Regulations (RIN 1545-BA96).

The ANPRM raises the possibility of providing an exception and prohibiting the sharing of information for the purpose of making RALS, if RALS have the consequence of a) tax payers exploiting certain tax filers, and b) creating incentives to defraud the tax system.

The ANPRM does not define exploitation. A contextual framework is provided by the Oxford University Press Political Dictionary, definition of exploitation

*(2) Taking unfair advantage of persons, their characteristics, or their situations. The difficulties are in specifying the nature of the unfairness of the advantage, and the ways in which the opportunity to take advantage arises in the first place, and/or is seized on a particular occasion. For these reasons, the analysis of exploitation is linked inextricably to understandings of power and (in)justice. What is distinctive about exploitation as a particular form of injustice has been controversial; so, too, have been the ways in which (if any) exploitation is a form of power, rather than a possible consequence of it. A particular problem is the identification of exploitative transactions within consensual exchanges, which for some theorists disguise the presence of a power relation, but for others guarantee its absence.*

The controversy of defining exploitation is also at the heart of the controversy of whether RALS are exploitative in a consensual transaction. The RAL industry argues these loan transactions are a legal exchange and provide the consumer with the benefit of receiving their tax refund sooner and for paying their tax preparation fees from the loan proceeds rather than cash upfront. Therefore, insists the industry, RALS are not exploitative.

In a broad analysis, we argue that RALS are exploitative as the loan agreement and formal disclosures, disguise the imbalance of power of the lenders to shift the distribution of income in its direction, impoverishing borrowers, even though their role serves no reasonable purpose. This exploitation is based on a persistent social relationship year after year.

This dynamic involves large corporate tax preparers such as H&R Block, Jackson Hewitt and Liberty Tax Services and their bank partners such JP Morgan Chase, HSBC, Santa Barbara Bank and Trust, Republic Bank providing services to consumers who are disproportionately low income, minority and receive the federal anti-poverty benefit the Earned Income Tax Credit. The inequality of between the corporation and consumer raises concerns of exploitation at both a societal level and within the individual transaction. That the two parties are different in size, resources and sophistication is not

per se controversial. But with the RAL transaction, we argue that it is exploitative because lenders and tax preparers use their differential to *take unfair advantage of persons, their characteristics, or their situations*.

These persons are in a situation which gives the corporations an opportunity for advantage. Consumers are required by law to file taxes. Those most likely to receive a RAL are low income and receiving an EITC cash benefit. While they have a choice in taking a RAL, the required duty of filing taxes and the legitimate business service of preparing taxes creates a situation in which providers of RALS take advantage of a certain population's situation (tax filing) and characteristic (low income) to make high cost loans of little value.

Further, we argue the practices of marketing RALS and providing RALS are unfair and exploitative of consumers because corporations provide misleading information, omit information and conduct business practices which undermine a fair transaction between the parties, thus moving from a consensual exchange to an exploitative transaction.

More simply, the high cost of RALS (36% to 700% APR) take money primarily from low income, minority households receiving anti-poverty benefits and give it to large corporate interests in exchange for little benefit other than a seven to ten day time savings in receiving a tax refund. This transaction takes place during a specific situation of tax filing required by law. This exploitation takes place on the individual transaction and in aggregate where \$900 million in RAL fees are collected from nine million tax filers of whom 84% are low income.<sup>1</sup> The transaction at the individual and aggregate level is unfair based on misleading business practices by the corporations.

### **Impact on North Carolina Communities and Households**

The Community Reinvestment Association of North Carolina has analyzed IRS SPEC data in its attached report "The High Cost of Refund Anticipation Loans in North Carolina" January 2007. We argue that the impact of RALS falls disproportionately on minority, low income households and neighborhoods and that RALS revenue is generated primarily from refunds derived from the federal Earned Income Tax Credit. The following narrative taken from the report illustrates the demographics of who uses RALS and is material to the argument that RALS are exploitive.

#### *Who Uses RALS*

The IRS SPEC database drills down to the zip code level. By using existing data from the US Census, we can intuit more about the actual characteristics of RAL users. For the most part, we rely upon statistics that describe the median or average of any variable about a zip code – be it percent of minority residents or income. The results are unusual in their predictability. High RAL usage neighborhoods are ones with more minorities, with low incomes, with lower than

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<sup>1</sup> (Wu, Chi Chi and Fox, Jean Ann. 2008. "Positive Improvements for Tax Refund Loans, but Consumers Still Warned to Avoid Them: Number of Refund Anticipation Loans Less than 10 million in 2006; Price Drop by Major Industry Players." Consumer Federation of American and the National Consumer Law Center. January 18<sup>th</sup>, 2008.

average rates of owner occupied homes, and with high concentrations of EITC recipients. With just four variables, we can predict more than 87 percent (adjusted r-squared equals .872) of the variation in the percent of RALS in a zip code.

In a regression model, the lower the number associated with significance, the more powerful that variable becomes as a predictor. The predictor here is the percent of RALS in a zip code. The regression model makes a few inferences: First, *the higher the amount of non-whites in a zip code, the more likely it is that it will be the location for a high percentage of RALS*. This is a very strong relationship. (t=6.96, sig=.000)

Some of the communities with the highest rates of RAL use are in areas within North Carolina's "Black Belt". Those include places like Rich Square, Wadesboro, and Ahoskie. RAL use is also high in some inner city neighborhoods in Charlotte with high levels of minority residents. The higher the percentage of white households, the less likely that there is a high incidence of RAL use. This pattern is mapped in Appendix One: RALS are highly concentrated in minority zip codes. Second, *owner occupancy matters*. This makes common sense once you know more about the demographics of RAL use. Owning a home is nothing if not a moat against financial insecurity. Paying high fees to get a tax return two weeks quicker speaks of a decision based upon a very high discount rate.

Third, *RAL usage is most frequent in low income neighborhoods*. Poor people use RALS. Again, the same truths about owning a home come up with this variable. It would be hard to not make this conclusion after examining data about refund anticipation lending. The most graphic evidence of that statement can be taken from looking at the map in Appendix Two. That map shows the overlay between zip codes with the highest rates to RAL use and zip codes with the highest rates of low income filers.

Last, *RAL users are more often than not also EITC users*. The EITC has been called the most successful antipoverty program in the short history of the War on Poverty. The EITC rewards work by giving families that have earned income a refundable tax credit. It is a logical and easy to understand benefit. It can be described as logical because it does not shrink as filers earn more income. It differs from entitlement programs that pay more to workers with lower income. The criticism of those programs is that they effectively discourage workers against seeking more income. The EITC is also simple to understand and easy to administer. It piggybacks on to an existing institution – the tax return – rather than requiring an additional agency.

RALS are frequently popular in the very neighborhoods that can least afford to spend extra money on fringe banking services. The impact is not just significant on a borrower by borrower level. It extends to entire regions. RALS plague the very parts of North Carolina most impacted by poverty.

The map in Appendix Two overlays RAL usage with one measure of poverty – the percent of filers in a zip code that are considered low income. It reflects the inequity in the distribution of income in the United States that so many filers are considered low income. Across North Carolina, almost 63 percent of filers qualify as low income. The hatching marks show zip codes where that rate of low income is more than one standard deviation greater (standard deviation is approximately 10 percent). For the sake of simplicity, that hurdle has been set at zip codes where the rate of low income is more than 75 percent.

We can see that this mostly includes zip codes in the eastern half of the state. A clustering of such zip codes exists in the areas east of Roanoke Rapids, another near Jacksonville, and another in the Sand Hills near Scotland County. The next table shows the zip codes with the highest rate of RAL usage in North Carolina.

Cities like Wadesboro (Anson County), Ahoskie (Hertford County), Rich Square (Northhampton County) and Rockingham (Richmond County) share one thing in common: they all are places considered among the poorest of the poor in North Carolina. Each is a Tier One County in the rankings of economic distress utilized by the North Carolina Department of Commerce. The fact that the filers in these communities are low income is hardly surprising.

In fact, the percent that are low income only clarifies the degree to which RALS strip dollars from the poor. These communities are some of the poorest in North Carolina. That these RALS are relied upon by a low income demographic is particularly clear in these instances. In some of these communities, more than 19 out of 20 RAL users is a low income tax filer. In every instance but one, more than three of four simultaneously received the Earned Income Tax Credit.

There appears to be a peer effect in the decision to use a RAL. Poor people living in rich communities use RALS much less often than do poor people living in very poor communities. To show that, we banded zip codes into ten different groups by median household income. The next table shows the difference in RAL use in the poorest and the richest zip codes. Income: median household income by zip code. What is interesting here is that these findings separate the income of a community from the income of a tax filer – we are comparing the choice to use a RAL among poor (EITC or Low Income) filers in both rich and poor places.

EITC users living in a very poor zip code are almost twice as likely to utilize a RAL as are EITC filers in a rich zip code. Low income filers living in a very poor zip code are more than three times as likely to utilize a RAL as are low income filers living in a rich zip code. The next table shows the zip codes with the greatest number of RAL applications.

Estimates have suggested that RALS regularly cost consumers more than \$100 per return<sup>6</sup> nationally. CRA-NC's own estimate finds roughly the same cost for consumers in North Carolina. Extrapolating from those, this table suggests that consumers collectively spent more than \$400,000 dollars in each of five North

Carolina zip codes. While rural areas have the areas with the highest rate of RAL use, urban areas have the most RAL users.

Clearly from this analysis there is a consistent pattern of persons with similar characteristics (low income and minority) and similar situations (receiving an EITC refund and filing taxes) who use RALS. We argue in the next section that these persons are being taken advantage based on unfair business practices as demonstrated in court findings and the results of mystery shopping.

### **Unfair and Deceptive Marketing and Business Practices**

A consensual, fair transaction that is above the accusation of exploitation is one where the consumer is informed and the transaction conducted fairly. The RAL lender and tax preparer must not have business practices which mislead, misinform or through omission of information unfairly take advantage of the borrower. Advocates argue that here too RALS are found to be exploitative.

From the American Heritage Dictionary: ex·ploi·ta·tion (ĕk'sploi-tā'shən) *n*.

1. The act of employing to the greatest possible advantage: *exploitation of copper deposits*.
2. Utilization of another person or group for selfish purposes: *exploitation of unwary consumers*.
3. An advertising or a publicity program.

We argue that tax preparers and RAL lenders meet each aspect of this definition of exploitation by taking the greatest possible advantage of a group of consumers through their advertising campaigns.

The Community Reinvestment Association of North Carolina argues that RALS are disproportionately marketed to low-income taxpayers, earned income tax credit (EITC) claimants, and communities with high concentrations of minority taxpayers. This predatory targeting of economically vulnerable communities is done largely by tax preparers. The New York Division of Human Rights filed complaints against Jackson Hewitt, Inc. H&R Block and Liberty Tax Services in January of 2008 which allege that both companies “disproportionately targets and sells these abusive products to communities of color and communities with a high concentration of military families, in violation of the Human Rights Law.”<sup>2</sup> Though this case has not been settled, we urge the IRS to consider the arguments and evidence of this complaint in the consideration of the role of tax preparers and lenders in targeting certain tax filers for this high cost loan.

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<sup>2</sup> *New York State, Division of Human Rights v. Jackson Hewitt, Inc. and Jackson Hewitt Tax Service, Inc.* Verified Complaints, available at [http://www.dhr.state.ny.us/pdf/Division%20vs.%20Jackson%20Hewitt\\_Complaint.pdf](http://www.dhr.state.ny.us/pdf/Division%20vs.%20Jackson%20Hewitt_Complaint.pdf) and *New York State, Division of Human Rights v. JTH Tax, Inc. and Subsidiaries, d/b/a Liberty Tax Service*, available at [http://www.dhr.state.ny.us/pdf/Division%20vs.%20Liberty%20Financial\\_Complaint.pdf](http://www.dhr.state.ny.us/pdf/Division%20vs.%20Liberty%20Financial_Complaint.pdf). Filed January 17, 2008.

As the National Taxpayer Advocate has noted, the majority of RALS borrowers are EITC claimants or other low-income taxpayers, many of whom are overly reliant on the advice of tax return preparers.<sup>3</sup> As numerous lawsuits and settlements indicate, tax preparers are often accused of engaging in deceptive, manipulative and fraudulent practices designed to induce such taxpayers to enter into RALS transactions. The annual RAL report produced by the National Consumer Law Center and the Consumer Federation of America describes the history of such misleading and fraudulent tactics on the part of large, national tax preparers.

For example, H&R Block, over a decade, attempted to avoid advertising RALS as what they are—high cost loans—instead using euphemistic terms, such as “rapid refunds” or “instant tax refunds.”<sup>4</sup> The Federal Trade Commission and various state courts, in multiple suits, found these practices were misleading and fraudulent.<sup>5</sup> In 2002, the Federal Court of Appeals for the Fourth Circuit had “little trouble concluding that . . . [H&R] Block acted maliciously, willfully, deliberately, and in bad faith in conducting [its] advertising campaign.”<sup>6</sup> Though private litigation cooled after 2004 because of the frequent use of arbitration clauses in RALS contracts, the California Attorney General brought suits against H&R Block and Jackson Hewitt for misleading statements in the promotion of RALS in 2006.<sup>7</sup> Jackson Hewitt settled for \$4 million in consumer refunds and \$1 million in penalties and costs.<sup>8</sup>

A number of other legal cases indicate that there is a consistent pattern of tax preparers making false or misleading advertising.

- ***Beneficial Corp. v. FTC***, 542 F.2d 611 (3rd Cir. 1976). FTC held that use of tax info for loan solicitations was unfair and deceptive trade practice amounting to abuse of confidential relationship in violation of 15 U.S.C.S. § 45(c). Court held that Commission proscribing use of the term “instant tax refund” or any other word or words of similar import or meaning, without consideration of the context, was an abuse of the Commission's remedial discretion. The court vacated and remanded the decision in this regard. Otherwise, the Commission's order was affirmed.

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<sup>3</sup> National Taxpayer Advocate FY 2007 Objectives Report to Congress, vol. II, *The Role of the IRS in the Refund Anticipation Loan Industry*, at 18 (June 30, 2006).

<sup>4</sup> See National Consumer Law Center/Consumer Federation of America's 2002 RAL Report discussing H&R Block's attempts to market RALS as “instant tax refunds” or “rapid refunds” at 25–27.

<sup>5</sup> *Id.*

<sup>6</sup> *JTH Tax v. H&R Block Eastern Tax Services*, 28 Fed. Appx. 207, 214 (4th Cir 2002) (unreported).

<sup>7</sup> Complaint, *People of California v. H&R Block, Inc.*, (Cal. Supt. Ct. San Francisco Feb. 15, 2006), available at [http://ag.gov/newsalerts/cms06/06-013\\_0a.pdf](http://ag.gov/newsalerts/cms06/06-013_0a.pdf); *People of the State of California v. Jackson Hewitt*, Case No. 070304558 (Cal. Supt. Ct. Alameda Cty Jan. 3, 2007), available at [http://ag.ca.gov/cms\\_pdfs/press/2007-01-03\\_Jackson\\_Hewitt\\_Settlement\\_Judgment.pdf](http://ag.ca.gov/cms_pdfs/press/2007-01-03_Jackson_Hewitt_Settlement_Judgment.pdf)

<sup>8</sup> See Complaint, *Hood v. Santa Barbara Bank & Trust*, Case No. 1156354 (Cal. Super. Ct. County of Santa Barbara march 18, 2003), available at [www.consumerlaw.org/initiatives/refund\\_anticipation](http://www.consumerlaw.org/initiatives/refund_anticipation).



- ***JTH Tax, Inc. v. H&R Block Eastern Tax Servs.***, 128 F.Supp.2d 926 (E. D. VA. 2001).<sup>9</sup> Lawsuit brought against H&R Block finding that H&R Block falsely advertised its RAL during the 2000 tax season.
- ***Carnegie v. Household Int'l, Inc.***, 445 F.Supp.2d 1032 (N. D. Ill. 2006). A nationwide class action lawsuit, originally entitled *Reynolds v. Beneficial National Bank*, charging that H&R Block's RALS partner, Beneficial/Household with violating a range of laws. The case was settled \$39.75 million in 2006.
- ***Hood v. Santa Barbara Bank & Trust***. Class action lawsuit challenging cross-lender agreements to collect late RALS fees in violation of California's debt collection and unfair trade practices law. See Complaint, Case No. 1156364 (Ca. Super. Ct. County of Santa Barabara 2003), available at [http://www.consumerlaw.org/issues/cocounseling/content/s\\_barbara\\_case.pdf](http://www.consumerlaw.org/issues/cocounseling/content/s_barbara_case.pdf).
- ***The People of the State of New York v. H&R Block, Inc.***, Lawsuit brought by the New Attorney General in response to the targeted marketing of Express IRAs to low-income clients. The Express IRAs were virtually guaranteed to fail based on the fee structure. See Complaint, available at <http://www.oag.state.ny.us/press/2006/mar/H%20%20R%20BLOCK%20COMPLAINT.pdf>.

### **Mystery Shopping Reveals Pattern of Exploitation**

The Community Reinvestment Association of North Carolina worked with the National Consumer Law Center to test tax preparers for the fairness of the loan transaction. The tests were conducted in Durham and Philadelphia. The complete results are available in the report "Tax preparers Take a Bite Out of Refunds, Mystery Shopper Tests Expose Refund Anticipation Loan Abuses in Durham and Philadelphia" April, 2008 submitted by reference with the National Consumer Law Center comments.

Below is the excerpt of the report which demonstrate that tax preparers have business practices that mislead or misinform borrowers or through the omission of information on the alternatives to receiving the refund, structure the transaction so as to steer the customer to taking the loan. While a few testers were fully informed, the majority in one fashion or another were not. The practice of not providing full and fair information when making the RAL is exploitative. Despite the existing regulations and affirmations of tax preparers to follow them, they do not. RALS are inherently an exploitative practice.

#### **1. Failure to disclosure that a RAL is a loan**

Three of ten testers (or 30%) in the Durham tests were not told that a RAL was a loan. The eleventh tester was not offered a RAL or RAC, and the twelfth tester never reached the issue because he withdrew due to poor quality tax preparation. For one preparer who did not explain that a RAL is a loan, the tester (TR) saw the watermark on the loan documents that disclosed the fact. Thus, many of the

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<sup>9</sup> Affirmed in part, vacated in part, and remanding in part, 2002 U.S. App. LEXIS 477 (4th Cir. 2002) (the appellate court substantially affirmed the District Court's decision, but vacated and remanded the calculation of damages nad scope of the injunction; findings of bad faith and malice upheld.)

Durham preparers did fulfill the basic requirement of informing the taxpayer of the nature of a RAL, but the fact that 30% did not raises concerns.

In Philadelphia, the rate was much worse – 2 of the 5 preparers (40%) did not explain that a RAL was a loan, and two more (40%) did so only after questioning by testers.

The CLS testers provided detailed narratives of their experiences. One tester (EF) described the lack of explanation at an independent preparer's office, reporting that the preparer never explicitly referred to the RAL as a loan, nor were the loan terms disclosed until the moment of signing. EF concluded that: "The loan was poorly explained, verging on misrepresentation." EF also explained:

I was then told that I had three options.

1. If I paid an additional \$48 I would receive my refund tomorrow.
2. I could pay \$42 and receive my refund in two weeks.
3. I could pay nothing and receive the refund in six weeks.

At no time did he refer to this as a loan. One could easily have thought he was just charging an extra fee for expedited service. At this point I asked what the total cost would be, including preparation. While he was rattling off the numbers he listed a \$53.46 fee to Chase. I then asked what Chase had to do with anything. He finally said that they were the bank that would be backing my Refund Anticipation Loan. I asked if the \$48 was pre-paid interest and he said "yes."

Another tester [KH] had this to say about a different independent preparer: The preparer always referred to the RAL, or refund anticipation loan, option by using the acronym "RAL." She never described it as a loan. The computer screen displaying the refund options did include the word "loan," but only once and in small print. When [KH] directly asked the preparer what a "RAL" was, the preparer told her, "It's the way you get your money faster."

A married couple of testers (A&VS) described a similar experience in a Jackson Hewitt office in Philadelphia. The Hewitt preparer only presented A&VS the options of a paper check taking 21-28 days, a RAC, a RAL, or an instant RAL. According to A&VS: the preparer did not explain that the "RAL"/one day option was a loan. The preparer always referred to the option of taking out a refund anticipation loan by using its acronym, "RAL," and never once used the word "loan" to describe it.

2. Presenting the RAL as a default, without presenting other options.

An especially egregious practice documented in the past has been signing taxpayers up for a RAL as a default, without presenting other options.<sup>2</sup> One tester (BK) appears to be a victim of this practice. A Liberty Tax preparer in Durham signed up BK for a RAL by default, and did not present her with other options. Also, a tester in Philadelphia (KH) was only presented with a RAL or RAC as an option, and not informed of free options.

The testing revealed another abusive practice -- requiring taxpayers to receive and pay for a RAC for a state refund. RAL banks do not offer loans on state refunds, but they do offer RACs for them. Three testers were automatically given a RAC for a state refund at a cost of \$10 when they received a RAL or RAC for their federal refund. This abuse was observed at two Jackson Hewitt offices in Philadelphia (A&VS and TM) and a Liberty office in Durham (OH). Since tax preparation fees could already be deducted from the RAL or RAC for the federal refund, imposing a \$10 fee for processing a state refund offers little benefit to the taxpayer, especially if the taxpayer has a bank account already.

### 3. Failure to Disclose Free E-File, Direct Deposit Option

Very few of the tax preparers in either city informed testers about the option to receive a refund in 8 to 15 days if they e-file and use direct deposit. In Philadelphia, all of the testers specifically noted that they were not offered the free e-file, direct deposit option. In Durham, only one tester (DL) reported that he was informed of the free e-file, direct deposit option. The failure to disclose the ability to receive an e-file, direct deposit refund in 8 to 15 days is problematic because this is the primary method that taxpayers can receive a quick refund without incurring any additional fees. Some states require disclosure of this free option, but in writing, not orally. Without such a disclosure, taxpayers may assume they need to wait several more weeks for a paper check by mail.

Furthermore, some testers were sold RACs, which cost \$30. RACs do not have an advantage in terms of speed over RALS. Also, some preparers charge ancillary fees, such as “document filing” and “e-file” fees, for RACs as well as RALS, making them almost as expensive as RALS. In fact, a couple of testers indicated that they got the impression a RAL was not that expensive because the preparer mentioned it was only a certain amount – e.g., \$9 to \$35 – on top of a RAC. One preparer erroneously told the tester (TM) it would be the same fee. When framed in this manner, some taxpayers may be tempted to take a RAL because they only focus on the marginal costs that the preparer emphasizes, not the total costs – nor the risks.

### 4. Confusion

Even when preparers explained that a RAL was a loan, some of the testers were confused by the preparer’s explanation of the product and by the fees. A common theme in the testing reports is confusion and lack of transparency.

For example, one tester (SH) reported that when a Block preparer discussed a RAL with her, the preparer did say it was a loan “But the fees was an (sic) unclear; she just seemed to do a lot of things w/o explaining them.” This tester also reported:

When it came time to end the procedure, she asked a co-worker, who had just come in about some of the fees that I may or may not incur with the different options for refund receipt [sic]. Overall, she was very nice, but I left feeling a little confused and when it comes to money, that’s not the way you want to feel.

Another tester reported:

[KH] was asked to fill out a two-sided form with her personal information. On the back of the form were three options she could choose for receiving her tax refund, described as: (1) RAL (24-48 hours), (2) Direct Deposit (10-14 days) and, (3) Check by Mail (6-8 weeks). The fees for the various options were not disclosed, so [KH] asked the tax preparer if she had a fee schedule. The preparer told her that a fee schedule was not available, but all of the fees would be broken down for her once the return had been prepared.

The “Direct Deposit” option turned out to be a RAC, not the free e-file, direct deposit option. Later on, after the preparer finished completing the return, she again reviewed the options for receiving the refund proceeds, but this time omitted the free “Check by Mail” option.

Also, two testers (JC and OH)) were denied RALS, and were flipped into RACs. In these cases, the preparers did not adequately explain that the testers would be given another product and they would be charged a fee. In fact, a Liberty preparer implied to one tester (OH) whose RAL was denied that he would receive a check from the government, which was untrue.

The second tester (JC) reported when he returned to the office of an independent preparer “she also notified me that my RAL was converted to a PERC. I asked what a PERC was, and she could not explain in a manner I understood.” A third tester (GC) was denied a RAL and was so confused that she could not even explain whether she had been flipped to a RAC or had paid for the tax preparation out of pocket.

Testers also reported being confused by the “e-file”, “document preparation” and other ancillary fees imposed by independent preparers. One tester (RH) stated “She discounted her fee of \$100.00 [sic] dollars, she had originally said 75.00 so later on I noticed there was a fee for document preparation she never mentioned.”

5. Rushing Clients through documents without allowing time to comprehend them.

One of the problems we have discussed before is that written disclosures are not useful because taxpayers do not have the opportunity to review them. This phenomenon was observed in some of the tests.

One tester (DC) reported being handed:

a series of forms which [the preparer] did not elaborate on that I had to sign to get the RAL. She told me the expected amount, minus their fee, and the banks fee to write the check, but did not explain anything I did not ask. And even when asking it was a very surface answer to the question because they were closing at 9pm. . . . I signed a lot of forms with the cursory explanation of ‘this just means’ and I was told I could pick my check up around the 29<sup>th</sup> and the state would mail a check directly to my house a couple days later. After later reviewing the forms in my packet which I am not sure whether I signed off some of these there were deeper explanations of

terms and conditions and other information which I am not sure whether I was presented or not because there was no place for signature or initials and they do not look familiar.

Another tester (EF) reported that when he tried to read the documents, the preparer at an independent store became anxious. EF recounted how:

The last thing I signed was the loan agreement. I began to read it over and he seemed anxious for me to just sign it and several times made comments to the effect that it was just paperwork laying out what we'd already discussed. The "contract" I signed is titled "Bank Product Information," is extremely vague, and does not explicitly list the terms of the contract being entered into. I thought I remembered signing a contract with at least some more boilerplate language in it, but if I did it was not included in the packet he handed over to me. Furthermore, as opposed to the \$48 figure I had been quoted, the actual bank fee was \$63—with no explanation from [the preparer] as to the disparity between the two figures. Of course, only \$11 of this consisted of pre-paid interest with the rest consisting of various processing charges.

Being rushed seems to be another theme of the tax preparation process. For example, the lead plaintiff in a RAL class action, *Hood v. SBBT*, recounts how she was rushed through the process and told to "sign here and here" so that her paperwork could go in the next "batch."<sup>3</sup> Another tester [TM] recounted how:

The preparer told [TM] that she did not want to keep her at Jackson Hewitt for too long, and she'd work to get her out of the office quickly. [TM] asked if she was being charged by the minute. The preparer cryptically answered, "Yes and no." She stated that there was not a per-minute charge, but the system tracks how long it takes to complete the taxes and she indicated that the fees were "time-based."

Finally, even when they were given adequate information, some testers had difficulty comprehending it. One tester (RH) noted that an independent preparer did show her a poster and pamphlet showing different options to receive a RAL or refund, and even asked her to read the information but "[s]incerely, there was so much info. I just scanned through it. It seemed they could charge me other fees, but she said only the 1%."

## 6. Dissemination of factually incorrect information

In a few instances, preparers gave factually incorrect information to testers about the impact of an unpaid RAL. One tester (EF) reported the following regarding an independent preparer:

I then asked if I would be responsible for any additional fees if the refund fell short of what he had projected. He assured me I wouldn't be responsible for any fees because "We deal with the government for you."

Another tester (AR) reported that when she asked a Block preparer why the APR on

a RAL was so high “she said that I wouldn’t need to worry about it, that’s just if the refund doesn’t come through from the IRS & if it turns out that I owe \$.”

## **RALS Facilitate Tax Fraud**

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

This not only harms vulnerable and unwitting taxpayers, but undermines overall tax compliance. For example, in one case charging fraud by tax preparers who used RALS as a key element of their scheme, the defendants allegedly garnered nearly half a million dollars through the filing of fraudulent claims.<sup>10</sup>

Many tax preparers rely upon the current regulatory structure to market RALS to clients to extract exorbitant fees or defraud the government. In a representative case, Donnella Anderson, operating a tax service from her home prepared tax returns for clients and marketed RALS to these same clients. As part of her scheme, she had the IRS deposit the refunds directly into her account. The court found that, “Anderson knowingly filed 25 fraudulent income-tax returns on behalf of her clients. Anderson altered or created false W-2s to increase the amount of income her clients earned, and listed fraudulent deductions and credits, all with an eye toward increasing the refund she would receive.”<sup>11</sup>

<sup>11</sup> She claimed more than \$114,375 in false refunds in one five month period.

There are numerous cases in which a perpetrator of tax fraud, who may be a tax preparer, will file or assist with the filing of fraudulent tax returns and then enter into RALS on behalf of their “clients” (who may or may not be knowledgeable participants in such schemes), in order to quickly profit off of fraudulent returns, grossly inflated fees, and charges associated with the RALS. The case of *United States v. Okoronkwo* typifies this scheme. As the court described: “Members of this conspiracy would recruit people to file tax returns and assist them in filling out fraudulent returns. . . . These returns were usually filed electronically through the rapid refund system at an office called Tax Sense. When the refund check arrived, conspirators would drive the filer to the bank to cash it, then collect the conspiracy's share of the refund.”<sup>12</sup> To effectuate this scheme, the conspirators “claimed refund anticipation loans [RALS] just under \$3,000, the maximum refund anticipation loan [RAL] a taxpayer could receive through the electronic filing

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<sup>10</sup> DOJ case against Tommie Lee Brown and Leonard Groomes for recruiting people to file fraudulent tax returns filed at H&R Block and requires a RLS from Household Bank FSB through H&R Block. Brown and Groomes filed approximately 74 false returns worth \$466,011.00. DOJ attorney Gregory G. Lockhart. Press Release: [http://www.usdoj.gov/tax/usaopress/2004/txdv04ohs40121\\_1.html](http://www.usdoj.gov/tax/usaopress/2004/txdv04ohs40121_1.html).

<sup>11</sup> In *U.S. v. Anderson*, the defendants got nearly half a million dollars in fraudulent returns. 251 Fed. Apprx. 365, 367 (7th Cir. 2007).

<sup>12</sup> 46 F.3d 426, 430 (5th Cir. 1995).

system. The conspirators were not generous: ordinarily, a filer would get to keep only \$200 out of a \$3000 refund.”<sup>13</sup> This is just one example of many such cases.

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

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

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<sup>13</sup> Id.