CENTER FOR RESPONSIBLE LENDING

April 7, 2008

Douglas Shulman
Commissioner
Internal Revenue Service
CC:PA:LPD:PR (REG-136596-07)
Room 5203
PO Box 7604
Ben Franklin Station,
Washington, DC 20044
VIA EMAIL: http://www.regulations.gov

RE: Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products in Connection With the Preparation of a Tax Return

Dear Commissioner Shulman:

The Center for Responsible Lending (CRL) appreciates the opportunity to comment to the Internal Revenue Service concerning the Advance Notice of Proposed Rulemaking regarding the marketing of Refund Anticipation Loans (RALs) by tax preparers. We commend the IRS for using its authority to curb the potential for abuse when tax preparers can use or share tax return information to sell refund anticipation loans and other products.

CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. We are affiliated with a community development lender, Self Help, which provides carefully underwritten loans to people and small business who have been underserved by other lenders. Over its 27 years of operation, Self Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses, and nonprofit organizations.

Our core philosophy is that responsibly underwritten and priced loans are an invaluable tool to help families and small businesses build wealth. We therefore find it particularly disheartening when we see unfair and usurious lending practices such as RALs that strip rather than build assets.

While we believe that many commercial RALs are abusive financial products that should not be available to consumers without significant protections beyond those currently available, we understand that the IRS does not have jurisdiction over the banks that make these loans. However, the IRS does have the authority to regulate the activity of commercial tax preparers and to sever the close link between the preparer and the loan that facilitates exploitation of taxpayers.

- **RALs carry usurious triple-digit APRs.** Like payday loans, RALs exploit taxpayers by charging them high fees for loans that generally last less than two weeks. Because these loans are primarily marketed

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to lower-income taxpayers, the majority of whom receive the Earned Income Tax Credit, RALs skim off hundreds of millions of U.S. Treasury dollars intended to assist low-income working families.[1]

- **Offering RALs creates a perverse incentive for tax preparers to put their own interests ahead of their clients or even to commit fraud.** Taxpayers trust and rely on their preparers to look out for their interests, yet these same preparers will work to their customers' disadvantage by selling them a product not in their best interest. Some preparers charge their own fees for RAL paperwork or get a kickback from the RAL bank. Tax preparers also are incented to inflate the amount of the tax refund fraudulently to maximize RAL income.[2] Excessive maximization of the refund is a particular problem for so-called "fringe" tax preparers such as car dealers, furniture stores, and jewelry stores, who then encourage their tax preparation customers to use RAL proceeds for the purchase of non-tax-related goods and services.

- **RALs enable tax preparers to charge higher tax preparation fees**. Because many lower-income taxpayers use RALs to pay tax preparation fees, the availability of the RAL makes taxpayers less sensitive to the price of preparation. It also enables preparers to refuse disclosure of the fee and to pad the price with ancillary RAL-related fees such as "e-filing," "service bureau," and other fees.

- **Many taxpayers who choose a RAL do not understand they are taking out a loan.** What makes RALs even worse than other usurious loans like payday loans is the fact that many taxpayers do not even understand that their RAL payment is a loan rather than an expedited refund. Commercial tax preparers aggressively market RALs with language suggesting to taxpayers that they are simply obtaining their tax refunds early.[3]

- **Some RAL recipients will ultimately be denied their refund or receive less than expected.** The RAL is secured by the taxpayer's tax refund, yet at the time the check is cut, the tax return has not yet gone through all of the IRS screens that will determine whether the expected refund is issued. The only screen that is run before banks cut the check is the Debt Indicator screen. However, the IRS has additional screens that still have to be run, such as the dependent database screen and the criminal investigation screen, and it is as a result of these screens that tax refunds will sometimes be denied or reduced.

- **Taxpayers who take out a RAL and then are denied their full refund can end up in some very dangerous situations.** If a taxpayer accrues RAL debt in one tax year, when that same taxpayer goes to

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[1] *See* Comments of the National Consumer Law Center (on behalf of its low-income clients), Consumer Federation of America, and Consumer Action, April 7, 2008, p. 9.

[2] The IRS experience with the Debt Indicator (the IRS screen that RAL lenders rely on) illustrates the connection between RALs and tax fraud. When the IRS terminated the Debt Indicator in 1994, RAL volume declined, and so did fraud. When the IRS reinstated the Debt Indicator, RAL volume went back up, and fraud went up by 1,400 percent. *See* John Tigue & Linda Lacewell, *Tax Litigation – Interview with Loretta C. Argrett – Part II*, New York Law Journal, July 17, 1997. Refund anticipation loans also aid criminals who commit tax fraud, including tax identity theft. The Treasury Department's own financial crimes experts have raised concerns about these loans. In August 2004, the Financial Crimes Enforcement Network (FinCEN) issued a warning to banks about the fraud potential of refund anticipation loans, noting that the speed of these loans leaves lenders little time to perform due diligence. FinCEN, SAR Activity Review, Issue 7, August 2004, at 15-17, available at http://www.fincen.gov/sarreviewissue7.pdf.

[3] Even the very names of many tax preparation services are designed to aid in this misdirection of taxpayers, such as ASAP Rapid Refund Tax Service (FLMagic Tax Refund (FL), Kai's Rapid Tax Refund Service (IL), Xpress Refunds Tax Service (IL), Fast Tax Back (MA), and the Tax Man Refund Express (MA). Similarly, RAL websites have names like 24hourtaxrefund.com, www.fastcashrefundexpress.com, rapidrefund.net, rapidtax.com, and rapidtaxrefund.com.

take out a RAL the following year through a different lender, the new lender can collect on behalf of the previous bank out of the taxpayer's refund in a practice known as "cross-collection." This private garnishment system is rarely disclosed in any way that a typical taxpayer can understand. Similarly, a taxpayer that uses their RAL as the down payment on a car runs the risk of having the car repossessed when the refund does not come through.

Answers to the Specific Questions in the ANPRM

1. If RALs and certain other products create a direct financial incentive for preparers to inflate tax refunds, are there alternative approaches that would eliminate or reduce this incentive?

As long as tax preparers receive any financial benefit from selling a RAL to a taxpayer, that tax preparer will have an incentive to inflate tax refunds or to impose unnecessary and abusive fees. Therefore, we believe any approach that severs the financial interest of the tax preparer from the provision of the RAL will be effective in preventing tax fraud. For additional specific ideas, we refer you to the comments submitted by National Consumer Law Center (on behalf of its low-income clients), the Consumer Federation of America, and Consumer Action.

We do not believe that an approach relying mainly on additional disclosures will make any significant headway in preventing taxpayer exploitation. In our extensive work in the areas of mortgage and payday lending, we have never seen disclosure operate effectively to protect borrowers from predatory lending.

2. If the marketing of RALs and certain other products exploit or have the potential to exploit certain taxpayers, is the approach described in this ANPRM better viewed as protecting taxpayers from exploitation or as restricting taxpayers' ability to control their tax return information? If the latter, is there an alternative approach that would address the concerns described above?

A rule prohibiting tax preparers from using tax return information to offer RALs will protect taxpayers from exploitation. We do not see how this rule could be interpreted as restricting a taxpayer's ability to control tax return information. A taxpayer can still take a copy of his or her tax return and do anything with it, including going to a bank to apply for a RAL (which would likely help the taxpayer understand much more clearly that the RAL is a "real" loan).

3. Should RACs be treated the same way as RALs and audit insurance, or do RACs present lesser concerns?

While RACs do not have the same potential for harm as RALs, our credit union experience leads us to believe that the best solution would be to help taxpayers open real bank accounts. People with bank accounts can now receive their refunds through direct deposit very quickly – as early as 10 days after filing electronically.[4] Banked customers also have access to other reasonably priced financial products to help them avoid other exploitative loans, such as payday and car title loans.

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[4] This timeline is according to IRS press release FS-2008-4, dated January 2008, available at http://www.irs.gov/newsroom/article/0,,id=177056,00.html.

4. Are there other products that present significant concerns for tax compliance or taxpayer exploitation that should be addressed by regulation?

In answer to this question, we refer you to the comments submitted by National Consumer Law Center (on behalf of its low-income clients), the Consumer Federation of America, and Consumer Action.

CRL appreciates the opportunity to comment on the IRS's ANPRM regarding the marketing of RALs. If you have any questions or would like more information, please do not hesitate to contact me at (202) 349-1878.

Sincerely yours,

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