Refund Loan Products and VITA: A Summary of Issues and Options*

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Introduction

In August, 2004, a group of people representing free tax preparation programs, national organizations and consumer advocacy groups met in Baltimore to discuss Refund Anticipation Loans (RALs). The meeting was hosted by the Annie E. Casey Foundation, a major funder of Earned Income Tax Credit (EITC) outreach and free tax preparation for low-income working families.

While the group represented a diversity of views, the overall sense of the attendees was that, attracted by the prospect of large tax refunds – mainly due to eligibility for the EITC – tax preparers and financial institutions take advantage of low-income filers by aggressively marketing products that are often unnecessary at best and predatory at worst. At the same time, the group recognized that there is clear market demand for products that help filers receive their refunds more quickly. In fact, many of those present were experimenting with offering their own versions of quick refund products.

Following the meeting, a workgroup was established to think through these issues and develop guidance for the field. This document provides an executive summary of the workgroup's output. *It begins with a brief overview of tax refund products and then discusses the three major products: RALs, RACs and Stored Value Cards. It explores ways to design better versions of each product that meet market demand in a more consumer-friendly way.* In addition, each topic below provides a reference to a more detailed document with additional information.

I. An Overview of Tax Refund Products

A more detailed discussion of this topic can be found in "A Primer on Fringe Products Associated with RALs" by Dey DelRio and Chris Keeley.

The world of financial products related to tax refunds is quickly expanding and each tax season sees new products and partnerships. Current products include:

Refund Anticipation Loans (RALs). RALs are high-cost, short-term loans secured by taxpayers' expected refunds. Consumers pay three fees for a RAL: a fee for commercial tax preparation, a fee to the preparer to process the RAL and a loan fee to the lender. The total cost can range from $180 to over $250, and eat away at about 10% of the consumer's refund. RAL volume has increased steadily over the past few years. In 2002 filing reason, an estimated 12.7 million consumers received RALs, paying approximately $1.14 billion in loan fees. EITC recipients made up 55 percent of RAL borrowers, even though they accounted for only 15 percent of taxpayers generally. Including tax preparation, loan, administrative and check-cashing fees, the total drain on EITC filers is $1.75 billion.

* For more information on this and related topics, see the companion documents: "A Primer Fringe Products Associated with RALs," "Building a Better Refund Anticipation Loan: Options for VITA Sites," "Building a Better Refund Anticipation Check: Options for VITA Sites" and "Building a Better Stored Value Card: Options for VITA Sites." All documents are available on the National Consumer Law Center's website at www.nclc.org.

Refund Anticipation Checks (RACs). RACs avoid many of the worst features of RALs because they are not loans. Instead, consumers pay to have a temporary account established, allowing them to receive the refund with the speed of direct deposit – generally 8-15 days. Consumers pay a fee to the bank and a separate fee to the tax preparer, totaling about $60, not including the tax preparation fee. Once the refund is deposited, the preparer subtracts its tax preparation and RAC fees, cuts a check to the taxpayer for the remainder of the refund and closes the account. In addition to being promoted as a separate "rapid refund" product, RACs serve as a default product if a consumer is denied a RAL.

Stored Value Cards. Taxpayers can have their refunds or RAL proceeds deposited onto a stored value card. Stored value cards can deliver the speed of e-filed/direct deposit for taxpayers without a bank account. They work like debit cards to make purchases and withdraw cash, but are not linked to a regular bank account. Stored value cards are often called "prepaid debit cards" and branded as a MasterCard or VISA. Stored value cards vary widely in terms of cost, convenience and level of consumer protection, but generally are more expensive and provide fewer protections than bank or credit union accounts.

Related Products. Many tax preparers market an assortment of other products in conjunction with tax preparation. Some of the more common ones are listed below:

- Rent-to-Own Stores. For example, Jackson Hewitt's partnership with Rent-A-Center provides for exclusive cross-marketing and places Jackson Hewitt agents in select Rent-A-Center stores. Taxpayers are offered incentives to use their refund or RAL to rent items at the Rent-A-Center.
- Check Cashers. H&R Block and Jackson Hewitt partner with check cashers to provide services – including check cashing machines – inside tax preparation offices for cashing tax refund and RAL checks. Fees are approximately 2-4% of the check amount, draining additional refund dollars.
- Car Dealerships. A number of tax preparers, including Liberty Tax, partner with car dealers. The dealers send customers' tax information to tax preparers, who e-file the returns. Customers receive a RAL which is used as a down payment for a car (minus RAL fees), and the tax refund is deposited into the dealership's account.
- Cross-Marketing of Other Products. For example, H&R Block markets mortgage, brokerage and financial advisory services to tax preparation clients. Lenders routinely market credit cards, loans, and other product to RAL customers.

The following table summarizes the benefits and costs of quick refund products:

Product	Speed	Cost	Risk	Who it is Best for
Refund Anticipation Loan	Quickest option – taxpayer can get refund in one or two days.	Costs vary by loan amount, but RAL fees for the typical EITC refund exceed $100.	Filers risk owing the lender and damaging their credit if refund is less than expected for any reason.	Filers in crisis who need their refund immediately.
Refund Anticipation Check	Taxpayers receive their refund at the speed of direct deposit, 8-15 days.	Less expensive than RALs; RACs typically cost a fixed $60.	There is little risk associated with RACs.	Filers without a bank account who want or need their refund more quickly, or who want to avoid paying up-front for tax preparation.

Stored Value Card	Taxpayers receive their refund at the speed of direct deposit, 8-15 days.	Costs can vary from $0 to more than $200, depending on product and usage.	Depending on how the card is structured, consumers risk overdrawing on their cards, or loss of the card.	Filers without a bank account who want or need their refund more quickly.

II. Building a Better Refund Anticipation Loan

A more detailed discussion of this topic can be found in "Building a Better Refund Anticipation Loan: Options for VITA Sites" by Amy Audetat, Susan Cocciarelli, Yolanda McGill and Bill Myers.

While the most affordable option is to wait the 10-15 days for a refund to be direct deposited, many people, for a variety of reasons, will want RALs regardless of the circumstances. There are some financially valid reasons for choosing a RAL: many low-income taxpayers don't have the money to pay preparation fees upfront; don't have access to bank accounts for direct deposit; are experiencing time-sensitive financial crises (i.e. broken down car or imminent eviction); or don't believe their mailboxes are a safe means of receiving large checks.

The free tax preparation field can meet this demand with non-predatory products, or alternative RALs, that also provide opportunities for asset development. An alternative RAL might include:

- Free or affordable up-front tax preparation fees
- Upfront, clear, and simple disclosure of costs of loan
- Clear advertisement that the RAL is actually a loan and not an accelerated refund
- Clearly allow client to pay all or some of the fees out-of-pocket
- Create a true bank account for unbanked recipients who would like an account
- Special fee structure for EITC customers
- Loan fees capped at 36% APR / priced as close to cost as possible
- Indemnification against claims by the lender from improper tax preparation
- Education on the cost of RALs and all options for receiving the refund cost-free
- Incentives for becoming banked, such as affordable accounts and eligibility regardless of Chex Systems / credit history
- Linkages to asset-building programs like financial education, IDAs, credit builder loans, homeownership assistance, etc.

Also, in designing an alternative RAL, avoid many of the worst practices of RAL providers:

- Cross collection arrangements among creditors allowing for automatic collection of other debts from the refund in loan agreements
- Mandatory arbitration clauses in loan agreements
- Failure to disclose all tax preparation fees (if any) prior to rendering service
- Failure to provide an option to pay tax preparation fees out-of-pocket
- Failure to inform customer of timetable for receiving refund directly from IRS
- Extra charges for cashing refund checks
- Extra charges to create a new account if the customer is already banked
- Allowing tax preparers to charge "administrative" fees, or otherwise providing financial incentives for tax preparers to arrange RALs
- Marketing additional fringe banking products such as Rent-A-Center arrangements

Alternatives Federal Credit Union in Ithaca, NY operated a VITA site that offered an alternative RAL – the Refund Express – in 2003. Alternatives used their existing Line of Credit to offer the Refund Express, which meant no new forms, paperwork or policies were required. The loan had a $20 set-up fee and an APR of 11.5%. In the first year, 20% of filers requested a Refund Express Loan, while only 10% requested these loans the second year (VITA staff attribute the decrease to increased education). In 2004, the average interest was less than $5, bringing the total cost to under $25. One year later, 66% of new members retained their accounts, and many had moved forward with IDAs, car loans, youth savings accounts, share certificates and other products.

III. Building a Better Refund Anticipation Check

A more detailed discussion of this topic can be found in "Building a Better Refund Anticipation Check: Options for VITA Sites" by Chi Chi Wu.

RACs are preferable to RALs in several respects. First, RACs do not bear the risks of a loan (such as liability for the repayment if for some reason the full refund is not paid by the IRS). Second, RACs are less costly than RALs, by about $75 for the average refund. Furthermore, if designed differently, RACs could be useful tools to encourage asset development.

An alternative RAC would involve a partnership with a bank or credit union to create a regular savings account. The RAC would be issued in an amount less than the entire tax refund, with the remainder deposited into the new account (issuing the full amount as a RAC would automatically close out the account). Essentially, the alternative RAC would use a bank account to "split" the refund into a portion for immediate use and a portion for savings. An alternative RAC might include:

- Free or affordable up-front tax preparation fees
- Upfront, clear, and simple disclosure of the RAC costs
- Clearly allow client to pay all or some of the fees out-of-pocket
- Special fee structure for EITC customers
- Free cashing of the RAC check (or a stored value card could be used)
- Education on the cost of RACs and all options for receiving the refund cost-free

Also, in designing an alternative RAC, avoid many of the worst practices of RAC providers:

- Cross collection arrangements among creditors allowing for automatic collection of other debts from the refund in the RAC agreement
- Mandatory arbitration clauses in the RAC agreement
- Failure to disclose all tax preparation fees (if any) prior to rendering service
- Failure to provide an option to pay tax preparation fees out-of-pocket
- Extra charges for cashing refund check.
- Allowing tax preparers to charge "administrative" fees, or otherwise providing financial incentives for tax preparers to arrange RACs
- Marketing additional fringe banking products such as Rent-A-Center arrangements

In addition, the bank account that is created as part of the alternative RAC should have the following features to maximize asset development and financial education:

- Eligibility regardless of Chex Systems / credit history
- No or low monthly fees
- No minimum balance or a low minimum that is waived until the refund comes in
- At least 20 free transactions each month
- Free or low-cost money orders / bank checks

- Possibility of opening a checking account at low or no cost (may be a special "second chance" account if required by the credit history)
- Low-balance certificates / savers' club
- Linkages to asset-building programs like financial education, IDAs, credit builder loans, homeownership assistance, etc.

Some programs already offer alternative RACs, though they are not marketed as such. For example, the Community Action Program of Tulsa partnered with Bank of Oklahoma and the Doorways to Dreams (D2D) Fund to split refunds in its Refunds to Assets Program. Participants were given the opportunity to receive part of their refund for immediate use while the remainder was deposited into an asset building account at Bank of Oklahoma. Thirty-one percent of clients offered this opportunity expressed an interest in participating.

IV. Building a Better Stored Value Card

A more detailed discussion of this topic can be found in "Building a Better Stored Value Card: Options for VITA Sites" by Chi Chi Wu.

A stored value card can deliver the speed of an e-filed/direct deposit refund for taxpayers without a bank account. Whether a stored value card will work well for consumers depends on the details of the card program. These programs vary widely in terms of the cost, convenience, and level of consumer protection. Below are some guidelines for consumer-friendly stored value cards:

- Don't use a stored value card unless you know the provider is financially sound. Look for cards issued by a bank.
- Ask the issuer to provide consumer protection equal to bank debit cards and do not rely solely on the VISA and MasterCard "zero liability" policies, which don't cover all of the circumstances where federal law provides protection.
- Ask for a fee structure that is as favorable as the one for a bank account with a debit card, and make sure the fee structure is set in writing and cannot be changed for at least a year.
- Look for a card that can be used at convenient ATM locations without an ATM surcharge,
- Be sure that promotional material that includes a fee schedule, so that they can see all the fees before they decide whether to agree to a card.
- Look for a card that does not permit intentional overdrafts (overdrafts when the issuer's computer records show that a transaction will overdraw an account).
- If many of your clients have a primary language other than English, find a card issuer that offers telephone customer service and complete informational materials in that language.

In addition, try to use the opportunity to make a stored value card a first step toward improved financial stability by:

- Providing education to clients about the use of the stored value card
- Providing a record keeping system for clients
- Offering checking accounts with debit cards
- Offering savings accounts or individual development accounts (IDAs) to unbanked taxpayers
- Waiving barriers to opening checking or savings account
- Offering low-cost ways to send money out of the U.S., using the stored value car
- Offering low-cost money orders or other ways to pay bills with the stored value card