For Immediate Release:
JANUARY 20, 2015

Contacts:
NCLC: Chi Chi Wu (cwu_at_nclc.org) or
Jan Kruse (jkruse_at_nclc.org), 617-542-8010
CFA: Michael Best (mbest_at_consumerfed.org),
202-939-1009

TAX PREP SERVICES: BUYER BEWARE

Consumer Advocates Warn of Risks from Incompetent and Unscrupulous Tax Preparers

(BOSTON) As tax season kicks off today, advocates from the National Consumer Law Center and Consumer Federation of America warn of the problems that taxpayers face due to the lack of regulation for paid tax preparers. “Tens of millions of consumers will use paid tax preparers to fill out their most important financial document of the year, yet most of these preparers are not subject to any minimum educational, training, or competency standards,” said Chi Chi Wu, staff attorney at the National Consumer Law Center (NCLC).

Because of this lack of minimum standards, consumers are at risk from incompetent preparers or preparers who commit fraud. Consumers who select incompetent or unscrupulous preparers could face audits by the Internal Revenue Service (IRS) or even criminal sanctions. Incompetence and fraud also could be costing federal and state governments tens of millions of dollars in lost tax revenue. Another risk is unscrupulous tax preparers who redirect taxpayers’ refund to a prepaid card under the preparers’ control.

Other problems faced by taxpayers using paid preparers are:

- **Inability to comparison shop for tax preparation fees**. Paid preparers often either decline to give price quotes for preparation services or give widely inaccurate estimates.

- **Needless fees paid for financial products.** Paid preparers offer and promote financial products that can be unnecessary and expensive, such as refund anticipation checks (RACs). In addition to the $25 to $60 fee charged by the banks that offer the RACs, preparers sometimes also charge their own “add-on” fees for these financial products.

Taxpayers at Risk from Incompetent and Abusive Paid Preparers
In the vast majority of states, paid tax preparers are not required to meet any minimum educational, competency, or training standards. While some tax preparers are licensed as certified public accountants (CPAs) or credentialed by the IRS as enrolled agents, these certifications are not mandatory and most preparers do not have them. Indeed, the only tax preparers, apart from CPAs and enrolled agents, required to pass a test are the unpaid volunteers at Volunteer Income Tax Assistance (VITA) sites. “With the 2014

court decision striking down the IRS rules requiring preparers to pass an exam and complete continuing education requirements, states need to develop minimum competency and educational requirements," noted Michael Best, policy advocate at the Consumer Federation of America. "Four states regulate tax preparers,[1] and we need to work to expand that number so that taxpayers are protected from fraud and abuse."

This lack of regulation has allowed incompetence and abuses by tax preparers to flourish. An April 2014 study from the Government Accountability Office (GAO) found disturbingly high levels of errors. The GAO sent undercover investigators to 19 paid preparer offices. Only 2 of the 19 preparers (11 percent) produced returns with the correct refund amount. The mistakes in the returns ranged from giving taxpayers $52 less to $3,718 more of a refund than they were entitled to receive. Some of the errors bordered on fraud, although the GAO did not characterize them as such. For example, the GAO report described how:

> *Two paid preparers demonstrated what the refund amount would be if the side income were reported compared to if it were not reported. Both preparers did not record the side income.*
>
> *In response to the investigator mentioning her unreported cash tip income, one paid preparer told her that tips not included on the Form W-2 do not need to be reported*

A report issued in March 2014 by NCLC summarized other mystery shopper testing studies conducted by consumer groups, advocacy organizations, and others, which found similar results. The percentages of problematic tests in those studies ranged from 25 percent to 90 percent. The NCLC report calls on states to regulate tax preparers and includes a Model Individual Tax Preparer Regulation Act for states to consider.

Tax Preparation Fees Are High and Opaque

Tax preparation fees are often high, and almost always non-transparent, making it nearly impossible for consumers to comparison shop. Tax preparers can charge up to $500 or more in fees, yet many will claim they cannot give a price quote or will give inaccurate estimates. The GAO's 2014 report found that the fees charged for tax preparation varied widely, even between offices affiliated with the same chain. In one testing scenario, fees ranged from $160 to $408; in the other testing scenario, fees ranged from $300 to $587. The GAO report also noted:

> *Paid preparers provided various reasons for the amount of the tax preparation fee, including, (1) the EITC form is the most expensive form to file, (2) the pricing and fees are at their peak from mid-January through February and then go down, and (3) there is a price difference depending if the tax return is completed in the morning or the evening.*

"Tax preparation is one of the few businesses in this country where consumers can't get an accurate price quote before buying the service," stated David Rothstein, director of Resource Development & Public Affairs at NHS of Greater Cleveland and author of "Improving Tax Preparation with a Model Fee Disclosure Box." "The lack of transparency and disclosure is stunning. How can there be a competitive market if consumers can't comparison shop due to lack of price information?"

A free or inexpensive alternative for low-income taxpayers is free tax preparation sites, including VITA sites (1-800-906-9887 or www.irs.gov) and AARP Tax-Aide sites: (https://locator.aarp.org/vmis/sites/tax_aide_locator.jsp). Choosing a VITA or AARP Tax-Aide site saves eligible taxpayers the cost of a tax preparation fee. Many VITA sites can also help taxpayers open a bank

---

[1] Maryland, Oregon, California, and New York.

account or get a low-cost prepaid card, which enables taxpayers to get fast refunds without paying a fee. Free tax preparation may be available on military bases as well.

There are also a number of websites that allow low- and middle-income taxpayers to prepare and file their taxes online for free, such as the IRS Free File program (www.irs.gov).

Refund Anticipation Checks and Non-Bank Refund Anticipation Loans
One problem that millions of taxpayers no longer face is high-cost, high-risk refund anticipation loans (RALs), which are no longer available from banks on a large scale, nationwide basis. However, taxpayers are still at risk of needless fees from tax-time refund products, such as:

- **Refund anticipation checks (RACs)** –RACs are a financial product used to deliver refunds and to pay for tax preparation fees by deducting them from the consumer's tax refund.
- **RALs from non-bank lenders** – A few payday and other non-bank lenders are offering RALs. These loans could be more expensive and riskier than bank RALs.

RACs

With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund monies. After the refund is deposited, the bank issues the consumer a check or prepaid card and closes the temporary account. RACs do not deliver refund monies any faster than the IRS can, yet cost $25 to $60. Some preparers charge additional "add-on" junk fees, which can range from $25 to several hundred dollars.

Many consumers who previously borrowed RALs may have now shifted to RACs. There were an estimated 21 million taxpayers who received a RAC in 2013, and 21.6 million in 2014, nearly 9 million more than the 12.9 million consumers who received a RAC five years earlier in 2009.

Since the main purpose of a RAC is to defer payment of the tax preparation until the refund arrives, it can be viewed as a high-cost loan of that fee. If a taxpayer pays $35 to defer payment of a $350 tax preparation fee for 3 weeks, the annual percentage rate (APR) is 174%.

Bank Accounts and Prepaid Cards Can Avoid RACs

Consumer advocates suggest that taxpayers looking for quick refund cash should consider lower-cost or free alternatives. Taxpayers with a bank account can get their tax refunds in 8 to 21 days with e-filing and direct deposit. Taxpayers without a bank account can get the same fast refund by e-filing and having their refund deposited to a prepaid card, including any payroll or prepaid card that the taxpayer already has. Taxpayers without a bank account should also consider opening a bank account to receive their refund. "For many taxpayers, their refund represents the largest infusion of money they will have all year and every dollar counts," stated Michael Best of CFA.

Prepaid cards are one alternative to allow taxpayers without a bank account to receive a fast refund. Taxpayers, however, should be cautious when selecting a prepaid card. "As with any financial product, taxpayers should compare costs and consumer protections," recommended NCLC's Chi Chi Wu.

Nonbank RALs

With the end of RALs made by banks, non-bank lenders have stepped into the fray. For the last couple of years, Liberty Tax Service had partnered with nonbank lenders to make RALs. One of these lenders, 1st Money Center, appears to be offering RALs through Drake Software to other tax preparers, with annual percentage rates of up to 218%. 1st Money Center also appears to be offering $200 "advances" to Jackson Hewitt customers, although Hewitt claims the advances are interest-free.

RALs made by nonbank lenders are not nearly as widespread as bank RALs once were. In 2014, less than 35,000 consumers applied for a non-bank RAL. In 2013 – the first year in which only nonbank lenders made RALs – a mere 100,000 consumers applied for the loans. In comparison, about 12.7 million consumers obtained a RAL at the height of the industry in 2002.

One reason that non-bank RALs are not as widespread is that, unlike banks, nonbank lenders are covered by state laws that cap interest rates, i.e., usury laws. Tax-time loans from payday lenders and other storefront outlets that offer to prepare taxes and make loans may be subject to state loan laws, usury caps, or loan broker requirements in states that have them. Seventeen states and the District of Columbia do not permit payday lending at all. Also, nonbank lenders may not have the funding necessary to make RALs on a broad scale. In order to make even the 100,000 RALs in 2013, nonbank lenders needed access to $150 million in capital (assuming loans of $1,500).

Upcoming Report Available in February 2015
NCLC and CFA will publish their annual comprehensive report on the tax preparation industry and tax-time financial products in February 2015. The report will be available on NCLC's website at www.nclc.org and on CFA's website at www.consumerfed.org.

Related Materials

Government Accountability Office: *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*, GAO-14-467T, Apr. 8, 2014, is available at: http://www.gao.gov/assets/670/662356.pdf.

NCLC Report: *Riddled Returns* (updated March 2014) is available at: http://www.nclc.org/issues/riddled-returns.html.

NCLC's Model Individual Tax Preparer Regulation Act (November 2013), is available at: http://www.nclc.org/images/pdf/high_cost_small_loans/model-individual-tax-preparer-reg-act.pdf.

NCLC has worked for over a decade on the issue of tax-time financial products, particularly refund anticipation loans (RALs). NCLC's annual RAL reports and other materials are available at www.nclc.org/issues/refund-anticipation-loans.html.

###

Since 1969, the nonprofit **National Consumer Law Center® (NCLC®)** has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. **www.nclc.org**

The **Consumer Federation of America** is an association of more than 250 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education. **www.consumerfed.org**