MAJOR CHANGES IN THE QUICK TAX REFUND LOAN INDUSTRY

The NCLC/CFA 2010 Refund Anticipation Loan Report

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EXECUTIVE SUMMARY

Refund anticipation loans (RALs) are 1 to 2 week loans made by banks, facilitated by tax preparers, and secured by the taxpayer's expected tax refund. RALs can carry triple digit APRs, and expose taxpayers to the risks of unpaid debt if their refunds do not arrive as expected.

This report contains the annual update on the RAL industry from the National Consumer Law Center and Consumer Federation of America.

The National Consumer Law Center is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations, who represent low-income and elderly individuals on consumer issues. National Consumer Law Center® and NCLC® are trademarks of National Consumer Law Center, Inc.

Consumer Federation of America is a non-profit association of about 280 groups, with a combined membership of over 50 million people. CFA was founded in 1968 to advance consumers' interest through advocacy and education.

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Some of the findings from this report include:

- RAL volume remained steady from 2007 to 2008, following a general trend toward decline over the years. Tax preparers and their bank partners made approximately 8.4 million RALs during the 2008 tax-filing season compared to 8.7 million in 2006, and a high of 12.4 million in 2004. Preliminary indications are that even fewer RALs were made in 2009.

- Consumers paid an estimated $738 million in RAL fees in 2008 to get quick cash for their refunds – essentially borrowing their own money, sometimes at extremely high interest rates. This price tag declined from $833 million in 2006, due in part to an expansion in price cuts by H&R Block and JPMorgan Chase.

- In addition to RAL fees, consumers paid another estimated $68 million in "application," "administrative," "e-filing," "service bureau," "transmission," or "processing" fees. Since the major preparation chains did not charge these fees in 2008, we based this estimate on an assumption that about 20% of RAL borrowers are charged this fee.

- For this year, all of the major RAL lenders have reduced their prices for RALs in the range of $1,000 to $4,000. The price for a typical RAL of $3,300 is $65, down from $100 to $110 for most RALs of that amount in 2007.

- The APRs for RALs can still reach triple digits. The RAL industry claims that the loans carry an APR of 36%, but that calculation does not include the fee for the dummy bank account used to repay the RAL. If the dummy account fee is included, the effective APR for RALs under $1,000 is still in the triple digits, with the APR for a RAL of $300 still being nearly 500% based on a 10-day loan period. The APR for a typical RAL of $3,300 is 72% while the APR for the maximum amount of $10,000 is about 50%.

- Add-on fees appear to be a growing source of profits for tax preparers from RALs and RACs. It appears that Jackson Hewitt is allowing its franchisees to reinstitute such fees in 2010, permitting a "Data and Document Storage Fee" of up to $40. "Mom & Pop" tax preparers or small chains, such as Mo' Money Taxes or Instant Tax Service, may charge multiple add-on fees, such as application, document processing, e-filing, service bureau, transmission/software, and technology fees. Some of these fees are set by the companies that provide software and technical support to tax preparers, such as Drake Software, ATX, and Taxwise.

- One of the three biggest RAL lenders, Santa Barbara Bank & Trust, was forced by its regulator to exit the RAL business for the 2010 tax season. SBBT was the main RAL lender for Jackson Hewitt, providing about 75% of the RALs offered by that chain. While Jackson Hewitt was able to reach a deal with a smaller RAL lender, Republic Bank & Trust, for about 45% of Hewitt's RAL volume, it was left without a RAL lender for over half its stores. There are signs that the FDIC may also force Republic and other FDIC-regulated banks out of the RAL business in coming years.

- The Internal Revenue Service has announced plans to regulate the tax preparation industry. It has proposed regulating tax preparers by requiring paid preparers to register, pass a competency test, take fifteen hours per year of continuing professional education, and comply with a code of ethics. The IRS announced that it would create a task force to look at RALs and RACs. Consumer advocates had hoped that the IRS would go further and enact rules to prohibit or regulate RALs and RACs. However, IRS efforts to regulate preparers will benefit consumers and may rein in some fringe preparers.

- Federal and state regulators have continued to take enforcement actions over RALs. The FDIC issued a cease and desist order against Republic Bank & Trust, finding that the bank had engaged in unsafe or unsound banking practices and had violated laws or regulations. The FDIC's order required Republic to institute a number of reforms to its RAL program. The California Attorney General won a lawsuit against Liberty Tax Service for deceptive advertising, abusive debt collection and other violations of federal consumer laws. The New Jersey Attorney General won its case against Malqui Tax for deceptive advertising of RALs.

- During 2009, three states enacted RAL laws that were based in part on the NCLC Model Refund Anticipation Act. Each of these laws prohibits tax preparers from charging any fees other than the fee charged by the bank for the RAL or RAC, *i.e.*, they prohibit add-on fees. New York's RAL law also requires tax preparers and RAL facilitators to register and pay an annual fee to the New York State Department of Taxation.

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PART I. OVERVIEW AND NUMBERS

Refund anticipation loans (RALs) are loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs are usually made for a duration of about 7-14 days (the difference between when the RAL is made and when it is repaid by deposit of the taxpayer's refund), fees for these loans can translate into triple digit Annual Percentage Rates (APRs).

RALs drain hundreds of millions of dollars from the pockets of consumers and the U.S. Treasury. They target the working poor, especially those who receive the Earned Income Tax Credit (EITC), a refundable credit intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, providing nearly $49 billion to nearly 24 million families in 2008.[1]

This report updates the NCLC/CFA annual reports on the RAL industry and the drain caused by RALs from EITC benefits. Those interested in background information on the industry and regulation should refer to the first NCLC/CFA RAL Report published in January 2002.[2] In addition to our yearly reports, we have issued special reports on the IRS Debt Indicator,[3] "pay stub" RALs,[4] a rebuttal of industry-funded RAL studies,[5] RALs and fringe tax preparers,[6] and mystery shopper testing of RAL providers in Philadelphia, PA and Durham, NC.[7]

RAL volume has remained steady, but price decreases in 2008 reduced the total price paid for RALs. The volume of RALs in 2008, the most recent year for which the

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[1] Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2007 (Returns Filed in 2008), Feb. 2010.

[2] Chi Chi Wu, Jean Ann Fox, and Elizabeth Renuart, *Tax Preparers Peddle High Priced Tax Refund Loans: Millions Skimmed from the Working Poor and the U. S. Treasury*, National Consumer Law Center and Consumer Federation of America, Jan. 31, 2002, [hereinafter "NCLC/CFA 2002 RAL Report"], *available at* www.consumerlaw.org/issues/refund_anticipation/content/RAL_final.pdf.

[3] Chi Chi Wu, *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud*, National Consumer Law Center (July 2005), *available at* www.consumerlaw.org/issues/refund_anticipation/content/Debt_Indicator_White_Paper.pdf.

[4] Chi Chi Wu and Jean Ann Fox, *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom* National Consumer Law Center and Consumer Federation of America, Nov. 2008.

[5] Appendix A to Chi Chi Wu, Jean Ann Fox, and Patrick Woodall, *Another Year of Losses: High-Priced Refund Anticipation Loans Continue To Take a Chunk Out Of Americans' Tax Refunds*, National Consumer Law Center and Consumer Federation of America, Jan. 2006, at 4 [hereinafter "NCLC/CFA 2006 RAL Report."].

[6] Chi Chi Wu, RALs, *Tax Fraud, and Fringe Preparers*, National Consumer Law Center, Feb. 2009. This report is Appendix A to Chi Chi Wu and Jean Ann Fox, *Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Taxpayers At Risk*, National Consumer Law Center and Consumer Federation of America, Feb. 2009 [hereinafter "NCLC/CFA 2009 RAL Report."].

[7] Chi Chi Wu, Kerry Smith, Peter Skillern, Adam Rust, and Stella Adams, *Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia*, National Consumer Law Center, Community Reinvestment Association of North Carolina, Community Legal Services of Philadelphia, April 2008 [hereinafter "Durham/Philadelphia Mystery Shopper Report"]

IRS has comprehensive data, was about 8.4 million, similar to a year ago in 2007. However, the amount paid for RALs declined from $833 million to $738 million, as the price of RALs dropped for more RAL customers.

A. RAL Volume Remains Steady

RAL volume remained steady from 2007 to 2008. IRS data indicates there was a slight decrease of 3% in the number of RAL applications from 2007 to 2008. About 1 in 17 taxpayers applied for a RAL.[8]

Based on IRS data, we estimate there were approximately 8.4 million RALs made in 2007. IRS data shows that there were 9.9 million RAL applications in 2007.[9] However, not all RAL applications result in loans, as a certain percentage are rejected based on the IRS Debt Indicator or other criteria.

We had previously used a rejection rate of 10% for RAL applications, based upon published statements from HSBC and Santa Barbara Bank & Trust (SBBT).[10] However, beginning in last year's report for the 2007 estimate, we used an estimate of 15% based on the industry's avowed statements of an approval rate closer to 85%. There are indications that the approval rate was lower than 85% for 2009,[11] and even lower in the 2010 tax season thus far.[12]

To give a better indicator of RAL trends, we provide of table that includes RAL applications in addition to total RALs made, since estimates for 2000 to 2006 were based on the 90% approval rate. Note that even rejected RALs cost taxpayers a fee, because they are automatically given a refund anticipation check (RAC) at a cost of about $30.

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[8] There were 149 million returns filed in the 2008 filing season, which was for Tax Year 2007. Data from IRS SPEC, Return Information Database for Tax Year 2007 (Returns Filed in 2008), Feb. 2010.

[9] *Id.*

[10] Santa Barbara Bank & Trust, *Why You Should Choose SBBT '05*; Household International, *Exploring the Refund Anticipation Loan (RAL): Questions and Answers*, on file with the authors.

[11] Eileen Connelly, Tighter Credit Make Tax Refund Loans Harder to Get, Associated Press, March 16, 2009. John Hewitt, the head of Liberty Tax Service, reported that the approval rate for Liberty-brokered RALs was 75%. Tom Shean, *Borrowing Against Tax Refund Getting Tougher*, Virginian Pilot, February 6, 2010

[12] *Id.* (John Hewitt reporting that approval rate for Liberty-brokered RALs was 55%).

The following chart documents the trends in RAL applications since 2000, using a 15% reject rate for 2007 and 2008 and 10% for years earlier: [13]

Filing Year	No. of RAL applications	Increase/decrease from prior year	No. of RALs made	RAL loan fees
2008	9.9 million	(-3%)	8.4 million	$738 million
2007	10.2 million	2%	8.67 million	$833 million
2006	10 million	(-7%)	9 million	$900 million
2005	10.7 million	(-22%)	9.6 million	$960 million
2004	13.8 million	2%	12.38 million	$1.24 billion
2003	13.5 million	(-4%)	12.15 million	$1.1 billion
2002	14.1 million	5%	12.7 million	$1.1 billion
2001	13.4 million	12%	12.1 million	$907 million
2000	12 million	--	10.8 million	$810 million

Preliminary information indicates that the number of RALs declined significantly in 2009. The IRS reports there were 8.4 million RAL applications, a 15% decrease.[14] Some of this decrease was due to the reluctance of some RAL banks to offer loans due to errors related to Recovery Rebate Credit claims.[15]

In 2008, the average RAL for one of the RAL lenders was $3,300.[16] RAL consumers in 2008 paid different prices, depending on the RAL lender and tax preparer. In 2008, H&R Block charged $65.26 for a RAL of $3,300.[17] Block had about 3.9 million RAL customers in 2008, or 46% of the RAL market.[18] However, it also charged an extra $20 for customers who did not receive the loan on the Block Emerald Card[19] - about 1.3 million consumers.[20]

[13] This chart is based on data from IRS SPEC and the annual RAL reports issued by NCLC and CFA.

[14] Government Accountability Office, *Tax Administration – Interim Results of IRS's 2009 Filing Season*, GAO-09-640, June 2009, at 21.

[15] Government Accountability Office, *2009 Tax Filing Season – IRS Met Many 2009 Goals, but Telephone Access Remained Low and Taxpayer Service and Enforcement Could Be Improved*, GAO-10-225, December 2009, at 19. The Recovery Rebate Credit was a special credit for taxpayers who did not receive a full economic stimulus payment in 2008 and whose circumstances may have changed, making them eligible now for some or all of the stimulus payment.

[16] Pacific Capital Bancorp, *Form 10-Q: Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended June 30, 2008*, at 18. [hereinafter "PCB June 2008 Form 10-Q"].

[17] H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors.

[18] *See* Section III.A, *infra*.

[19] Chi Chi Wu and Jean Ann Fox, *Coming Down: Fewer Refund Anticipation Loans, Lower Prices from Some Providers, But Quickie Tax Refund Loans Still Burden the Working Poor*, National Consumer Law Center and Consumer Federation of America, Mar. 2008, at 8. [Hereinafter "NCLC/CFA 2008 RAL Report"].

[20] *See* Section III.A, *infra*.

In 2008, JPMorgan Chase charged $65 for a RAL of $3,300, plus a $10 "technology access" fee.[21] The remainder of the industry (SBBT, HSBC and Republic Bank & Trust) charged between $110 to $120 (or $115 on average).[22] SBBT had about 2.3 million RAL customers in 2008, and Republic had about half a million.[23]

Given these various prices, we assume the following amounts were paid for RALs in 2008:

$ 254.5 million – H&R Block customers
$ 26.0 million – additional amount from H&R Block customers receiving paper checks
$ 264.5 million – SBBT customers
$ 57.5 million – Republic Bank & Trust customers
$ 135.5 million – all others

$ 738 million

This compares to an estimated $833 million in RAL fees in 2007[24] and the high of $1.24 billion in RAL loan fees in 2004.[25]

This $738 million estimate for 2008 does not include the added fees paid for loan products that provide a RAL on the same day that the taxpayer's return is prepared. Lenders charged an additional $25 to $55 for same-day RALs, a fee which the consumer pays on top of regular RAL fees.[26] We know that H&R Block made 1.5 million "Instant Money" RALs in 2004.[27] Assuming a similar number in 2008, this adds at least another $37.5 million to the RAL drain.[28] We do not have data on the number of same-day RALs made by the rest of the industry.

In addition to the fee charged by the RAL lenders, tax preparers and other third parties can charge their own fees for RALs. These fees, which we call "add-on" fees, are discussed in detail in Section II.C, below.

In 2008, the three major tax preparation chains did not charge add-on fees (Jackson Hewitt appears to have started charging them again in 2010). However, many independents and smaller chains did in 2008. These smaller players have about 70-75%

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[21] JPMorgan Chase, *Chase Tax Related Products – 2008 Program Highlights*, on file with authors.
[22] NCLC/CFA 2008 RAL Report at 10-11.
[23] *See* Section III.D and F, *infra*.
[24] NCLC/CFA 2009 RAL Report at 16.
[25] *Id.* at 5.
[26] H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors; Santa Barbara Bank & Trust, *Bank Product Program 2009*, October 2008, on file with the authors; https://www.republicrefund.com/Products/Pricing.aspx, visited Feb. 22, 2008.
[27] Peter Tufano and Daniel Schneider, *H&R Block and "Everyday Financial Services*," Harvard Business School, October 2004, at 7.
[28] Note that Block customers paid an additional $25 for an Instant RAL in 2008. H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors. This was significantly less than the same-day RAL surcharge for other tax preparers; thus, the drain created by these products may even be greater if we had data on industry-wide sale.

of the paid preparer market, and 40% of the RAL market.[29] At one point, Santa Barbara Bank & Trust allowed preparers to charge a document processing fee of up to $40.[30] However, we have seen add-on fees from independent preparers sometimes add up to several hundred dollars.

If we assume that about half of independent preparers charge add-on fees, it would equate to 20% of the RAL market or 1.7 million consumers. Using SBBT's cap of $40 – a conservative assumption given the proliferation of multiple fees – these add-on fees increased by about $68 million the amount paid for RALs in 2008. Thus, taxpayers lost somewhere in the neighborhood of $800 million collectively to get loans a mere one to two weeks sooner than they could have gotten their refunds from the IRS.

B. RAL Pricing

Due to changes over the last several years, the price of RALs has dropped significantly for loans in the $1,000 to $4,000 range, where most EITC refunds fall. Thus, for example, the price of a typical $3,300 RAL has decreased from $100 or $110 in 2007 to about $65 in 2010 – a savings of 35% or more. The effective Annual Percentage Rate (APR) for this RAL is about 72%, down from 110 APR% or more in 2007.

H&R Block was the first to lower its prices, dropping the price of all of its RALs to 1.07% of the loan amount, plus $29.95 for the "Refund Account Fee."[31] This is the fee supposedly for the "dummy" bank account at the RAL bank used to receive the consumer's tax refund from IRS to repay the RAL. Block charges an additional $20 if the consumer receives a paper check.

H&R Block 2010 Sample RAL fees[32]

Amount of Loan	Loan Fee
$300	$33.17
$500	$35.31
$750	$37.99
$1,000	$40.68
$1,500	$46.04
$2,000	$51.41
$3,000	$62.14
$4,000	$72.87
$5,000	$83.60
$9,999	$137.23

[29] See NCLC/CFA 2009 RAL Report, Appendix A, at Section II.A; Jackson Hewitt Tax Service, *Investor Presentation – December 2006 Update*, November 22, 2006, at 8.
[30] Plaintiff's Local Rule 56(a)(1) Separate Statement of Undisputed Facts at ¶8, n. 1, Pacific Capital Bank, N.A. v. Conn., No. 3:06-CV-28 (D. Conn. Aug. 10, 2006).
[31] H&R Block, *Sample RAL and Instant RAL*, Jan. 2008, on file with the authors.
[32] *Id*. We have been informed by Block that its RAL fees did not change in 2009 or 2010.

The next industry player to significantly lower prices was JPMorgan Chase. Chase also charges a fee of about 1% of the loan amount plus $32 for its version of the dummy bank account fee.[33] Chase's loan fees are as follows.[34]

JPMorgan Chase 2010 RAL Fee Schedule

Amount of Loan	Loan Fee
$300-$1,000	$35
$1,500	$47
$2,000	$52
$3,000	$62
$4,000	$72
$5,000	$82
$9,999	$131

As discussed in Section II.A, the other major RAL lender, Santa Barbara Bank & Trust, has been forced out of the RAL business by its federal banking regulator. Part of its customer base has been taken over by Republic Bank & Trust.

Republic has also lowered its prices to a level comparable to Block and Chase. It now charges $29.95 for a "Tax Refund Administration Fee," plus 0.78% of the loan amount.[35] Sample loan fees would be:

Republic Bank & Trust 2010 Sample RAL fees

Amount of Loan	Loan Fee
$300	$32.29
$500	$33.85
$750	$35.41
$1,000	$37.75
$1,500	$41.65
$2,000	$45.55
$3,000	$53.35
$4,000	$61.15
$5,000	$68.95
$10,000	$107.95

Note that, as we have discussed in prior reports, current RAL prices are not at historic lows.[36] In 1994, RALs were priced at a flat fee of $29 or $35. If those prices had remained comparable, a RAL would only cost $41.98 or $50.67 in today's dollars (the equivalent of $29 or $35 in 1994 adjusted for inflation).[37]

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[33] JPMorgan Chase, *Application/Agreement for Chase Refund Anticipation Loan and/or Bonu$ Deposit Account – 2010*, on file with authors.
[34] *Id.*
[35] https://www.republicrefund.com/Products/Pricing.aspx, visited Feb. 21, 2010.
[36] *See* NCLC/CFA 2008 RAL Report at 9-10.
[37] Using the Department of Labor's inflation calculator at http://www.bls.gov/data/inflation_calculator.htm.

Even with price cuts by the major players, RALs continue to represent a huge drain on the tax refunds of almost 8.4 million consumers. Moreover, the fee for the RAL comes on top of the fee for tax preparation, which averages $187 at Block[38] and can be higher for other preparers.[39] Altogether, the consumer might pay about $250. If the consumer chooses a tax preparer that charges an add-on fee of $40 per loan, the total would rise to as much as $290. A low-income taxpayer could save this entire amount and still receive a quick refund using direct deposit by choosing a free tax preparation program that offers e-filing.

Despite the lower prices, APRs can still reach the triple digits for loans under $1,000. The RAL industry claims that the loans carry an APR of only 36% or less, which is a traditional maximum small loan rate cap for state usury laws. However, their calculation of this APR does not include the $30 or so charged as a fee for the Refund Account. RAL lenders do not include this fee in the APR, claiming that it is comparable to the charge for the non-loan refund anticipation check (RAC), discussed in Section II., E, below. We have challenged this unbundling in the past, for reasons explained in past RAL reports.[40]

If the Refund Account fee is included, the APRs for RALs are much higher. They can be quite dramatically higher for the loans in the lowest tier ($300 to less than $1,000) - in the triple digits. Thus, the APR for a RAL of $300 is almost 500%. Conversely, the APRs for RALs of greater amounts are lower. The APR for a $10,000 RAL is about 50%.[41] As discussed above, the APR for an average RAL of $3,300 has declined from about 110% to 72% APR.

We continue to report a version of the APR that includes document processing or other add-on fees, if they are charged, because those fees when charged represent a cost of credit for a RAL. For loans with document processing or add-on fees of $40, the fees can translate into APRs of about 85% ($10,000 loan) to nearly 1,300% ($300 loan).

Tax preparers and their bank partners also offer an "instant" same day RAL for an additional fee, from $25 to $55. Some of the APRs for an instant RAL of around $1,500 are 185% (Block) and 211% (Chase).

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[38] H&R Block Inc., *2009 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 18. [Hereinafter "H&R Block 2009 Form 10-K"].

[39] Tax preparation fees were as high as $355 in mystery shopping conducted in Durham, NC and Philadelphia, PA. Durham/Philadelphia Mystery Shopper Report at Attachment 2.

[40] *See* Chi Chi Wu and Jean Ann Fox, *All Drain, No Gain: Refund Anticipation Loans Continue to Sap the Hard-Earned Tax Dollars of Low-Income Americans*, January 2004, at 5 [hereinafter referred to as "NCLC/CFA 2004 RAL Report."].

[41] These APRs are based upon a 10 day loan period. The estimated time provided by the federal government to receive a refund with e-filing and direct deposit is 8 to 15 days. IRS, *2010 IRS e-file Refund Cycle* Chart, Publication 2043, April 2009. The median time would be 11.5 days, and the loan itself takes one or two days to process. The Treasury Inspector General for Tax Administration's analysis of IRS data confirmed that the average time for an e-filed, direct deposit refund is 10 days. Treasury Inspector General for Tax Administration, *Many Taxpayers Who Obtain Refund Anticipation Loans Could Benefit from Free Tax Preparation Services*, Reference Number: 2008-40-170, Sept. 8, 2008, *available at* http://www.ustreas.gov/tigta/auditreports/2008reports/200840170fr.pdf.

C. Should Tax Preparation Fees Sometimes Be Considered as Part of the Price of RALs?

For years, NCLC and CFA have been careful to distinguish between the fees related to RALs and RACs (loan fees, add-on fees) and the fee for tax preparation. For example, we have never included the tax preparation fee in the Annual Percentage Rate calculations for RALs.

However, there is an argument that sometimes the price of tax preparation is paid in order to obtain a RAL. The recent exit of SBBT from the RAL market has demonstrated how taxpayers view the price of tax preparation as part of the price of a RAL. Consumers who went to Jackson Hewitt or other tax preparers that were unable to provide a RAL complained:

> "I had my taxes done at jackson hewitt this year like i have in the past but the guy who did them told me that an ral would take as much time as the ar so i chose the ar. I called today and my return has been accepted by the irs, but that now I have 8 to 15 days to wait. ... If i would have known the ar was the same as doing the taxes myself (which i was not informed of) i would have saved myself the 300 tax prep fees and done them myself."[42]

> "This deception cost us 385.95 for a refund that we would've not gotten any sooner than if I had e-filed (via Turbo-Tax). [43]

> "We had our taxes done yesterday at Jackson Hewitt, just as we have done for the past 7 years. We applied for a RAL, as we have always done. ….Then she tells me that they expect our refund to be available on Feb 5th. Ummm....what happened to 5-7 days??? now we're on 8-15 days. So now they are charging me 320 for something I could have done myself for free."[44]

Thus, it appears that some low-income taxpayers use the services of a commercial tax preparer instead of self-preparing only to get a RAL. For example, consider the story of Pam Guinn, as reported by the Ft. Wayne Journal Gazette. Ms. Guinn, a mother of three children, informed the reporter that she usually prepared her taxes herself. However, she decided to go to Instant Tax Service after hearing a RAL advertisement.[45] The experience cost her $401 – $31 in RAC fees, $244 for tax preparation, $59 in e-file fees, a $17 transmission software fee, and a $50 service bureau fee (Ms. Guinn was denied a RAL; if she had been approved, she would have been charged an extra $100, or $501 in total). She would not have incurred any of these fees if not for being attracted by the advertisement for a RAL.

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[42] http://answers.yahoo.com/question/index?qid=20100119125141AAtoJjd. Note that these on-line consumer complaints have not been verified by NCLC or CFA.
[43] http://www.consumeraffairs.com/finance/jackson_hewitt.html#ixzz0fL5kjm3O.
[44] http://www.consumeraffairs.com/finance/jackson_hewitt_p4.html#ixzz0fLBpUvmH.
[45] Frank Gray, *Using Paid Preparers a Taxing Experience*, Ft. Wayne J. Gazette, March 5, 2009.

Even some tax preparers themselves agree. One commenter on an Internet message board for independent paid preparers noted:

> I think you get a lot of people in some of the chains who would have prepared it themselves if it was not for the RAL. So perhaps they qualify for free tax prep due to low income or EIC, but don't want to wait a week or two... In which case the $200 or $300 a big chain charges for a couple kids with child tax credit and EIC could be considered part of the RAL. After all, the taxpayer treats it that way.[46]

D. Impact on Low-Income Taxpayers and EITC recipients

RALs are mostly marketed to low-income taxpayers. According to IRS data, 86% of taxpayers who applied for a RAL in 2008 were low-income.[47] Industry data similarly shows that most RAL borrowers are low to moderate income taxpayers.[48] A 2005 survey by CFA found that the majority of RAL borrowers (58.7%) earned below $40,000.[49]

RALs continue to drain hundreds of millions of dollars from the Earned Income Tax Credit. IRS data shows that in 2008 nearly two-thirds (63%) of RAL consumers were EITC recipients, or 5.3 million families.[50] Yet EITC recipients made up only 16% of individual taxpayers in 2008.[51] Thus, EITC recipients are vastly overrepresented among the ranks of RAL consumers.

In addition, IRS data shows that 26% of EITC recipients applied for a RAL in 2008.[52] A startling 44% of EITC recipients obtain either a RAL or a RAC; in other words, nearly half of EITC recipients pay part of their publicly funded benefits to a bank to obtain a tax-related financial product. In contrast, only about 7% of taxpayers who do not receive the EITC get a RAL or RAC. [53]

Based on this IRS data, we estimate that about $465 million was drained out of the EITC program in 2008 by RAL loan fees.[54] Add-on fees added another $42 million to the drain.[55]

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[46] http://www.atxcommunity.com/topic/6319-hosed-by-sbbt/page__hl__SBBT__st__20 (viewed Feb 12, 2010).

[47] Data from IRS SPEC, Return Information Database for Tax Year 2007 (Returns Filed in 2008), Feb. 2010.

[48] *See* NCLC/CFA 2007 RAL Report at 11.

[49] NCLC/CFA 2006 RAL Report at 12.

[50] IRS data reports that 6.2 million EITC returns were associated with a RAL in 2008. Data from IRS SPEC, Return Information Database for Tax Year 2007 (Returns Filed in 2008), Feb. 2010. Using the 85% approval rate, *see* Section I.A *supra*, the number of approved RALs is 5.3 million.

[51] There were 23.8 million EITC returns and 149 million individual tax returns in 2008. Data from IRS SPEC, Return Information Database for Tax Year 2007 (Returns Filed in 2008), Feb. 2010.

[52] *Id.*

[53] Karen Masken, Mark Mazur, Joanne Meikle, and Roy Nord, *Do Products Offering Expedited Refunds Increase Income Tax Non-Compliance*, Office of Research, Analysis and Statistics, Internal Revenue Service, 2008, at 3, on file with authors.

[54] This is 63% of the $738 million total paid for RALs in 2008, *see* Section I.A, *supra*.

Non-loan fees also drain significantly from EITC benefits. The EITC is the nation's largest anti-poverty program. One criticism has been that no other anti-poverty program requires its beneficiaries to pay for the cost of accessing the benefit, which includes both the drain created by RALs and by tax preparation fees. Including tax preparation provides a fuller picture of how EITC benefits are chipped away. EITC recipients who got RALs paid an additional $991 million in tax preparation fees. In addition, some percentage of these recipients paid check cashing fees.

Type of Fee	Cost to Taxpayer	Drain on EITC Program
RAL loan fee (inc. dummy account fee)	$65 or $115	$ 465 million
Add-on Fee (for 20%)	$40	$ 42 million
Total	**$105 or $155**	**$ 507 million**
Tax preparation fee	$187	$ 991 million
Total with tax preparation	**$ 292 or 342**	**$ 1.5 billion**

[55] Weighted to 20%, *see id*.

PART II. UPDATES AND ANALYSIS

A. Major RAL Lender Forced to Exit

On Christmas Eve 2009, Pacific Capital Bancorp announced that its federal banking regulator, the Office of Comptroller of Currency, had refused to provide regulatory approval for the bank to make RALs in the 2010 tax season.[56] Pacific Capital Bancorp is the parent company for Santa Barbara Bank & Trust (SBBT). Pacific Capital Bancorp also announced that it would sell SBBT's Tax Division to a private equity firm.[57]

SBBT was the main RAL lender for Jackson Hewitt, providing about 75% of the RALs offered by that chain. Jackson Hewitt reached a deal with a smaller RAL lender, Republic Bank & Trust, for that bank to provide more RALs to Hewitt, but the increase only made up about 45% of Hewitt's RAL volume.[58] Thus, Jackson Hewitt was left without a RAL lender for over half its stores. The private equity firm that purchased SBBT's RAL business stated that it would make non-loan RACs to those stores, but not RALs.[59]

As a result of these developments, analysts estimate that Jackson Hewitt has experienced a 20% decrease in customer volume in 2010.[60] Anecdotal reports allege that some Jackson Hewitt franchisees are attempting to stem the loss of customers by failing to tell customers that they cannot offer RALs, or by claiming that "no one can do RALs."[61]

Other Jackson Hewitt franchisees are dealing with the loss of RALs by attempting to convince customers to choose a RAC instead of a RAL. These attempts have been somewhat successful, with franchisees reporting "Yes, we are hurting, but have had suprising [sic] success converting RAL clients to ARs [refund anticipation checks]"[62] and "In my tax shop..ive had little trouble converting rals to racs."[63] This success supports the theory that a tax preparer's recommendation can heavily influence taxpayers as to whether to get a RAL or choose a less expensive (or even free) option.

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[56] Press Release, *Pacific Capital Bancorp Announces Planned Sale of Refund Anticipation Loan and Refund Transfer Businesses*, Dec. 24, 2010.
[57] *Id.*
[58] Jackson Hewitt, Inc., *Form 8-K -Entry into a Material Definitive Agreement*, Regulation FD Disclosure, Dec. 30, 2010.
[59] Rich Turner, CEO, Santa Barbara Tax Products Group, LLC, *Message Sent to Transmitters from SBTPG*, Jan. 13, 2010, on file with authors.
[60] Michael Millman, Millman Research Associates, JTX: *Franchisee Optimism Scarce*, Feb. 3, 2010.
[61] Trish McIntire, *Shame on You Jackson Hewitt*, Our Taxing Times Blog, Jan. 25, 2010, at http://trishmc.typepad.com/mac_tax_talk/2010/01/shame-on-you-jackson-hewitt.html (last visited Feb. 22, 2010). Complaints about Jackson Hewitt from www.consumeraffairs and www.ripoffreport.com.
[62] *JH Future*, Yahoo Message Boards for Jackson Hewitt, Feb. 8, 2010 (last viewed Feb. 12, 2010).
[63] Noteworthy RAL Topic, Yahoo Message Boards for Jackson Hewitt, Jan. 22, 2010 (last viewed Feb. 12, 2010).

Jackson Hewitt was not the only tax preparer affected by SBBT's exit. Instant Tax Service is another chain that used SBBT. Like Jackson Hewitt, some Instant Tax franchisees failed to inform their customers that they could not offer a RAL, even after the customers had their tax returns prepared and filed by the franchisee. When these customers did not receive RAL checks at the time they were promised, they became extremely upset, to the point that one Instant Tax franchisee called the police.[64]

A number of independent preparers also lost the ability to offer RALs because they had agreements with SBBT. Some of these preparers attempted to "piggyback" by partnering with tax preparers that did have access to RALs.[65]

Finally, it appears there are signs that the FDIC may also force Republic and other FDIC-regulated banks out of the RAL business in coming years.[66] If this is true, the only banks that would make RALs would be JPMorgan Chase and HSBC. And if HSBC exits the RAL market in 2011 as it is rumored to, it could leave Chase as the sole remaining RAL bank.

B. IRS to Regulate Tax Preparers

On January 4, 2010, the IRS announced its plans to finally regulate the tax preparation industry.[67] Currently, most tax preparers are not subject to any sort of licensing, competency or minimum educational requirements, a fact long criticized by consumer advocates and others, such as the National Taxpayer Advocate.[68]

The IRS has proposed regulating tax preparers by requiring paid preparers to:[69]

- register with the IRS and obtain a unique identification number;
- pass a competency test;
- take fifteen hours per year of continuing professional education; and
- comply with a code of ethics.

The IRS's proposals were the result of its six month review of the tax preparation industry, which it also published on the same day. CFA was invited to present at an IRS Commissioner's forum as part of this review, and also filed written comments along with

[64] Linda Wagar, *Angry Customers Demand Money Back After Quick Tax Refund Offer Falls Through*, WDAF-Fox TV, Jan. 20, 2010. *See also* Katie Byard, *Tax Service Promoting Fast Loans Can't Keep Promise*, Akron Beacon Journal, Jan. 18, 2010.
[65] http://www.indeed.com/forum/job/tax-preparer/Getting-approved-banks-RAL/t44668/p3 (last visited February 16, 2010).
[66] Adam Rust, *Confirmed: RALs Over for Republic and River City*, Bank Talk Blog, Feb. 24, 2010, at http://banktalk.org/2010/02/24/confirmed-rals-over-for-republic-and-river-city/ (visited Feb. 24, 2010).
[67] Internal Revenue Service, *Return Preparer Review*, IRS Publication 4832, December 2009, *available at* http://www.irs.gov/pub/irs-utl/54419l09.pdf [hereinafter "IRS Return Preparer Review"].
[68] *See* National Taxpayer Advocate, *FY 2009 Annual Report to Congress*, December 31, 2009, at 41.
[69] IRS Return Preparer Review at 32-41.

NCLC.[70] The IRS's plan to regulate tax preparers will phase in over the next few years, and not apply to this tax year.[71]

As for RALs and RACs, the IRS announced that it would create a task force to look at these products. It also promised to reexamine the Debt Indicator, an electronic acknowledgement service provided by the IRS that tells tax preparers whether a taxpayer's refund will be paid or will be intercepted for government debts.[72] The Debt Indicator has benefited the RAL industry by lowering potential loan losses.[73]

Consumer advocates had hoped that the IRS would go further and enact rules to prohibit or regulate RALs and RACs. The IRS had already opened a rulemaking docket in January 2008 asking whether the agency should prohibit tax preparers from sharing tax return information with banks to make RALs.[74] NCLC and CFA had submitted extensive comments in this rulemaking.[75]

While more was hoped for on RALs and RACs, consumers will benefit greatly from the IRS effort to strengthen regulation of tax preparers. A tax return is probably the most critical financial interaction that a consumer has with the federal government during the year, and a wrongly prepared return can lead to dire economic consequences. Ensuring that tax preparers are competent, licensed, and bound by a code of ethics will benefit the consumers that rely on this industry for critical advice and assistance.

C. Add-One Fees and the Role of Software Intermediaries

Add-on fees are fees separately charged by tax preparers, and in addition to the RAL or RAC fees charged by the banks. Add-on fees appear to be a growing source of profits from RALs and RACs. All three of the major tax preparation chains - Block, Jackson Hewitt and Liberty Tax – had promised to stop charging add-in fees several years ago.[76] However, it appears that Jackson Hewitt has begun allowing its franchisees

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[70] Jean Ann Fox and Chi Chi Wu, Consumer Federation of America and National Consumer Law Center, *Comments to the IRS Commissioner's Return Preparer Review Forum*, IRS Notice 2009-60 August12, 2009, *available at* http://www.consumerfed.org/elements/www.consumerfed.org/file/CFA_and_NCLC_comments_on_RALs_to_IRS_8-12-09.pdf.
[71] *Id.* at 33.
[72] *Id.* at 39-40.
[73] *See* Chi Chi Wu, *Corporate Welfare for the RAL Industry: the Debt Indicator, IRS Subsidy, and Tax Fraud,* National Consumer Law Center (July 2005), *available at* www.consumerlaw.org/issues/refund_anticipation/content/Debt_Indicator_White_Paper.pdf.
[74] 73 Fed. Reg. 1131 (Jan. 7, 2008).
[75] *Comments of National Consumer Law Center, Consumer Federation of America, et al. regarding Advance Notice of Proposed Rulemaking - Guidance Regarding Marketing of Refund Anticipation Loans (RALs) and Certain Other Products*, April 7, 2008, *available at* http://www.consumerlaw.org/issues/refund_anticipation/content/comments_040708.pdf.
[76] NCLC/CFA 2008 RAL Report at 7.

to charge add-on fees in 2010, permitting a "Data and Document Storage Fee" of up to $40.[77]

In addition, tax preparers not affiliated with one of the three big commercial tax preparation chains will often charge add-on fees. These other preparers may consist of single office "Mom & Pop" shops, or they may be small chains, such as Mo' Money Taxes or Instant Tax Service.

There are multiple types of add-on fees. Some of the names for add-on fees that we have observed include:

- Application fees
- Document processing fees
- E-filing fees
- Service bureau fees
- Transmission/software fees.
- Technology fees

Some preparers will charge several add-on fees. The cumulative impact of add-on fees can be very expensive. Mystery tester shopping has found add-on fee totals ranging from $25 to $324.[78] This year, a staffer for the Community Reinvestment Association of North Carolina reported that Mo' Money Taxes quoted him the following list of fees, including three add-on fees:[79]

Bank fee -	$32
Add-on Fees -	$71
consisting of:	
Technology Fee - $15	
E-file fee - $29	
Application fee - $27	
Tax prep fee -	$315
Total	$418

A New Jersey court decision documents how a local chain, Malqui Tax, charged a document preparation fee of $134 plus a service fee of $15, to RAL and RAC customers.[80]

[77] Jackson Hewitt, Inc., *What is the Data and Document Storage Fee?*, Ask Jackson Hewitt, December 10, 2009, on file with authors.
[78] Durham/Philadelphia Mystery Shopper Report at Attachment 2.
[79] Adam Rust, *Mo' Money Costs More Money*, Bank Talk Blog, Jan. 18, 2010 at http://banktalk.org/2010/01/18/mo-money-costs-more-money (last visited Feb. 17, 2010).
[80] Press Release, Office of the New Jersey Attorney General, *Tax Preparation Firm Ordered to Pay $3.5 Million for Deceptive Sales of "Refund Anticipation Loans,"* April 14, 2009, *available at* http://www.nj.gov/oag/newsreleases09/pr20090414a.html.

In many cases, add-on fees are not actually determined by the tax preparer, but by the software or transmitter company that the preparer uses. These companies provide the software and technical support to storefront tax preparers. Some of the software or transmitter companies and the fees they charge include:

Name of Software Provider	Fees charged	Amount
Drake Software	Document Preparation Fee E-file Fee	$20 $10
Taxwise	Bank Technology Fee Transmitter Fee	$11 to $21 $11
ATX	Bank Technology Fee Transmitter Fee	$11 to $21 $11
TaxWorks	Transmitter Fee Technology Access Fee	$10 $14 or $15

Previously, some of these fees may have been rolled into the price of the RAL finance charge, with the RAL bank paying the software company and preparer a kickback out of the loan fee. After the banks lowered their prices, they apparently stopped paying these kickbacks, thus forcing the software companies to impose separate fees to maintain their profits from RALs and RACs.[81]

Two of the above companies (ATX and Taxwise) are actually owned by the same entity – Commerce Clearing House (CCH), which is a subsidiary of Wolters Kluwer, a Dutch corporation. CCH is a prominent publisher of tax and business law information, both print and electronic.

CCH/Wolters Kluwer recently rolled out another software/transmitter, RefundOne. RefundOne helps used car dealers make RALs that are used as a down payment on a vehicle. RefundOne boasts that "now, a customer in the used car market can actually go to their used car dealer to get their taxes prepared."[82] RefundOne caters to "buy here, pay here" dealers,[83] which target consumers with impaired credit histories and often charge high APRs. RefundOne appears to be similar to TaxMax, another software provider/transmitter catering to used car dealers that we have written about.[84]

D. <u>Pay Stub RALs</u>

"Pay stub" and "holiday" RALs are loans made prior to the tax filing season, before taxpayers received their IRS Form W-2s and can file their returns. Both H&R Block and Jackson Hewitt offer these loans.

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[81] Trish McIntyre, *The RAL Question*, Taxing Times Blog Oct 29, 2009, at http://trishmc.typepad.com/mac_tax_talk/2009/10/index.html (last visited Feb. 17, 2010).
[82] Wolters Kluwer NV Innovation Investor Day, Financial Disclosure Wire, September 25, 2008.
[83] Press Release, Wolters Kluwer Financial Services Launches RefundOne Q4, Sept. 16, 2009.
[84] Chi Chi Wu, RALs, *Tax Fraud, and Fringe Preparers*, National Consumer Law Center, Feb. 2009, at 13.

Jackson Hewitt's version is called the MoneyPower Line of Credit, up to $600, issued by MetaBank. MetaBank charges $20 plus a 2% fee for the first advance from the line. In addition, it charges a 12% charge per advance, as well 24% periodic interest.[85] A taxpayer who borrows the entire $600 in the first advance would be charged a $104 fee. If the MoneyPower loan is repaid in one month, the total fee would be $116. A one month, closed-end loan with the same loan amount and fee would have an APR of 232%.

H&R Block's version uses its Emerald Advance Line of Credit. This is a line of credit that Block had offered previously to its Emerald Card customers, and is available for some customers on a year-round basis, for up to $1,000.[86] The Emerald Line of Credit carries an interest rate of 36% plus an annual fee of $45.[87] For a $500 advance repaid in one month, the total fee is $60. A one month, closed-end loan with the same loan amount and fee would have an APR of 158%. If the borrower keeps the line open after tax season, the interest rate is lowered to 9%, but requires either payroll direct deposit to Block's Emerald Card or a savings account linked to the card.[88] Block sold 887,000 Emerald Advances in 2008 and more than 1 million in 2009.[89]

RALs based on pay stubs present risks to taxpayers, because they are based on estimated tax returns before the taxpayer receives final tax information from a W-2. For example, before filing the tax return, the preparer will not have any information about whether the IRS is planning to seize all or part of the taxpayer's refund to pay a child support or student loan debt.

In addition, Jackson Hewitt in the past appeared to force pay stub RAL borrowers to return to the same office to have their taxes prepared, preventing these taxpayers from going to competitors or seeking free volunteer assistance.[90] Currently, Jackson Hewitt does not require that MoneyPower customers return, but does charge a $25 "Tax Planner Purchase" fee.[91] Block does not require Emerald Advance customers to return to Block for tax preparation, but 91% of them do return.[92]

The Emerald Advance is also significant because Block has explicitly stated that it intends to use the product in place of traditional RALs if the latter are prohibited, or become obsolete when the IRS is able to issue refunds in a matter of days. A Block official has stated: "This year was a successful year of seasoning for our Emerald

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[85] MetaBank, MoneyPower Line of Credit Terms and Conditions, 2010, on file with authors.
[86] H&R Block, Emerald Advance Overview, Jan. 14, 2009, at 3, on file with authors.
[87] *Id.*
[88] *Id*; H&R Block, Inc. F2Q09 (Qtr End 10/31/08) Earnings Call Transcript, Dec. 8, 2008, from Seeking Alpha at http://seekingalpha.com/article/109760-h-amp-r-block-inc-f2q09-qtr-end-10-31-08-earnings-call-transcript.
[89] H&R Block 2009 Form 10-K at 18.
[90] Chi Chi Wu, *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom*, National Consumer Law Center (Nov. 2006), at 7-8.
[91] *See* Jackson Hewitt, H*ow do I explain the fee calculations for the MoneyPower Line of Credit?*, undated, on file with authors.
[92] H&R Block, Inc. *F2Q09 (Qtr End 10/31/08) Earnings Call Transcript*, Dec. 8, 2008, from Seeking Alpha at http://seekingalpha.com/article/109760-h-amp-r-block-inc-f2q09-qtr-end-10-31-08-earnings-call-transcript.

Advance program which is part of the suite of financial products we could offer clients in place of the traditional RAL if the rules change."[93]

NCLC and CFA issued a report on pay stub and holiday RALs in November 2008, entitled *Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom*.[94]

E. <u>RACs and Bank Accounts</u>

Refund anticipation checks (RACs) are a non-loan payment device offered by RAL banks. With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund check. After the refund is deposited, the bank issues the consumer a paper check or prepaid debit card with the RAC proceeds and closes the temporary account.

RACs generally cost around $30. In the past 3 years, the IRS has separately reported RAC data. In 2008, about 12 million taxpayers received a RAC,[95] at a cost of about $360 million. This was a 7% increase from 11.2 million taxpayers in 2007.

Thus, the number of RACs has increased significantly from 2007 to 2008, and exceeds the number of RALs. RACs present different issues than RALs. They are less expensive than a RAL, although they are still very pricey for what is essentially a one-time use bank account. Consumers with a bank account can receive their refunds in the same amount of time but avoid paying a fee for a RAC, if they simply use e-file and a direct deposit to their own bank accounts.

A taxpayer who does not have a bank account should be encouraged to open one. In addition to speeding refunds, bank accounts help taxpayers avoid paying check cashing fees to access funds from a tax refund.

RACs present other problems. Like RALs, they make taxpayers less sensitive to the price of tax preparation, permitting tax preparers to hide the ball when consumers might attempt to comparison shop. RACs permit the taxpayer to have the price of tax preparation deducted from the refund. When taxpayers obtain a RAL simply because they cannot afford the price of tax preparation upfront, the RAC is essentially a loan of the tax preparation fee – and an expensive one at that. Paying $30 to borrow a tax preparation fee of $187 for two weeks equates to an APR of 417%!

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[93] H&R Block, Inc. *F4Q09 (Qtr End 04/30/09) Earnings Call Transcript*, June 29, 2009, from Seeking Alpha at http://seekingalpha.com/article/146073-h-amp-r-block-inc-f4q09-qtr-end-04-30-09-earnings-call-transcript (quote from Sabrina Wiewel – Chief Tax Network Officer).

[94] *Available at* www.consumerlaw.org/action_agenda/refund_anticipation/content/PaystubRALsReport.pdf.

[95] Data from IRS SPEC, Return Information Database for Tax Year 2007 (Returns Filed in 2008), Feb. 2010.

In addition to the RAC fee itself, many tax preparers who charge add-on fees, such as "document processing" or e-filing for RALs, will charge these fees for RACs as well. This can significantly add to the expense of a RAC.

There are other options for receiving fast refunds for taxpayers without bank accounts. H&R Block customers who received the Emerald Card last year could have this year's refunds direct deposited onto those cards, and avoid the fee for a RAC altogether. There are similar prepaid debit cards available to taxpayers who use free tax preparation sites.

PART III. INDUSTRY PLAYERS

This section provides basic information on the RAL activity of key industry players, an overview that we provide annually in our RAL reports. We discuss certain other topics affecting these players, such as regulatory measures, law enforcement actions, and other events, in other parts of this report.

The RAL industry is made up of a handful of RAL lending banks, three commercial preparation chains, and thousands of independent preparers that offer and arrange for RALs. The loans are made by banks because of the banks' ability to avoid state interest rate caps and because IRS rules prohibit the tax preparer from being the RAL lender.[96]

A. H&R Block

H&R Block is the nation's largest tax preparation chain, accounting for 14.6% of all individual tax returns in 2008.[97] In 2008, Block's RAL business made 3.85 million RALs,[98] which is the same number that it made in 2007.[99] Block processed 16.5 million tax returns (excluding software/online processed returns) in 2008;[100] thus, about 23% of customers who went to a Block office received RALs that year. For 2009, it appears that Block's RAL business decreased dramatically, to 2.95 million loans.[101]

Block earns fees from RALs through its arrangement to have Block Financial Corporation buy a 49.9% interest in RALs arranged by its tax preparation offices. In 2008, Block earned $190 million in revenues from RALs, plus $24.1 million from its Emerald Advance product, representing about 7% of the company's revenues from tax services.[102] In 2009, Block's RAL profits dipped to $142.7 million, plus $22.7 million in revenues from the Emerald Advance product, constituting about 5.5% of tax services revenue.[103]

Block offers the Emerald Card, a bank account based on a prepaid debit card platform, to its tax preparation customers. The Emerald Card also allows customers to access the Emerald Advance Line of Credit, which is a pre-season or "pay stub" product that provides loans of up to $1,000, discussed in Section II.D, above. Block sold 2.6

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[96] *See* NCLC/CFA 2002 RAL Report at 18-19.
[97] H&R Block Inc., *2008 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934,* at 6. [hereinafter "H&R Block 2008 Form 10-K"].
[98] *Id.* at 24.
[99] H&R Block Inc., *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934,* at 26.
[100] H&R Block 2008 Form 10-K at 24.
[101] H&R Block Inc., *2009 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934,* at 18. [hereinafter "H&R Block 2009 Form 10-K"].
[102] H&R Block 2008 Form 10-K at 25.
[103] H&R Block 2009 Form 10-K at 18-19.

million Emerald Cards in 2008[104] and nearly 3 million in 2009.[105] It made 887,000 Emerald Advances in 2008 and more than 1 million in 2009.[106]

B. <u>HSBC</u>

HSBC is the RAL lender for H&R Block. In addition, HSBC previously had made RALs through independent prepapers. Over the last two years, HSBC stopped working with independent preparers and is only working with Block.[107] There has been speculation that HSBC will exit the RAL business once its contract ends with Block in 2011.[108]

C. <u>Jackson Hewitt</u>

Jackson Hewitt is the second largest tax preparation chain in the country, preparing 3.4 million returns in 2008, or about a 4% share of the paid preparer market.[109] Its main bank partner for RALs and other tax financial products was Santa Barbara Bank and Trust (SBBT), which provided 75% of Hewitt's RALs.[110] The other 25% were provided by Republic Bank & Trust of Kentucky.[111] Thus, Jackson Hewitt has been greatly affected by SBBT's forced exit from the RAL business, as discussed in Section II.A above.

In 2008, Jackson Hewitt sold one or more financial product to 3.1 million (or 91%) of its customers.[112] It no longer breaks out the number of RALs it makes in its SEC filings. However, we had estimated that Jackson Hewitt brokered about 1.3 to 1.4 million in 2007. Given its 7% or 8% decline in 2008, we assume that the number of RALs declined similarly, to 1.2 to 1.3 million RALs.

In 2009, Jackson Hewitt's numbers declined again, by about 12 or 13%. That year, the company processed 2.96 million tax returns[113] and about 2.75 million (or 93%)

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[104] H&R Block, Inc. *F2Q09 (Qtr End 10/31/08) Earnings Call Transcript*, Dec. 8, 2008, from Seeking Alpha at http://seekingalpha.com/article/109760-h-amp-r-block-inc-f2q09-qtr-end-10-31-08-earnings-call-transcript.
[105] H&R Block, Inc. *F4Q09 (Qtr End 04/30/09) Earnings Call Transcript*, June 29, 2009, from Seeking Alpha at http://seekingalpha.com/article/146073-h-amp-r-block-inc-f4q09-qtr-end-04-30-09-earnings-call-transcript.
[106] H&R Block 2009 Form 10-K at 18.
[107] HSBC Finance Corp., *Form 10-Q: Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended September 30, 2008*, at 38.
[108] Jonathan Epstein, *HSBC Tries to Put its House in Order*, Buffalo News, September 13, 2009, C1; Maria Aspan, *Refund Anticipation Loans Take Hit Some See as Fatal*, American Banker, Aug. 3, 2009.
[109] Jackson Hewitt Tax Service Inc., *2008 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 30 [hereinafter "Jackson Hewitt 2008 Form 10-K"].
[110] *Jackson Hewitt Shares Fall on Tax-Season Troubles*, Associated Press, Jan 13, 2010.
[111] *Id.*
[112] Jackson Hewitt 2008 Form 10-K at 29. This includes RALs, RACs and Hewitt's "Gold Guarantee."
[113] Jackson Hewitt Tax Service Inc., *2009 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 30 [hereinafter "Jackson Hewitt 2009 Form 10-K"].

of these taxpayers were sold a financial product.[114] Given this decline, we assume Jackson Hewitt made about 1 to 1.1 million RALs in 2009.

Jackson Hewitt continues to derive a startling percentage of its profits from financial products. In 2008, it earned $71 million in financial product fees, or 26% of its revenues.[115] It earned $60 million in 2009 in such fees, or 24% of revenues.[116] Thus, Jackson Hewitt is much more dependent than Block on RALs and other tax financial products. In fact, one commentator noted:

> in fiscal 2009 Jackson Hewitt (NYSE: JTX) derived $59.9 million of revenue from "financial product fees." According to analysts and company representatives, greater than 85% of this line item was RAL and RAC fees that have minimal associated costs (according to management it is roughly 80% margin). At 80% margin this represents 104% of pretax earnings of $45.9 million. Simply put, Jackson Hewitt [] loses money without RAL and RAC fees.[117]

D. Santa Barbara Bank & Trust/Pacific Capital Bancorp

Jackson Hewitt's main RAL partner was Santa Barbara Bank & Trust (SBBT), a subsidiary of Pacific Capital Bancorp. On December 24, 2009, Pacific Capital's federal banking regulator, the Office of Comptroller of Currency, refused to provide regulatory approval for the bank to make RALs in the 2010 tax season.[118] Thus, SBBT is effectively out of the RAL business.

SBBT sold its tax financial products division for $10 million to a private equity firm, which named itself Santa Barbara Tax Funding Group (SBTFG).[119] SBTFG has a partnership with MetaBank, a federal thrift based in Iowa, to process refund anticipation checks.[120] In addition, MetaBank makes pay stub RALs for Jackson Hewitt, discussed in Section II.D., *above*. However, MetaBank is not making regular tax season RALs for Jackson Hewitt.

In 2008, SBBT made 7.43 million RALs and RACs, a 1.6 million or 27% increase from 2007.[121] This was probably a result of HSBC's decision to cease offering RALs

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[114] *Id.* at 29.
[115] Jackson Hewitt 2008 Form 10-K at 3, 28.
[116] Jackson Hewitt 2009 Form 10-K at 29.
[117] *H&R Block: Stars Are Aligning*, from Seeking Alpha, Nov. 3, 2009, at http://seekingalpha.com/article/170806-h-r-block-stars-are-aligning.
[118] Press Release, *Pacific Capital Bancorp Announces Planned Sale of Refund Anticipation Loan and Refund Transfer Businesses*, Dec. 24, 2010.
[119] Press Release, *Pacific Capital Bancorp Completes Sale of Refund Anticipation Loan and Refund Transfer Businesses*, Jan. 14, 2010.
[120] Rich Turner, CEO, Santa Barbara Tax Products Group, LLC, *Message Sent to Transmitters from SBTPG*, Jan. 13, 2010, on file with authors.
[121] Press Release, *Pacific Capital Bancorp Reports 42% Increase in Earnings Per Share for First Quarter of 2008,* April 29, 2008.

through most independent preparers.[122] SBBT had a mix of 73% RACs and 27% RALs,[123] so we estimate SBBT made about 2.3 million RALs in 2008.

In 2009, SBBT made 7.26 million RALs and RACs, with a mix of 77% RACs and 23% RALs.[124] Thus, we estimate SBBT made about 1.67 million RALs in 2008.

E. Liberty Tax Service

Liberty Tax is the third significant commercial tax preparation chain in the country, with 3,200 locations.[125] The chain is well-known for hiring people to dress up in Statue of Liberty costumes as a form of advertisement during tax season.[126]

Liberty earned $22.5 million in RAL and RAC fees in 2008, or about 25% of revenues.[127] It similarly earned $23.8 million in RAL and RAC fees in 2009, or 29% of its revenue.[128] About 37% of Liberty Tax customers obtain a RAL; another 37% obtain a RAC.[129] Thus, about three-quarters of Liberty's customers get some sort of financial product. Liberty's percentage of revenues from RALs and RACs, as well as the high percentage of its customers who get these products, indicate the chain has a similar RAL/RAC business as Jackson Hewitt.

In 2009, the California Attorney General obtained a judgment against Liberty Tax finding the chain had engaged in deceptive advertising and other violations. A full description of this judgment is in Section IV.B, below.

F. Republic Bank & Trust

Republic Bank & Trust is a state-chartered bank located in Louisville, Kentucky. Republic is a lending partner for Jackson Hewitt. Republic has also vigorously pursued independent preparers, especially after HSBC ceased making RALs to most of this group.

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122 Pacific Capital Bancorp (PCBC), Transcript of Q1 2008 Earnings Call, May 19, 2008, from Seeking Alpha at *http://seekingalpha.com/article/77942-pacific-capital-bancorp-q1-2008-earnings-call-trancript* (reporting 15% increase in number of paid preparers that had signed up to offer SBBT RALs).

123 Pacific Capital Bancorp, Pacific Capital Bancorp Reports 42% Increase in Earnings Per Share for First Quarter of 2008, April 29, 2008.

124 Pacific Capital Bancorp, Pacific Capital Bancorp Reports First Quarter Results, April 30, 2009.

125 Liberty Tax Service, *About Liberty*, http://www.libertytax.com/about-liberty-tax-service.html (visited February 10, 2010).

126 Susanne Nadeau, *Face to Face with Kim Northagen, Lady Liberty*, Grand Forks Herald, February 8, 2009.

127 JTH Tax, Inc. and Subsidiaries (d/b/a/ Liberty Tax Service), *Consolidated Financial Statements for April 30, 2009 and 2008* (With Independent Auditors' Report Thereon), at 3.

128 *Id.*

129 Chyna Broadnax, *Tax Filers Desperate for Early Returns*, Statesville Record & Landmark, Feb. 27, 2009.

In 2008, Republic made 525,650 RALs.[130] It earned $13.2 million in net income from RALs and RACs in 2008, or about 40% percent of the bank's income.[131] This was a dramatic increase in Republic's RAL and RAC income from 2.8 million (or 11% of bank income) in 2007.[132]

On February 10, 2009, the Federal Deposit Insurance Corporation issued a cease and desist order against Republic.[133] This order is discussed in Section IV.B, below. The FDIC crease and desist order follows on the heels of Republic's withdrawal of its application with the Office of Thrift Supervision to convert its regulatory status from a state-chartered bank to a federally chartered thrift.[134] Consumer advocates, including NCLC and CFA, had opposed Republic's application, in part because of Republic's RAL practices.

G. JP Morgan Chase

The most significant of the RAL lending banks not affiliated with Block or Hewitt is JPMorgan Chase. Chase does not report on the number of RALs that it makes, although we estimate it makes about 1 to 1.5 million RALs. It partners with about 13,000 independent preparers to make RALs.[135] In 2009, Chase had a 2% increase in the number of RALs it made.[136]

H. Other Banks and Preparers

There are a handful of other banks that make RALs. For some reason, the two of the most significant banks, like Republic, are located in Louisville, Kentucky: River City Bank[137] and Fort Knox Financial Services/Ohio Valley Bank, which operates as Refund Advantage.[138]

Mo Money Taxes is a small chain of about 250 stores.[139] Mo Money is known for its outlandish advertisements that could be considered to include racial stereotyping and to be offensive.[140] Mo Money also charges high fees, as discussed in Section II.C, above.

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[130] Letter from Steve Trager, CEO, Republic Bank to the Office of Thrift Supervision, September 23, 2008, on file with authors.
[131] Republic Bancorp, *2008 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934,* at 5. [Hereinafter "Republic 2008 Form 10-K"].
[132] Republic Bancorp, *2007 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 6, 14.
[133] The order can be reviewed at http://www.fdic.gov/bank/individual/enforcement/2009-02-10.pdf.
[134] Alex Davis, *Republic Drops Effort to Change Regulators*, Louisville Courier-Journal, Mar. 14, 2009.
[135] Maria Aspan, *Refund Anticipation Loans Take Hit Some See as Fatal*, American Banker, Aug 3, 2009.
[136] Barry Schlachter, *High-Interest Tax Refund Anticipation Loans Under Fire*, Fort Worth Star-Telegram, Mar. 28, 2009.
[137] *See* www.rcbral.com.
[138] *See* www.refund-advantage.com.
[139] Letter from Mo' Money Taxes Corporate Headquarters to KMOV-TV (St. Louis), Jan 21, 2010.
[140] Adam Rust, *Mo' Money Taxes Gets a Slap Down*, Bank Talk Blog, Feb. 12, 2010 at http://banktalk.org/2010/02/12/mo-money-taxes-gets-a-slap-down/ (last visited Feb. 18, 2010).

PART IV. REGULATION, ENFORCEMENT, LITIGATION AND ADVOCACY

A. RAL Legislation

During 2009, three states enacted RAL laws that were based in part on the NCLC Model Refund Anticipation Act.[141] In addition, Michigan enacted a RAL law that primarily focuses on disclosures.

Arkansas[142]

Arkansas enacted a law regulating RAL facilitators. The new law prohibits facilitators from charging a fee or other consideration in the making or facilitating of a RAL or RAC, apart from the fee charged by the bank. Thus, the new law bans add-on fees, such as document preparation, service bureau, or transmitter fees. It permits facilitators to charge fees that are charged to all customers, including those who do not obtain RALs or RACs, and specifically permits charging a fee for tax preparation.

As for disclosures, the Arkansas law requires facilitators to post a list of RAL fees in a 16 by 20 inch document in 28 point type, as well as provide a written document with disclosures. Both the wall posting and written document disclosures must include a warning that (1) a RAL is a loan; (2) the consumer is liable for the full amount of the loan if the tax refund is less than expected; and (3) the consumer can receive a refund in 8 to 15 days without paying any extra fees or taking out a loan.

The Arkansas law also requires oral disclosures by the facilitator. The oral disclosures include: (1) a RAL is a loan; (2) the consumer is liable for the full amount of the loan if the tax refund is less than expected; (3) the RAL fee; and (4) the RAL interest rate. The oral disclosures must be made in the language used primarily used between the facilitator and consumer.

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[141] Available at www.consumerlaw.org/issues/refund_anticipation/content/RevisedModelRALStatuteCommentary1208.pdf

[142] Ark. Code §§ 4-116-101 to 4-116-108.

Maine[143]

Maine's RAL law prohibits RAL facilitators from charging a fee or other consideration in the making of a RAL or RAC, unless it is included in the disclosed RAL or RAC fee charged by the creditor. Thus, it appears the Maine law bans add-on fees. The Maine law does permit facilitators to charge a tax preparation fee if the same fee in the same amount is charged to all customers, including those who do not obtain RALs or RACs.

The Maine law requires written disclosures that include both the fee for the RAL or RAC, and the fee for tax preparation. The written disclosures must include a special RAL interest rate that includes the fee for the temporary or "dummy" bank account in its calculation. Finally, the written disclosure must inform the consumer when the RAL or RAC will be issued.

Like the Arkansas law, the Maine law also requires oral disclosures. The required disclosures are that: (1) a RAL is a loan that lasts only one to two weeks; (2) the consumer is liable for the full amount of the loan if the tax refund is less than expected; (3) the amount of the RAL fee; and (4) the RAL interest rate. A schedule of RAL and RAC fees must be prominently displayed, along with a warning that (1) a RAL is a loan; (2) the consumer is liable for the full amount of the loan if the tax refund is less than expected; and (3) the consumer can receive a refund in 8 to 15 days without paying any extra fees or taking out a loan.

The Maine law contains additional prohibitions for RAL facilitators against (1) engaging in collection of a delinquent RAL debt; (2) arranging for check cashers or other third parties to charge a fee or referring the consumer to a check casher; (3) engaging in any unfair or deceptive acts; (4) arranging for RALs secured by state tax refunds; (5) including certain abusive clauses in a RAL contract; and (6) advertising RALs without disclosing that the product is a loan.

New York[144]

The New York RAL law requires tax preparers and RAL facilitators to register, obtain a unique identification number, and pay an annual $100 fee to the State Department of Taxation and Finance. The new law prohibits facilitators from charging a fee or other consideration in the making or facilitating of a RAL or RAC. Thus, the New York law bans add-on fees, such as document preparation, service bureau or transmitter fees.

The New York RAL law is in addition to a prior law establishing certain disclosures[145] and a "Consumer Bill of Rights Regarding Tax Preparers."

[143] Maine Rev. Stat. tit. 9-A §§ 10-102 and 10-310.
[144] N.Y. Tax Law § 32; N.Y. Gen. Bus. Law § 372.
[145] Summarized in Appendix A to NCLC's model state RAL law, *available at* www.consumerlaw.org/issues/refund_anticipation/content/RevisedModelRALStatuteCommentary1208.pdf

In addition, the new law requires oral disclosures, including disclosures that: (1) a RAL is a loan that lasts only one to two weeks; (2) the consumer is liable for the full amount of the loan if the tax refund is less than expected; (3) if the refund is delayed, there may be additional costs that the consumer may have to pay; (4) the amount of the RAL fee; and (5) the RAL interest rate. The oral disclosures must be made in the language used primarily used between the facilitator and consumer.

The New York law contains additional prohibitions for RAL facilitators against (1) engaging in collection of a delinquent RAL debt; (2) arranging for check cashers or other third parties to charge a fee or referring the consumer to a check casher; (3) engaging in any unfair or deceptive acts; and (4) including certain abusive clauses in a RAL contract.

Michigan[146]

Michigan enacted a disclosure-only RAL law. Prior to completion of the application, the preparer must disclose: (1) the RAL loan fee schedule (2) the fact that a RAL is an extension of credit and not the actual refund; (3) that the consumer may have the return filed electronically without a RAL; (4) the average time in which the consumer could expect to receive the refund with electronic filing and direct deposit/mail or with paper filing and direct deposit/mail; (5) that the IRS does not guarantee the amount or time of the payment of a refund; (6) that the consumer is responsible for repayment of the loan in the event the refund is not paid or is not paid in full; (7) the estimated time when the consumer will receive the loan proceeds; and (8) the fee if the RAL is not approved.

Prior to entering into the loan agreement, the preparer must disclose: (1) the estimated total RAL fees; and (2) the estimated APR under the Truth in Lending Act. There is no mandatory type size or mandatory language for the written disclosures. The Michigan RAL law also prohibits any local government from enacting a stronger RAL ordinance.

There are currently a total of 17 states regulating RALs. The other thirteen states are: California, Connecticut, Illinois, Minnesota, Nevada, New Jersey, North Carolina, Oregon, Tennessee, Texas, Virginia, Washington State, and Wisconsin. The laws for these thirteen states are summarized in Appendix A to NCLC's model state RAL law.[147] These laws primarily rely on disclosures to protect consumers from RAL abuses, which are limited in their effectiveness.

[146] Mich. Comp. Laws §§ 446.111 to 446.121.
[147] *Available at* www.consumerlaw.org/issues/refund_anticipation/content/RevisedModelRALStatuteCommentary1208.pdf

B. Enforcement

During 2009, there were a number of developments in government enforcement actions involving RALs. The most significant, of course, was the Office of Comptroller of Currency's action in forcing Santa Barbara Bank & Trust out of the RAL market, discussed in Section II.A, above. Other significant actions include:

1. FDIC Cease & Desist Order against Republic Bank & Trust[148]

On February 10, 2009, the Federal Deposit Insurance Corporation issued a cease and desist order against Republic, finding that the bank had engaged in unsafe or unsound banking practices and had violated laws or regulations. The FDIC's order required Republic to institute a number of reforms to its RAL program. These reforms included:

(1) greater board oversight of management;
(2) hiring qualified management, developing an overall compliance plan, and a developing business plan for its RAL business;
(3) establishing a training program about all relevant consumer protection laws for all tax preparers who contract with Republic; and
(4) hiring an external auditor to evaluate tax preparers for their compliance with all consumer law protections.

As part of the last requirement, Republic must audit at least 10% of tax preparers who offer Republic RALs and who were not evaluated in a prior year.

2. Judgment Against Liberty Tax Service Obtained by California Attorney General

Several years ago, the California Attorney General's Office filed lawsuits against all three major tax preparation chains. The lawsuits alleged that these companies made misleading statements in their promotion of RALs and RACs, violated consumer protection laws in their cross-lender debt collection practices, and violated IRS privacy rules regarding sharing of information for cross-marketing.[149]

In June 2009, the California Attorney General's Office won its lawsuit against Liberty Tax Service.[150] The San Francisco Superior Court issued a judgment against Liberty, finding that the company had:

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[148] Order to Cease & Desist, In the Matter of Republic Bank and Trust Co. Louisville, KY (Federal Deposit Insurance Corp. FDIC-08-308b), *available at* http://www.fdic.gov/bank/individual/enforcement/2009-02-10.pdf.
[149] Complaint, California v. JTH Tax, Inc., Case No. CGC-07-460778 (Cal. Super. Ct. Feb. 26, 2007); Judgment, People of the State of California v. Jackson Hewitt, Case No. 070304558 (Cal. Sup. Ct. Jan. 3, 2007); People of California v. H&R Block, 2006 WL 2669045 (N.D. Cal. Sep. 18, 2006).
[150] Statement of Decision, People of California v. JTH Tax, Inc., Case No. CGC-07-460778 (Cal. Super. Ct. June 15, 2009).

(1) engaged in deceptive marketing, including ads that promoted "refunds in one day" or "refunds in only 24 hours;"
(2) violated the Fair Debt Collection Practices Act by assisting Santa Barbara Bank & Trust in cross-lender debt collection; and
(3) violated the Truth in Lending Act for failing to disclose that RACs are actually loans for the tax preparation fee, and that the RAC fee is a finance charge.[151]

The California Superior Court ordered Liberty Tax Service to pay $1.16 million in civil penalties and $135,886 in restitution to consumers.

3. Judgment Against Malqui Tax Obtained by New Jersey Attorney General

In 2007, the New Jersey Attorney General's Office sued Malqui Tax, a local tax preparation chain, for deceptive advertisement of RALs. The lawsuit alleged that Malqui Corporation misrepresented RALs as tax refunds, and did not disclose that they were loans. The lawsuit also alleged that Malqui failed to clearly tell consumers about the high interest rates and fees for RALs.

On April 6, 2009, the New Jersey Attorney General won its lawsuit against Malqui Tax. A New Jersey Superior Court found that Malqui and its owner were liable for hundreds of Consumer Fraud Act violations.[152] These violations included:[153]

(1) Advertising and selling RALs and similar financial products as income tax refunds;
(2) Deceptively advertising RALs as loans in English, while describing them as refunds in Spanish;
(3) Marketing and brokering RALs and similar financial products in a manner likely to confuse taxpayers into believing that such products are a way to quickly receive tax refunds from the IRS;
(4) Advertising RALs with no hidden fees then charging undisclosed fees for these products;
(5) Deceptively touting the speed with which Malqui could obtain refunds for consumers while actually selling RALs; and
(6) Misrepresenting to consumers that they could get a loan in the amount of their anticipated tax refund, when the proceeds of RALs are actually far less after fees and finance charges.

Malqui was ordered to pay $1.86 million in penalties and to repay $1.64 million to RAL borrowers. The $1.64 million in consumer restitution was based on a $134

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[151] *Id.*
[152] Transcription of Proceedings - Decision, Milgram v. Malqui Financial Group, Inc., Docket No. HUD-C-39-07 (N.J. Super. Ct. Apr. 6, 2009), on file with authors.
[153] Press Release, Office of the New Jersey Attorney General, *Tax Preparation Firm Ordered to Pay $3.5 Million for Deceptive Sales of "Refund Anticipation Loans,"* April 14, 2009, *available at* http://www.nj.gov/oag/newsreleases09/pr20090414a.html.

document preparation fee and $15 service bureau fee that 10,980 customers each paid to Malqui in 2006 and 2007.

4. Maryland Commissioner of Financial Institutions

In 2005, the Maryland Commissioner of Financial Institutions issued an advisory warning tax preparers who assisted Maryland taxpayers in obtaining RALs that they were operating as credit services organizations (CSOs), and that they must be licensed and comply with Maryland's CSO law.[154] In response, H&R Block sued the Commissioner, alleging that federal law preempted the requirements of Maryland's CSO law because Block is serving as an agent of a national bank when it facilitates RALs. A federal district court ruled partly in Block's favor, holding that federal law did preempt the fee caps and contract requirements of Maryland's CSO law, but not the licensing, bonding, and disclosure provisions.[155]

This decision was appealed to the Fourth Circuit Court of Appeals. The Fourth Circuit sent the case back to the district court, holding that the lower court should have first addressed the issue of whether tax preparers who make RALs are covered as "credit services organizations" under the CSO law.[156]

5. *Illinois Division of Finance and Professional Regulation*

In November 2009, the Illinois Division of Finance and Professional Regulation issued an order prohibiting consumer installment lenders in that state from facilitating RALs.[157] The Division sent notices to 128 consumer installment lenders that offered RALs and tax preparation services.

6. *North Carolina Commissioner of Banks*

The North Carolina Commissioner of Banks took action against Mo' Money Taxes for its failure to comply with the North Carolina RAL law. Mo' Money had failed to register its thirteen offices in North Carolina with the Office of the Commissioner of Banks (OCOB), as required by the North Carolina RAL law. Mo' Money agreed to pay a civil penalty of $13,000 and to properly register as a RAL facilitator. In addition, Mo' Money agreed not to have any meritorious complaints filed against it with the OCOB for the next five years.[158]

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[154] Maryland Commissioner of Financial Regulation, *Refund Anticipation Loans/Rapid Refund Program Advisory 05-01*, Jan. 24, 2005.
[155] Decision, H&R Block Eastern Enterprises, Inc. v. Turnbaugh, Civ. Ac. No. 07-1822 (D. Md. July 30, 2008).
[156] H & R Block Eastern Enterprises, Inc. v. Raskin, --- F.3d ---, 2010 WL 155383 (4th Cir. Jan. 15, 2010).
[157] Press Release, Governor Quinn Cracks Down on Predatory Refund Anticipation Loans, Nov. 23, 2009.
[158] Consent Order, In re: Application of Mo Money of North Carolina, Inc., Docket No. 10:036:RAL (Feb. 8, 2010).

C. Litigation

Harper v. Jackson Hewitt[159]

This was one of several class actions alleging that H&R Block and Jackson Hewitt's facilitating of RALs violated state Credit Services Organization (CSO) laws. These laws regulate both credit repair organizations and "any person or organization who assists or offers to assist consumers in obtaining an extension of credit," which should cover tax preparers who offer to arrange RALs. However, the court in Harper believed that this issue was an open question.

Harper v Jackson Hewitt was filed in federal court, but the court certified this question to the West Virginia State Supreme Court. NCLC, CFA and other consumer groups filed an amicus brief in the case supporting the plaintiffs.

Additional Credit Services Organization Cases

Several new CSO cases were filed, including:

- Fugate v. Jackson Hewitt – Kansas City, MO.[160]
- Norris v. Jackson Hewitt, Inc. – the federal District Court dismissed this case, holding that the plaintiff failed to sufficiently allege that she had been damaged by Hewitt's violation of the Indiana Credit Services Organization Act.[161]

D. Alternative RALs

Free tax preparation programs across the country continue to provide low-cost alternative RALs. These include Alternatives Credit Union in Ithaca, NY, and AccountAbility Minnesota.

The San Antonio Refund Express Loan program provided 2,164 RALs with an average loan amount of $2638.[162] There is no loan fee; however, $5 of the taxpayer's refund is placed into a savings account with a credit union.

The city of Savannah, GA, piloted an alternative RAL program making 71 loans for average refunds of $2,850. That program charged a $5 share fee and about $34.[163]

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[159] 2009 WL 3160484 (S.D.W.Va. Sept. 29, 2009).
[160] Kelly Wiese, *Jackson Hewitt Faces Lawsuit in Kansas City over Tax Refund Loans*, Missouri Lawyers Weekly, Apr. 6, 2009.
[161] 2009 WL 4744286 (S.D. Ind. Dec. 8, 2009).
[162] Julie Bosland and Michael Karpman, National League of Cities - Institute for Youth, Education, and Families, *The State of City Leadership for Children and Families* (2009), *available at* http://otdweb.nlc.org/ASSETS/E263FE71C1534FFA8CE583D83B386F65/IYEF_State_of_City_Leadership_9-09.pdf.
[163] Jan Skutch, *Income Tax Program Seek to Capture Tax Breaks for Working Poor*, Savannah Morning News, Jan. 17, 2010.

The city of Newark, NJ partnered with TD Bank to offer free RALs.[164] In Manatee County Florida, the Tropicana Federal Credit Union made alternative RALs.[165]

A new entrant in the RAL market is Advent Financial, which works with both VITA sites and independent commercial preparers to make low cost RALs. For VITA sites, Advent charges a finance charge of 0.976%, or $29.28 for a $3,000 RAL, or 35.6% APR.[166]

E. Advocacy

A coalition of local and state consumer advocacy groups continued their coordinated campaign against RALs. These groups included the California Reinvestment Coalition (CRC), the Community Reinvestment Association of North Carolina (CRA-NC), Neighborhood Economic Development Advocacy Project (NEDAP), and Woodstock Institute.

The coalition of local and state consumer groups, along with NCLC and CFA, sent a letter to FDIC Chairman Sheila Bair asking that the FDIC undertake additional examination and enforcement action over Republic's RAL program. On February 27, 2009, the FDIC issued a cease & desist order against Republic, which is discussed more fully in Section IV.B, above.

In April 2009, the coalition of local and state groups, along with NCLC and CFA, sent a letter to the Office of Comptroller of Currency (OCC) urging that agency to adopt standards for oversight and supervision similar to those that the FDIC imposed on Republic Bank. The groups especially urged the OCC to take action against Pacific Capital Bancorp. In response, the OCC provided a copy of a 2007 guidance on RAL lending which required such oversight and supervision. The coalition responded by questioning whether there had been any enforcement of this 2007 guidance, pointing out the recent California court decision finding Liberty Tax Service had engaged in deceptive advertising (Pacific Capital was Liberty's RAL lender). This effort may have played a key role in the OCC's decision to deny approval of Pacific's RAL program for 2010.

The coalition of local and state consumer groups, as well as other advocacy organizations, issued reports on RALs, including:

- Adam Rust and Peter Skillern, Community Reinvestment Association of North Carolina - *Fast Cash, Less Refund – Refund Anticipation Loans in North Carolina*, Jan. 19, 2010, *available at* http://www.cra-nc.org/files/Download/2010RALSfinal.pdf.

[164] Press Release, *Free Volunteer Income Tax Assistance Programs for Residents*, US Federal News, January 15, 2010.
[165] *AARP, IRS Team Up for Tax Prep*, Bradenton Herald, Jan. 21, 2010,
[166] http://www.advent-financial.com/vita.html.

- Sarah Duda, Katie Buitrago, Geoff Smith, Woodstock Institute, *Diverted Opportunity – Refund Anticipation Loans Drain Wealth from Low Wealth Tax Filers and Communities of Color,* Jan. 2010, *available at* http://www.woodstockinst.org/publications/download/diverted-opportunity%3a-refund-anticipation-loans-drain-wealth-from-low-wealth-tax-filers-and-communities-of-color/.

- Alexis Iwanisziw and Sarah Ludwig, NEDAP, *Rapid Rip-Offs: Tax Refund Anticipation Lending In New York City*, Jan. 2010, *available at* http://www.nedap.org/pressroom/documents/FINAL2010RALsREPORT1-19-10.pdf.

- Sarah Dewees and Leslie Parrish, First Nations Development Institute and Center for Responsible Lending, *Borrowed Time: Use of Refund Anticipation Loans Among EITC Filers in Native American Communities*, April 2009, *available at* http://www.responsiblelending.org/other-consumer-loans/refund-anticipation-loans/borrowed-time-rals-in-native-american-communities.pdf.

- Elizabeth Paulhus, West Virginia Center on Budget & Policy, *"Magic" Money a Mere Illusion: Refund Anticipation Loans & the Earned Income Tax Credit in West Virginia*, July 2009, *available at* http://www.wvpolicy.org/downloads/WVCBP-RAL-082509.pdf.