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April 7, 2008

CC:PA:LPD:PR (REG-136596-07)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

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

Dear IRS Commissioner:

I am writing from Woodstock Institute to comment on the Internal Revenue Service Advance Notice of Proposed Rulemaking regarding the disclosure and use of tax return information by tax preparers for the purpose of marketing products such as RALs. Woodstock Institute believes that the sale of RALs and other credit and consumer products in conjunction with the preparation of taxes serves as an incentive to inflate tax refunds. In addition, past Woodstock Institute research has demonstrated that RALs negatively impact the asset building potential of lower-income people in the Chicago region, particularly recipients of the Earned Income Tax Credit. Woodstock strongly encourages the IRS to enact rules that would limit the availability of RALs.

Woodstock Institute is a 35-year old applied research and advocacy organization working to ensure that safe and affordable credit options are available throughout lower-income and minority communities. Working to identify asset building opportunities and ensure that public policies are in place to ensure that lower-income people receive the maximum possible benefit from those opportunities, Woodstock is particularly concerned by the impact of refund anticipation loans on the asset building potential of recipients of the Earned Income Tax Credit.

This letter details the incentives created by RALs for tax preparers to inflate returns and discusses additional measures that should be adopted to prevent this practice. It also describes circumstances that could occur during the sale of refund anticipation checks (RACs) that may require additional protections.

About Woodstock Institute and the Impact of RALs in the Chicago Region

Previous Woodstock research found that RALs have a substantial negative effect on the asset building potential of recipients of the Earned Income Tax Credit, as well as other taxpayers.¹

Past Woodstock research has found that:

- The Earned Income Tax Credit returned \$903 million to working families in the Chicago region, with an average value of \$1,764 per recipient.
- In the Chicago region, on average, 38 percent of all Earned Income Tax Credit recipients use refund anticipation loans to receive their refunds faster, paying \$48,282,872 million in tax preparation and loan fees.
- Refund anticipation loan usage is geographically concentrated, and in the Chicago region it is particularly high in south suburban Cook County. Of the top 15 Chicago region communities ranked by refund anticipation loan usage, 9 of these communities were located in the south suburbs.
- Across the state of Illinois, 53 percent of recipients who live in predominantly minority tracts use RALs compared with only 27 percent of recipients in predominantly white tracts. Similarly, 57 percent of recipients in low-income zip codes use RALS compared with 19 percent of recipients in upper-income tracts.

Key Issues to Consider As Part of Future Rulemaking

The IRS notice laid out several questions about the ability of this proposal to reduce the incidence of fraud in refund anticipation loan lending, discussion of alternative strategies for reducing fraud, and the potential for abuse in the marketing or sale of other, similar tax products. The following section provides answers to these three questions.

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

Woodstock Institute believes that RALs create an incentive for tax preparers to put their own interests ahead of their clients, or to inflate refunds. Some preparers charge their own fees for RAL paperwork and/or receive compensation from the RAL lender. Taxpayers must be assured that their tax preparers to look out for their interests and to prepare honest returns. RALs provide a financial reward for preparers to market a product not in the taxpayer's best interest, in violation of that trust.

Additional steps the IRS should take to prevent fraud associated with refund anticipation loans:

- **Eliminate the Debt Indicator.** Woodstock recommends, as it has in past regulatory comment letters, that the IRS eliminate the Debt Indicator in order to reduce fraud or predatory practices associated with refund anticipation loans. In 1994, before eliminating the Debt Indicator for tax returns associated with refund anticipation loans, the IRS estimated that 92 percent of fraudulent

¹Feltner, Thomas. 2006. *Reinvestment Alert 29: Refund Anticipation Loan Usage Rates Negatively Impact the Asset Building Potential of the Earned Income Tax Credit*. Chicago, IL: Woodstock Institute.

returns filed electronically involved refund anticipation loans. Both RAL volume and RAL fraud dramatically declined after its elimination. Despite the unacceptable risk of fraud, the IRS reinstated the Debt Indicator in 1999, after which RAL fraud rates increased.² Because the Debt Indicator's intended purpose, to lower the rates associated with refund anticipation loans, was never achieved it should be eliminated.³

- **Prohibit the sale of RALs in conjunction with the sale of a consumer product.** When the amount a taxpayer receives from the proceeds of a RAL is connected to the financing of an additional product, such as a car or furniture, there is considerable incentive for the tax preparer/merchant to inflate the amount of the return in order to maximize available funds and increase sales.
 - **Decrease the processing time for tax refunds.** By decreasing the time it takes to process tax refunds, the IRS can encourage taxpayers, particularly lower-income taxpayers claiming to EITC, to avoid using RALs, since they will offer no tangible benefit to the taxpayer.
2. **If the marketing of RALs and certain other products exploit or have the potential to exploit certain taxpayers, is the approach described in this ANPRM better viewed as protecting taxpayers from exploitation or as restricting taxpayers' ability to control their tax return information? If the latter, is there an alternative approach that would address the concerns described above?**

Preventing the disclosure of private taxpayer information should be viewed as a strategy to protect taxpayers from exploitation, since there is considerable evidence that RALs are associated with high levels of fraud. Woodstock Institute also encourages the IRS to develop additional protections such as those listed above that would reduce the asset-stripping effect of RALs on lower-income people, particularly recipients of the Earned Income Tax Credit.

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

Woodstock Institute has several concerns about the Refund Anticipation Check products offered by RAL providers, but finds them to be generally of less concern than the RAL product. For taxpayers without traditional bank accounts, the RAC is a payment option which allows them the use of a temporary bank account to take advantage of direct deposit from the IRS. When used as a payment mechanism, the RAC is far more expensive than a traditional bank account, but provides the taxpayer the opportunity to take advantage of direct deposit to receive their funds.

For other taxpayers, with or without bank traditional bank accounts, a RAC may be used to help the taxpayer finance the tax preparer's tax preparation fee. In this case, the RAC is not a payment mechanism, but an extension of credit with the same risks associated with RALs (e.g. cases where a refund is reduced, delayed or denied by the IRS). In this case, the borrower has an outstanding obligation that the proceeds from the tax refund are expected to fulfill, and this obligation exists regardless of whether or not the refund is deposited. In this case, since the RAC is a credit product

²Wu, Chi Chi. 2005. *Corporate Welfare for the RAL Industry: The Debt Indicator, IRS Subsidy, and Tax Fraud*. Boston, Massachusetts: National Consumer Law Center. p. 10.

³Wu, Chi Chi. 2005. *Corporate Welfare for the RAL Industry: The Debt Indicator, IRS Subsidy, and Tax Fraud*. Boston, Massachusetts: National Consumer Law Center. p. 10.

marketed by tax preparers, it should be subject to the same restrictions on information disclosure as currently proposed for RALs.

With several modifications, such as those proposed by the National Consumer Law Center (NCLC) RACs could serve as a beneficial payment mechanism.⁴ NCLC has suggested several changes, such as reasonable tax preparation fees; upfront, clear, and simple disclosure of RAC costs; ability for customers to pay all or part of RAC fees out of pocket; a lower fee structure for EITC recipients; education on options for receiving tax refunds cost-free; option of free tax preparation or other means to pay for preparation besides receiving a RAC. If instituted, these changes would mitigate many of the problems associated with the high cost of RACs.

Recommendations

Tax preparers should be trusted advocates working on behalf of their clients, and where there is significant incentive to inflate returns or otherwise encourage clients to choose products that may not fit their circumstances, additional protections should be instituted. The IRS proposal to prohibit the disclosure of private taxpayer information in conjunction with sale of RALs and some forms of RACs that have continually been the source of fraud is one type of protection that should be instituted. Woodstock Institute hopes that the IRS also considers a number of additional steps recommended in this comment letter that are necessary to reducing the asset-stripping effects of these harmful products.

Sincerely,

Tom Feltner
Policy and Communications Director

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⁴Ibid. p. 7.