PREDATORY TAX-TIME LOANS STRIP $324 MILLION FROM NEW YORK CITY'S POOREST COMMUNITIES

An Analysis of Tax Refund Anticipation Lending in NYC 2002 – 2005

New Economy Project (formerly NEDAP)
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This report was prepared by the Neighborhood Economic Development Advocacy Project (NEDAP), a resource center that provides legal, technical, and policy support to community groups in New York City's low income communities and neighborhoods of color. NEDAP's mission is to promote community economic justice and eliminate discriminatory financial practices that harm communities and perpetuate inequality and poverty.

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Tax preparation sites used to be places where people went to get their taxes prepared. Now, using clever and "zany" marketing campaigns that inundate low-income communities and neighborhoods of color, tax preparers are now perhaps better known for making tax refund anticipation loans, or "RALs," a usurious loan product that strips millions of dollars from the poorest New York families and neighborhoods each year.

Analyzing IRS data on RALs for the four-year period, from 2002 through 2005, NEDAP found that RALs siphoned more than $324 million out of New York City's poorest communities. [1] **The loans were overwhelmingly concentrated in the city's lowest income neighborhoods of color, in Central and East Harlem, the South Bronx, Central and Northeast Brooklyn, and Southeast Queens.**

Some of the world's largest financial institutions, including HSBC and JPMorgan Chase, make these loans through the hundreds of tax prep sites that serve as their brokers, reaping lucrative profits by taking a bite out of people's tax refunds and credits. By taking advantage of a regulatory loophole, RALs lenders are able to circumvent New York State's usury laws.

"Pay stub" and "holiday" loans, new and arguably more abusive loans made by tax preparers, are on the rise in New York. These loans are made before tax season begins, and are based on a projection of the borrower's tax refund and tax credits using the person's pay stub. (See attached alert.)

Poster advertising pay stub loans, in NYC subway station (12/06).

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[1] New York City RAL, EITC, and low-income taxpayer data are derived from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database, W&I Research Group 2, October 2006 ("IRS"). The report analyzes data over the four years for which IRS data on RALs are available. Data researched was for Tax Years 2001–2004.

In just one year, the number of outlets that offer pay stub and holiday loans increased from approximately 6,000 at the end of 2005, to approximately 20,500 at the end of 2006, nationally. These figures include the three largest tax preparation chains, and do not include independent tax preparers.[2]

FINDINGS

NEDAP analyzed four years of IRS data showing tax returns filed with RALs in New York City.[3] Below is a summary of findings.

From 2002 through 2005:

- **New Yorkers lost more than $324 million of their tax refunds and credits through RALs.**

- **In many of the poorest New York City neighborhoods, an estimated 1 out of every 5 taxpayers received a RAL.**

- **Taxpayers in the South Bronx, Central and Northeast Brooklyn, Central and East Harlem, and Southeast Queens were the hardest hit by RALs, both in terms of the percentage of RALs made, and the total amount of money drained.**

  The below chart shows the ten New York City zip codes from which RALs extracted the largest dollar amounts, city-wide.

NEIGHBORHOOD	BOROUGH	ZIP CODE	TOTAL FEES
Brownsville	Brooklyn	11212	$8,563,268
Morrisania/Melrose	Bronx	10456	$8,161,740
East New York/Cypress Hills	Brooklyn	11207	$7,895,896
Tremont	Bronx	10453	$7,881,750
Flatbush	Brooklyn	11226	$7,515,922
Highbridge/Morrisania	Bronx	10452	$7,050,864
East New York/Cypress Hills	Brooklyn	11208	$6,639,152
Tremont/East Tremont	Bronx	10457	$6,622,938
Canarsie	Brooklyn	11236	$6,553,422
Bushwick/Bedford-Stuyvesant	Brooklyn	11221	$6,359,296
TOTAL FOR 10 ZIP CODES			$73,244,248

The below chart shows the ten New York City zip codes with the highest percentages of tax returns filed with a RAL.

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[2] Research findings, Harvard Business School (2007); personal correspondence on file with NEDAP. Lending data are not publicly available for pay stub and holiday loans.

[3] NEDAP issued a report on RALs in March 2006 that documented the RAL providers' targeting of low-income taxpayers and communities for these under-regulated loans. The report highlighted the impact of RALs on low-income New Yorkers and the neighborhoods in which they live. This year, in addition to updating the 2006 report with a snapshot of the most recently reported RAL data, NEDAP has measured the cumulative impact of RALs in New York over the last four years.

NEIGHBORHOOD	BOROUGH	ZIP CODE	PCT RALS
Hunts Point	Bronx	10474	29.0%
Morrisania/Melrose	Bronx	10456	28.7%
Central Harlem	Manhattan	10030	28.4%
Mott Haven	Bronx	10454	26.8%
Brownsville	Brooklyn	11212	26.4%
Bedford-Stuyvesant	Brooklyn	11233	26.2%
Tremont/East Tremont	Bronx	10457	25.7%
Central Harlem	Manhattan	10039	25.4%
Highbridge/Morrisania	Bronx	10452	24.5%
Mott Haven	Bronx	10455	24.5%

- **Approximately 77% of all New Yorkers who received a RAL were low income.**

- **RALs are overwhelmingly concentrated in predominantly African-American and Latino neighborhoods.**

In 2005 alone:

- **New Yorkers paid more than $75 million in RAL-related tax preparation and fees.**

- **Low-income taxpayers paid approximately $59 million in tax preparation and RALs fees.**

- **Nearly 1 in 5 New Yorkers claiming the Earned Income Tax Credit (EITC) borrowed a RAL.**

- **Of all New York City taxpayers taking out a RAL, approximately 61% claimed the EITC.**

See attached maps.

<u>POLICY RECOMMENDATIONS</u>

At the federal level:

- Legislation is needed to put an end to usurious RALs.

- Until such legislation is passed, regulators that oversee banks making RALs, including the Office of the Comptroller of the Currency, the national bank regulator, should order their regulatees to cease making predatory RALs, and paystub and holiday loans.

At the state level:

NEDAP supports recommendations issued by New Yorkers for Responsible Lending (NYRL), a state-wide coalition that has identified RALs as a serious credit abuse.[4] NYRL has called on the NYS legislature to pass a state law that would:

- Require tax preparers in New York State to register with the NYS Department of Banking;

[4] NYRL is a state-wide coalition of more than 125 seniors, consumer, civil rights, affordable housing, and community development organizations and community development financial institutions dedicated to promoting fair credit access. NEDAP is a founding member of NYRL and serves on its Steering Committee.

- Require that RALs providers and facilitators comply with New York State's 25% usury cap, to the extent permitted by law;
- Require meaningful disclosure of RAL fees and terms to borrowers;
- Create a fiduciary duty on the part of tax preparers to taxpayer clients; and
- Prohibit abusive cross-collection practices by RAL lenders.

At the local level:
RALs directly undercut the City's initiative to encourage low- and moderate-income New Yorkers to file for the EITC. The City should:
- Lead an aggressive consumer education campaign to warn New Yorkers about RALs;
- Cease partnering with tax preparation companies that offer RALs, such as H&R Block and Jackson Hewitt, which are partners in the City's EITC education effort;[5] and
- Support state and federal legislative and regulatory actions to eliminate RALs.

At all levels, government should aggressively support development of sound and affordable small, short-term loans as well as free tax preparation services.

CONCLUSION

RALs cost low- and moderate-income working New Yorkers more than $324 million in the four year period, from 2002 through 2005. RALs not only take a huge bite out of working families' income, but they also directly undermine community development and the city's economy, overall. Millions of dollars in tax refunds and Earned Income Tax Credits that New Yorkers would return to the local economy instead go to pay for these extremely high-cost, short-term loans.

RALs, and their pay stub variation, have joined a new generation of inferior and abusive financial products that are specifically targeted at low- and moderate-income communities and neighborhoods of color using predatory, and often discriminatory, practices. In addition to alerting the public about RALs and challenging RALs issuers to end their abusive lending business, legislative and regulatory intervention is needed to eliminate RALs from the tax system at state and federal levels.

[5] "Mayor Bloomberg Announces Expanded Effort to Boost Filings for the Earned Income Tax Credit," Mayor's Office PR-021-06, Jan. 19, 2006.

New Economy Project (formerly NEDAP)

PREDATORY LENDING ALERT

For community groups and advocates
December 2006

Tax Preparers and Banks Roll Out High Cost "Pay Stub/Holiday" Loans

The Neighborhood Economic Development Advocacy Project (NEDAP) is reaching out to community groups to alert them to a new predatory loan product known as "pay stub" or "holiday" loans, which are targeted at working people strapped for cash.

****** ACTION NEEDED: Groups are encouraged to inform their members and constituents about these predatory loans, and provide information on sound, affordable alternatives (see below).***

Signs have cropped up in subway stations and in low income communities for "Instant Money Now" and "HELP-Holiday Express Loan Program" loans – designed to lure low income New Yorkers into tax prep offices before tax season even begins. Companies like Jackson Hewitt and H&R Block are aggressively marketing pay stub/holiday loans, promising people fast cash and an early jump on their tax refunds. These loans, however, are risky and extremely high-cost to the borrower.

How do Pay Stub Loans Work?
Pay stub/holiday loans are available as early as November. They are made based on a person's projected tax refund and Earned Income Tax Credits (EITC), using his or her pay stub. The loans are intended to hook taxpayers into coming back to get their taxes done during tax season. At that time, it is generally expected that borrowers will repay their pay stub/holiday loan by taking out a second high-cost loan, known as a tax refund anticipation loan (RAL). Unlike pay stub/holiday loans, RALs are secured loans, made against the borrower's expected tax refund and EITC.

What are the Costs and Risks of these Loans?

- Pay stub loans can set in motion a cycle of expensive debt for borrowers, sometimes even before the New Year has begun.
- Most pay stub loans carry annual percentage rates (APRs) in the triple-digits.
- Pay stub loans are made without regard to borrowers' actual ability to repay the loan.
- Pay stub loans often include additional, sometimes hidden, fees. For instance, one lender requires borrowers to receive their pay stub loan on a debit card, in turn requiring them to pay fees to load the money onto the card and usage fees.
- One lender begins to make collection calls on pay stub loans in the middle of January, weeks before many borrowers have even received their W-2 from their employer. Borrowers may be pressured to return to the tax prep office and repay the loan before they even have the documentation necessary to get their taxes done.

How do Refund Anticipation Loans Harm Low-Income Communities?
Nationwide, RALs have stripped billions of dollars from low income communities. A report issued by NEDAP found that low income taxpayers in New York City paid nearly $92 million in tax preparation and RALs fees in 2004, and that nearly 1 in 4 New Yorkers claiming the EITC borrowed a RAL in 2004. In New York City, the neighborhoods with the highest percentages of RALs include Hunts Point and Morrisania in the Bronx, Brownsville and Ocean Hill in Central Brooklyn, and Central Harlem in Manhattan – some of the lowest income communities in the city.

Many advocates consider industry RALs predatory and exploitative of the working poor, and think RALs and pay stub/holiday loans should be prohibited.

Who Profits from Refund Anticipation Loans?
Although tax preparers are the public face of pay stub RALs, it is actually a small handful of banks – HSBC, JPMorgan Chase, Santa Barbara Bank & Trust, and Republic Bank & Trust – that makes virtually all pay stub loans and RALs. The banks making pay stub RALs and the tax preparation businesses marketing them are expected to generate huge profits from pay stub loans. HSBC, the country's largest RALs issuer, made $16.1 billion in RAL loans in the first nine months of 2006.

Because most pay stub loans will be refinanced through RALs, NEDAP anticipates that an increase in pay stub loans will lead to an increase in the total number of RALs issued during tax season.

Some major industry players have publicly acknowledged the abusive nature of pay stub loans. According to Mark Ernst, chief executive of H&R Block, the nation's largest tax preparer, "The association of these high-cost pay-stub loans with tax preparation generally is not good for consumers…" One bank recently left the pay stub loan business, suggesting that it would not offer these "legally questionable" products, "especially since most Pay Stub loan customers receive their refunds through the EITC."

What Alternatives are Available to Taxpayers?
Low income taxpayers can receive free tax prep assistance at a number of sites throughout New York City and State, including at Volunteer Income Tax Assistance (VITA) sites. Many credit unions have special savings programs designed to help prepare people for holiday season expenses and loans that are much more affordable than pay stub loans and conventional RALs.

If you would like a list of community development credit unions, free tax prep sites, or if you are affiliated with a community-based organization and would like to learn more about advocacy efforts to curb pay stub lending and abusive RALs, please call NEDAP at (212) 680-5100.