RAPID RIP-OFFS:
TAX REFUND ANTICIPATION LENDING
IN NEW YORK CITY

2010 Annual Report on RALs

Sign outside NYC tax prep service

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New Economy Project (formerly NEDAP)
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This report was prepared by the Neighborhood Economic Development Advocacy Project (NEDAP). NEDAP's mission is to promote community economic justice and eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty.

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2010 Report

BACKGROUND

Since 2006, NEDAP has issued several reports documenting the impact of tax refund anticipation loans (RALs) on New York City. This report, the fourth in the series, analyzes IRS data on RALs for tax filing year 2007, and calculates the total economic drain on low income New Yorkers and communities.[1]

RALs are high cost, very short-term loans, made during tax season. RALs are usurious by any standard, with annual percentage rates between 50% and 500%.[2] In New York City, as in other parts of the country, RALs are made primarily to people living in low income communities of color, including a significant portion of people who receive the Earned Income Tax Credit (EITC).

Tax preparers that offer RALs typically advertise them as "instant loans" or "rapid refunds" to entice people to use their tax prep services.[3] When getting a RAL, people are borrowing against their own money – which serves as collateral on the loan. RALs are marketed as an "advance" on tax filers' expected IRS refunds and tax credits. But RALs come at great cost, as hefty fees and high interest are charged for what is essentially a one- to two-week loan.

RALs borrowers sign over their refunds and credits to the bank making the loan, which receives the funds directly from the IRS within a matter of days. In recent years, the IRS has steadily shortened the time period in which it issues refunds on electronically-filed returns. Tax filers who file their returns electronically and choose direct deposit into a bank or credit union account can now expect their tax refunds and credits within 10 business days, and often sooner. Given the IRS's significantly shortened turnaround time, RALs cannot be justified even as an emergency loan program, as some in the industry have claimed.

Large national banks, including JPMorgan Chase and HSBC, make RALs through tax preparers, who serve as their brokers. These banks reap sizeable profits by taking a large bite out of low income workers' tax refunds and credits. By exploiting a regulatory loophole, which exempts national banks from complying with state consumer protection laws, RALs lenders are able to circumvent New York State's usury laws and charge triple digit interest rates on RALs.[4]

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[1] Tax filing year 2007 is the most recent year for which IRS RALs data are available at the zip code level, New York City RAL, EITC, and low-income taxpayer data are from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database ("IRS"). Data used covered tax filing year 2007.

[2] Wu, Chi Chi and Fox, Jean Ann (2009). "Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Tax Payers At Risk." Available: http://www.consumerlaw.org/issues/refund_anticipation/content/2009_RAL_Report.pdf

[3] In New York City, it is illegal to advertise RALs as rapid refunds; tax preparers must describe them as loans.

SUMMARY OF FINDINGS

NEDAP analyzed IRS data for New York City, for tax filing year 2007. Key findings are as follows:

- **RALs fees siphoned more than $54.7 million from New Yorkers' tax refunds and Earned Income Tax Credits (EITC).**[5]

- **The total number of RALs made in New York City decreased between 2006 and 2007**, from 194,004 to 188,527.[6]

- **RALs continued to be highly concentrated in NYC communities of color.** [7] Notwithstanding the overall decrease in the number of RALs made, seven out of ten RALs in NYC were made to people living in predominantly black or Latino neighborhoods, and more than $37.9 million in fees were extracted.

- **The vast majority of RALs were made to low income New Yorkers and EITC recipients.** 81% of RALs were made to low-income tax filers, and 61% to EITC recipients. Among all New Yorkers claiming EITC, 16% received a RAL, compared to 22% in 2006.

- **The South Bronx, followed by Central and Northeast Brooklyn, was hardest hit by RALs**, both in terms of the percentage of residents who received RALs, and the total amount of money drained from their communities. (See charts below for top five zip codes.)

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[4] New York State's usury cap on small loans is 25%.

[5] *Id*. Each year the National Consumer Law Center (NCLC) publishes a report on RALs, and calculates the average fee for tax preparation and borrowing a RAL. According to NCLC, the average tax preparation fee is $183 and average RAL fee is $107, for a total cost of $290.

[6] IRS data include the number of RAL "inquiries," i.e., applications for refund anticipation loans, per zip code. The number of RALs inquiries is a standard proxy for the number of RALs made, as approximately 85% of RAL inquiries are approved by the lender. Tax preparers that offer fewer than 10 RALs in a zip code are not required to report their RALs inquiries to the IRS, and these RALs are therefore not reflected in the data. Data on race and ethnicity by zip code are from the 2000 U.S. Census.

[7] Communities of color are defined as zip codes in which 50% or more of the population is black or Hispanic, according to the 2000 Census.

IMPACT ON NYC NEIGHBORHOODS

Neighborhoods in the South Bronx were hardest hit by RALs, in terms of fees extracted and the percentage of tax filers who received a RAL.

The chart below shows the top five NYC neighborhoods from which RALs extracted the largest **amount of fees**, in tax filing year 2007.

Neighborhood (Zip Code)	Borough	Total Fees
1. Morris Heights (10453)	Bronx	$1.74 million
2. Morrisania/Melrose (10456)	Bronx	$1.63 million
3. Highbridge/Morrisania (10452)	Bronx	$1.43 million
4. Tremont/East Tremont (10457)	Bronx	$1.32 million
5. East New York/Cypress Hills (11207)	Brooklyn	$1.23 million

The chart below shows the top five neighborhoods in terms of **percentage of tax filers** who received RALs in 2007.

Neighborhood (Zip Code)	Borough	% of Tax Filers Receiving RALs
1. Hunts Point (10474)	Bronx	18.9%
2. Morris Heights (10453)	Bronx	17.1%
3. Morrisania/Melrose (10456)	Bronx	16.9%
4. Mott Haven (10454)	Bronx	16.7%
5. Highbridge/Morrisania (10452)	Bronx	16.0%

Please see Appendix for maps showing the concentration of RALs in NYC's low income neighborhoods and communities of color.

POLICY RECOMMENDATIONS

At the federal level:
A federal solution is necessary to address abusive RALs and to ensure that taxpayers, especially low income filers and EITC recipients, are not stripped of their assets. EITC is the single greatest federal anti-poverty program in the U.S., and has become the single greatest profit generator for RALs providers. In NYC, more than 60% of all RALs were made to EITC recipients, draining a vital income source for more than 110,000 working poor families.

Virtually all banks that make RALs are nationally chartered. Since 2004, because of the Office of the Comptroller of the Currency's (OCC) sweeping federal preemption ruling, national banks have been able to circumvent state consumer protection laws, including state usury caps. The small loan usury cap in New York State, for example, is 25%.

Specific recommendations at the federal level are as follows:

- At minimum, RALs to EITC recipients must be prohibited. Congress should prohibit the use of EITC as collateral on loans, including RALs.

- Congress should pass a strong federal usury cap. The federal usury law should not preempt stronger state laws.

- Federal banking regulators that oversee the small number of banks that make RALs -- in particular the national bank regulator, the OCC – should order all of their regulated institutions to cease making usurious RALs.

- The IRS should close loopholes that facilitate the making of RALs and should ensure tax filers' privacy. For example, IRS rules now permit RALs lenders to have access to tax filers' private information, and allow tax preparers to share individuals' tax returns with banks that issue RALs.

- The IRS should significantly improve access to electronic filing of tax returns, and expedite delivery of tax refunds. Both improvements would go a long way to eliminating the perceived need to use commercial tax preparers and obtain a RAL.

- Funding for free Volunteer Income Tax Assistance (VITA) programs should be significantly expanded.

At the state level:
In 2009, New York State enacted legislation governing tax preparers that offer RALs. The new law incorporates several key recommendations included in NEDAP's previous RALs reports, and supported by New Yorkers for Responsible Lending (NYRL), a state-wide coalition that has identified RALs as a serious credit abuse.[8]

[8] NYRL is a state-wide coalition of more than 145 seniors, consumer, civil rights, affordable housing, and community development organizations and community development financial institutions dedicated to promoting fair credit access.

The new law, for example, requires tax preparers that make RALs in New York State to register with the NYS Department of Taxation and Finance. It also requires meaningful disclosure of RAL fees and terms to borrowers. It will be critical for New York State to monitor tax preparers' compliance with the new law and to enforce its provisions.

Unfortunately, state legislators have been impeded since 2004 from curbing abusive RALs altogether, because of OCC preemption. Action is still needed to:

- Require that RALs providers and facilitators comply with the state's 25% usury cap.

- Create a fiduciary duty on the part of tax preparers to taxpayer clients.

- Prohibit abusive collection practices by RAL lenders.

<u>At the NYC level:</u>
RALs directly undercut the City's initiative to encourage low- and moderate-income New Yorkers to file for the EITC. The City should:

- Cease partnering with tax preparation companies that offer RALs, such as H&R Block, which are partners in the City's EITC education effort;[9] and

- Support state and federal legislative and regulatory actions to eliminate RALs.

RALs are part of a spectrum of high-cost and abusive credit products that exploit working poor families by offering fast cash. This segment of the financial services market has proven highly lucrative – but at great cost to low income people and communities, as well as to people and communities of color. There are clearly structural poverty and economic justice issues that government at all levels must urgently address.

In the immediate context of RALs, government at all levels should affirmatively support the development of sound and affordable small, short-term loans, and well as free tax preparation services.

CONCLUSION

RALs cost low- and moderate-income working New Yorkers an estimated $54.7 million in 2007 – and more than $368 million in the six-year period from 2003 through 2007.[10] 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

[9] New York City lists H&R Block and Jackson Hewitt as partners in its EITC Campaign, and links NYC information pages to the tax preparers' websites:
http://www.nyc.gov/html/ofe/html/poverty/taxcampaign_partners.shtml
See also, "New York City Kicks Off Tax Season With the 6th Annual Earned Income Tax Credit (EITC) Campaign" January, 2008. Available: http://home2.nyc.gov/html/dca/html/pr2008/pr_012308.shtml
[10] Available: http://nedap.org/resources/reports.html

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.

In addition to alerting the public about RALs and challenging RAL 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.