

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



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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.

This study was prepared by Chris Keeley and Sarah Ludwig. Maps were prepared by Joby Thoyalil and Thu Tuyen To. Photos by Amanda Jeannopoulos and Julia Nagle.

For more information, please contact NEDAP at (212) 680-5100, or visit our website at www.nedap.org.

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

You've seen the signs that crop up in tax prep storefronts during tax season: Rapid Refund! Instant Money! ¡Dinero al Instante!



Clearly no one is giving away free money. Rather, tax time has become a season for gouging the working poor, through so-called tax refund anticipation loans (“RALs”), a usurious product that siphons millions of dollars from the poorest New York families and neighborhoods each year. Banks, including HSBC, one of the world’s largest financial institutions, 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.

RALs providers target low-income taxpayers and communities for these under-regulated loans. This report highlights the impact of RALs on low-income New Yorkers and the neighborhoods in which they live.

EXECUTIVE SUMMARY

NEDAP’s findings, based on its analysis of IRS data for tax filing season 2004 (tax year 2003), the most recent year for which data are available, are as follows:¹

- New Yorkers lost more than \$92 million of their tax refunds and credits through RALs, in 2004. This figure includes an estimated \$48.7 million in tax prep fees and \$43.4 million in RAL fees.²
- Approximately 77% of all New Yorkers who received a RAL were low income.³

- **In many of the poorest New York City neighborhoods, an estimated 1 out of every 4 taxpayers received a RAL.** Low-income New Yorkers are far and away the hardest hit by RALs.
- **Low-income taxpayers in New York City paid approximately \$70.6 million in tax preparation and RALs fees in 2004.**
- **Nearly 1 in 4 New Yorkers claiming the Earned Income Tax Credit (EITC) borrowed a RAL in 2004.** Of all New York City taxpayers taking out a RAL, approximately 58% claimed the EITC.
- **Low-income neighborhoods are hit disproportionately hard.** The 20 zip codes with the highest proportion of RALs have a median household income of \$20,500 – far below the city-wide median household income of \$38,300.
- **RALs are overwhelmingly concentrated in predominantly African-American and Latino neighborhoods.** The highest percentages of RALs city-wide are in neighborhoods that are 95% Black or Latino.

See attached maps.

BACKGROUND

H&R Block, Jackson Hewitt, Liberty Tax, and myriad independent tax preparers market “quick money” to get people to use their services. In fact, these solicitations are for some of the highest rate loans you can find anywhere, arranged by tax preparers at the time they file clients’ income tax returns and funded by a small handful of banks.

Taxpayers typically pay from \$100 to \$250 to take out a tax refund anticipation loan (RAL), including tax preparation and filing fees. They receive their so-called Rapid Refunds in 1-3 days, and never actually see their tax refund and credits. Instead, as a requirement of getting the loan, taxpayers authorize the IRS to send their funds directly to the lender. The lender then receives the borrower’s full funds within a matter of one to two weeks. Nationally, taxpayers paid an estimated \$1.4 billion in 2004 to receive their tax refunds and credits through these usurious loans.⁴

RALs cost up to hundreds of dollars in fees and carry annual interest rates of 40% - 700%, despite their low risk. Before the tax preparer even makes the RAL, the taxpayer’s information is sent to the IRS, as well as to a national database of RALs providers, to determine any outstanding debt.⁵ If the tax refunds turn out to be less than expected, borrowers have to repay the RAL out of pocket or the RAL reportedly converts to a high-cost loan.⁶

The advantages of getting a RAL are highly questionable, especially since the IRS has significantly expedited its turnaround time for sending out people's tax refunds. People who take out a RAL typically receive their loan within 1 to 3 days. By comparison, people who electronically file their taxes can receive their refunds directly from the IRS in approximately 8 to 15 days (or sooner), if they have a bank or credit union account into which their money can be wired.

RALs are all but unregulated: Tax preparers who broker RALs are not licensed to make these loans, and the cost of making RALs is completely unregulated. Most people who received RALs were not aware that they, in fact, took out a loan.⁷

RALs providers target low-income taxpayers, and drain more than a billion dollars each year from their pockets and communities.

RESEARCH FINDINGS

1. NYC Totals

More than 300,000 New York City taxpayers paid approximately \$92 million in 2004 to claim their 2003 refunds and tax credits through RALs. That is 1 out of every 10 New York City taxpayers.

Total Fees Paid	\$92,082,702
Total Number of RALs	333,633
Average Fee (incl. RALs and tax prep fees)	\$276

2. Income Targeting

An estimated 3 out of 4 RALs made by these unregulated loan brokers was to a low-income New Yorker.⁸

% of RALs Made to Low-income Taxpayers	77%
RALs Made to Low-income NYC Taxpayers	255,877
Total Number of RALs	333,633

Low-income taxpayers in New York City paid approximately \$70.6 million in tax preparation and RALs fees in 2004.

Low-income neighborhoods were hit disproportionately hard. In many of the poorest New York City neighborhoods, approximately 1 out of every 4 taxpayers received a RAL. The 20 zip codes with the largest dollar amounts siphoned out by RALs, and the 20 zip codes with the highest proportion of RALs, have median household incomes of \$25,500 and \$20,500, respectively – far below the city-wide median household income of \$38,300. (See *attached maps*.)

Nearly 1 in 4 New Yorkers claiming the Earned Income Tax Credit borrowed a RAL in 2004.

% Returns with EITC & RAL	24%
Total Tax Returns with EITC in NYC	805,373
Number of Returns with EITC & RAL	195,081

Of all New York City taxpayers taking out a RAL, approximately 58% claimed the EITC.

% of RALs to EITC Taxpayers	58%
Total Number of RALs	333,633
Number of Returns with EITC & RAL	195,081

3. Race Targeting

RALs are also disproportionately and overwhelmingly concentrated in predominantly African-American and Latino neighborhoods. Neighborhoods with the highest percentages of RALs city-wide include Hunts Point and Morrisania in the Bronx, Brownsville and Ocean Hill in Central Brooklyn, and Central Harlem in Manhattan. (See *attached maps*.)

NEDAP analyzed the concentration of RALs by zip code, in terms of: (1) percentage of RALs made; and (2) total dollar amount siphoned off by RALs. The highest concentrations of RALs in both categories were made in neighborhoods that are greater than 95% Black or Hispanic, according to the 2000 Census.

THE ROLE OF BANKS

Tax preparers facilitate, or broker, RALs for a small handful of major banks.⁹ HSBC, Pacific Capital Bancorp, and JP Morgan Chase make more than 90% of all RALs nationally.¹⁰

- HSBC, through its subsidiary HSBC Taxpayer Financial Services, generated more than \$13.3 billion in RALs in 2004.¹¹
- Pacific Capital Bancorp, the parent company of Santa Barbara Bank & Trust, estimates its operations cover 25%-30% of the RAL and Refund Anticipation Check (RAC) market nationally. Pacific Capital Bancorp reports that its RAL and RAC business accounted for 30% of its pretax income in 2004.¹²
- Some tax preparation firms, such as H&R Block, hold a financial stake in the RALs they broker.¹³

- Like many forms of predatory lending, Wall Street investment houses inject significant money into this industry through securitization. At least one major RALs funder recently bundled its RALs for sale on the secondary market.¹⁴
- RALs are also tied to other fringe financial services, including high-cost stored-value cards, rent-to-own stores, and check cashing outlets. Tax preparers can cross-market other products (e.g., credit cards, mortgages) during or after the tax preparation process.¹⁵
- At least one tax preparation outlet has courted not-for-profit organizations to refer their members to the tax outlets offering RALs, in return for incentives and donations.¹⁶

RECOMMENDATIONS

NEDAP supports recommendations issued by New Yorkers for Responsible Lending (NYRL), a state-wide coalition that has identified RALs as a serious credit abuse.¹⁷ 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;
- 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.

CONCLUSION

Tax refund anticipation loans (RALs) are part of the growing array of fringe and predatory financial services that target low-income consumers and neighborhoods. Public attention is desperately needed at community, policy-making, and legislative levels to address the systematic gouging of low-income people and neighborhoods by financial services providers. RALs provide an important view of how abusive, high-cost financial services have civil rights and economic justice implications, beyond the individual consumer transaction.

ENDNOTES

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, Project 2-05-02-2-016E, October 2005 ("IRS").

² The "# of RALs" refers to the total number of preparer debt inquiries submitted to the IRS. An estimated 90% of preparer debt inquiries are approved for a RAL. Chi Chi Wu and Jean Ann Fox, "Another Year of Losses: High-Priced Refund Anticipation Loans Continue To Take a Chunk Out Of Americans' Tax Refunds," National Consumer Law Center/Consumer Federation of America, January

2006 (“NCLC/CFA Report”), and citing Santa Barbara Bank & Trust, *Why You Should Choose SBBT '05*, available at www.taxwise.com/pdf/Why%20SBBT.pdf; Household International, *Exploring the Refund Anticipation Loan (RAL): Questions and Answers*, on file with NCLC and CFA.

³ “Low-income” is defined as returns with Adjusted Gross Income less than the EITC income limit (\$34,678). IRS.

⁴ NCLC/CFA Report.

⁵ The IRS checks to see if the taxpayer owes on past taxes, student loans, or child support, for example. The national database is part of a “cross-collection” agreement among RAL issuers. Any alleged debt is paid directly to the previous lender out of the taxpayer’s current expected refund, without meaningful notice to the taxpayer.

⁶ Meeting notes with industry representatives, on file with NEDAP. The unpaid RAL might appear as negative information on the taxpayer’s credit report.

⁷ Wu and Fox, “All Drain, No Gain: Refund Anticipation Loans Continue to Sap the Hard-Earned Tax Dollars of Low-Income Americans,” National Consumer Law Center/Consumer Federation of America, January 2004.

⁸ “Low-income” is defined as returns with Adjusted Gross Income less than the EITC income limit (\$34,678). IRS.

⁹ One tax prep company explains, “The (tax preparation) Company acts only as a facilitator between the client and the bank in preparing and submitting the loan documentation and receives a fee for these services payable upon consummation of the loan. None of the Company’s funds are used to finance these loans, and the Company has no liability for repayment of these loans.” Gilman & Ciocia, *2004 Form 10-K Annual Report Pursuant to Section 13 or 15(d) of the Securities*.

¹⁰ Pacific Capital Bancorp, *2004 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 5 and 62. HSBC entered the RALs business when it acquired Household, and Chase when it acquired Bank One.

¹¹ HSBC Finance Corporation, *2004 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 10. According to the filing:

HSBC Taxpayer Financial Services is the leading U.S. provider of tax-related financial products to consumers through nearly 25,000 unaffiliated professional tax preparer locations and tax preparation software providers. Serving more than 8.2 million customers annually, this business leverages the annual U.S. income tax filing process to provide products that offer consumers quick and convenient access to funds in the amount of their anticipated tax refund. This business generated a loan volume of approximately \$13.3 billion in 2004.

¹² Pacific Capital Bancorp, *2004 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 5 and 62 (“Pacific Capital”).

¹³ H&R Block, *2004 Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, at 3. H&R Block reports that its “RAL participation revenue was \$168.4 million in fiscal year 2004 and \$160.0 million in fiscal year 2002.” *Id.*

¹⁴ Pacific Capital, at 62.

¹⁵ Deyanira Del Río and Chris Keeley, “A Primer on Fringe Products Associated with RALs,” NEDAP, November 2004.

¹⁶ Documentation on file with NEDAP.

¹⁷ NYRL is a state-wide coalition of more than 115 seniors, consumer, civil rights, affordable housing, and community development organizations and community development financial institutions dedicated to promoting fair credit access. NEDAP serves on NYRL’s Steering Committee and convenes the coalition.