

IRS takes a step on refund loans

Eileen Ambrose

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Might the refund anticipation loan's days be numbered?

Last week, the Internal Revenue Service said for the first time it will be looking at refund loans and whether they encourage cheating among tax preparers, as some critics claim. Sounds hopeful, though at this point the agency only is seeking public comment.

"This is the smallest step forward you can take," says Jean Ann Fox, director of consumer protection for the Consumer Federation of America. Still, Fox says her group will use this opportunity to make a case against refund loans.

"The IRS has opened a dialogue about how tax return information should or should not be used in the marketing of high-cost, high-risk loans to the working poor," she says.

A refund loan is an advance on your tax refund - minus fees. The loan is repaid when the IRS deposits your refund in the bank.

Given the fees charged, you are essentially borrowing money from The Bank of Tony Soprano. Even so, millions of tax filers likely will take out refund loans this tax season. Don't be one of them.

Sure, you want to get your hands on your refund as soon as possible. But ask yourself: Is it really worth paying, say, \$125, to get your money a day or a few days faster?

Joanna Smith-Ramani, director of the Baltimore CASH Campaign, says it's possible to get a refund in three days if you file electronically and have the refund directly deposited in your bank account. A refund anticipation loan might be only one day faster, she says.

Consumer advocates say the threat of delayed refunds this year, because of the late passage of legislation to alter the alternative minimum tax, shouldn't affect most filers who typically take out refund loans.

Lower-income filers usually are tempted by the promise of quick cash through refund loans. To help these filers get refunds quickly and at no cost, the CASH Campaign is offering free tax preparation service starting Jan. 19. The free service will be available at 16 city locations for those with incomes under \$40,000, Smith-Ramani says.

And if you don't have a bank account, no problem. CASH Campaign is working with PNC Bank to open accounts on the spot, which will help speed your refund, Smith-Ramani says. For more information, call 410-685-0525.

Consumer advocates for years have tried to dissuade filers from taking out refund loans. They're making progress, although it's been slow.

The latest annual report on refund loans by the Consumer Federation and National Consumer Law Center found that the number of filers taking out loans fell in 2005 by nearly 3 million to 9.6 million.

The cost of loans also dropped. Filers paid an estimated \$960 million in refund loan fees in 2005, a 22 percent decrease from the year before. But refund loans still are no bargain. The loan fee on the average \$2,500 refund ranged from \$57 to \$111. Translating that into annual interest, the rate for a 10-day loan was 85 percent to 170 percent. On a \$500 refund the interest rate is more than 500 percent.

And these figures don't count the cost of tax preparation or an application fee that's sometimes charged.

There were other small victories in the past year.

The IRS, for instance, stopped allowing tax preparers to hawk refund loans under its Free File program.

And tax preparers no longer pitch so-called holiday refund loans. These loans were made before the tax filing season using information on a paycheck stub rather than the more accurate W-2 and tax return. Their quick demise likely was due to the losses sustained by banks making these riskier loans, Smith-Ramani says.

It will be a while before we learn the outcome of the IRS' look into refund loans.

The agency says it's concerned about tax preparers possibly getting financial incentives to cheat and inflate a filer's refund for loan purposes.

The IRS doesn't know yet if there is a problem, says David Williams, director of electronic tax administration. If it is, a possible solution would be to prohibit a tax preparer from using information gained while preparing a return to market a refund loan to the client, he says.

This wouldn't ban refund loans, Williams adds, because a filer can always go elsewhere for one.

eileen.ambrose@baltsun.com.

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