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From the Baltimore Sun

Costly twist on tax refund loan is called a bad deal

Eileen Ambrose -- Personal Finance

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Taxpayers who use the IRS Free File program should notice something new this year: No more pitches for refund anticipation loans.

That's a victory for consumer advocates who for years have criticized the IRS for letting tax preparers in the Free File program market loans whose fees - translated into annual interest - reach into the triple digits. If not higher.

But advocates now are raising alarm on a new variation of refund anticipation loans called pay-stub loans.

These loans are based on estimated refunds using information from pay stubs and can be taken out weeks before the tax season kicks off. Consumer advocates say they are riskier and can be costlier than other refund loans. Some tax preparers don't like pay-stub loans, although they offer them anyway.

And Maryland regulators are now looking at these loans to see if they comply with state law that sets limits on how much interest can be charged for small loans.

The best thing to do with these loans is the same thing you should do with refund loans: ignore them. You'll have to wait longer to get the money, but you'll get your entire refund without any fees subtracted.

And you might not even have to pay for tax preparation if you qualify for Free File or other free services for those with low to moderate incomes.

This message is hard to get across to cash-strapped consumers who have waited a year for a tax refund, says Joanna Smith-Ramani, director of Baltimore CASH Campaign, a nonprofit that helps low-income households.

She notes that Jackson Hewitt, a leader in pay-stub loans, markets its product under the name "Money Now Loan."

"What's our motto, 'Money Later?' " she says. "It's a very difficult message, the wait message."

For years, advocates have railed against refund anticipation loans. Tax firms prepare a filer's return and the taxpayer can receive a loan within a day or so based on the expected refund. The loans are repaid with refunds, usually within two weeks.

Loan fees run about \$100 for the typical refund of \$2,150, which works out to an annual percentage rate of 178 percent, according to a survey last year by the National Consumer Law Center and the Consumer Federation of America.

But as the IRS works to speed up refunds, tax preparers and their bank partners have introduced pay-stub loans to get money into taxpayers' hands even faster, consumer groups say. That may sound desirable, but the cost is often high.

Borrowers don't need to wait for their W-2s to arrive. Instead, tax preparers estimate refunds using the borrower's year-end or latest pay stub. Lenders also look at the prospective borrowers' credit scores and other factors. The loans usually come due in mid-February when borrowers get their refunds.

Some tax preparers offered pay-stub loans as early as November, pitching them as "holiday" refund anticipation loans.

Fees vary depending on the lender, tax preparer and size of the loan.

A second report by the Consumer Federation and National Consumer Law Center in November found that fees at one lender last year ranged from \$61 for a loan of about \$490 to \$102 for an \$1,800 loan.

On top of that, Jackson Hewitt tacked on a \$50 service fee that could later be applied to toward tax preparation costs, the report found.

Advocates also warned that some taxpayers might not get their refunds in time and be forced to take out a traditional refund anticipation loan to repay the pay-stub loan. That means you're "paying twice to borrow money," says the Consumer Federation's Jean Ann Fox.

Other risks

And there are other risks. Refund estimates based on pay stubs might be inaccurate, and your actual refund might not be enough to cover the loan, consumer advocates say.

Jackson Hewitt did not respond to e-mail and phone call requests for information on its pay-stub loans. H&R Block says in an e-mail that its Instant Money Advance Loan is about half the cost of what competitors' charge and about 40 percent less than a cash advance on a credit card.

"I don't like the product," says John Hewitt, chief executive of Liberty Tax Service. "If Block and Jackson Hewitt weren't doing it, we wouldn't be doing it."

Hewitt says Liberty lost customers to Jackson Hewitt last year because of pay-stub loans. This year, Liberty is offering them company-wide.

Indeed, lenders and tax preparers say they offer pay-stub loans because consumers want them.

But it's at a steep price that's best avoided.

If you don't have a bank account, open one so you can receive your refund more quickly through direct deposit, Fox says.

Then take advantage of free tax preparation services, if you're eligible.

Getting help

Filers can call First Call for Help at 410-685-0525 or 800-492-0618 to find out about free tax services in Maryland.

Or, those with incomes of up to \$52,000 can file under the IRS Free File program at www.irs.gov starting in mid-January.

Electronic filers with a bank account can receive a direct deposit refund in 10 to 14 days, says Bert Dumars, director of electronic tax administration. A tip for those in a hurry: File on Wednesday afternoons when things aren't as busy.

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