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Tax refund loans can be pricey

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-- Borrowing against your own tax refund is a bad idea.

Cash-strapped taxpayers sometimes agree to do it, lured by the promise of getting money faster.

But refund anticipation loans - RALs - and their "instant" refund cousins carry many pitfalls for consumers, including the danger that the refunds used to secure the loans could be siphoned off to pay an outstanding debt, leaving the consumer saddled with no refund and a pricey loan to repay.

The loans have fallen under scrutiny by both the Internal Revenue Service and the Treasury Department, which are seeking public comments in anticipation of writing rules. Several states are considering legislation to reel in, if not the loans, then at least the marketing around them.

Some of the more egregious practices of the past are gone - like last year's "pay stub RAL," in which refund anticipation loans were given based not on income as shown on W-2s but on a person's last paycheck stub. (Some of those who took up the offer apparently were identity thieves using other people's check stubs - a situation that may have hastened the product's demise.)

Tax preparers have agreed not to market RALs to consumers who participate in the IRS' electronic Free File program. A few banks that offer the loans through tax preparation offices have ended cross-collection agreements or at least have begun giving consumers more-explicit warning that their refunds could be captured to pay another debt.

The cost of the loans has also fallen in the last few years, according to Chi Chi Wu, an attorney with the National Consumer Law Center, who has tracked refund anticipation loans for years. This year, the center found, the price of the average \$2,600 refund anticipation loan is anywhere from \$58 to \$110 - if all goes well and the loan is repaid on time.

Still, consumers who take out refund anticipation loans are paying relatively high fees to borrow their own money for a short period.

Consumers can get loan money in one to two days; the IRS says taxpayers who file electronically can see their returns deposited directly into their bank accounts within 10 days.

Nearly 9 million taxpayers nationwide took out refund anticipation loans in 2006. The National Consumer Law Center and Consumer Federation of America said Friday that those consumers spent \$900 million in loan fees.

The majority of folks who borrowed against their refunds were the ones who could least afford it: The products are marketed to low-income taxpayers, particularly those eligible for the Earned Income Tax Credit, a refund meant to help the working poor.

"Everybody wants to get to the trough of Earned Income Tax Credit anti-poverty money," said Jean Ann Fox, who works for the Consumer Federation.

Lately, car dealers and furniture stores have gotten into the act, wooing consumers to take out the loans and use the proceeds as deposits on big-ticket items.

"The marketing is extremely aggressive," said David Rothstein of Policy Matters.

IRS data show about half the taxpayers nationwide who are eligible for the Earned Income Tax Credit take out refund anticipation loans. But when eligible consumers are asked directly whether they've borrowed against their tax returns, Rothstein says, only about 10 percent say they have. His conclusion is that consumers don't necessarily understand these products are loans instead of just a speedier return.

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