

IRS plan irks tax firms

Groups call tax advances predatory lending

BY MICHAEL SCHWARTZ

michael.schwartz@pilotonline.com

The tax preparation industry earlier this month felt the immediate impact of an IRS proposal that could limit tax preparers' ability to offer controversial and lucrative refund anticipation loans.

On Jan. 3, as soon as the IRS issued requests for comments that would prohibit tax-return preparers from disclosing or using taxpayer return information to sell

the loans, Jackson Hewitt Tax Service stock fell more than \$7 a share. The company, founded in Virginia Beach, typically has trade volumes of a couple hundred thousand shares per day. More than 7 million shares changed hands in the 48 hours following the IRS's announcement.

Having grown in popularity since the advent of electronic filing, refund anticipation loans or RALs, short-term cash

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advances offered against a customer's anticipated income tax refund, have become an increasingly vital line of revenue for tax preparation companies like Jackson Hewitt, Liberty Tax and H&R Block. The products have also become controversial as many consumer groups view them as predatory because of the high short-term interest rates.

John Hewitt, co-founder and former head of Jackson Hewitt and current head of Virginia Beach-based Liberty Tax Service, said about 35 percent of Jackson Hewitt and 20 percent of Liberty Tax customers choose to get RALs rather than wait for the IRS to send their tax returns. Liberty Tax expects to file 1.3 million tax returns this year.

Because it is illegal for tax preparers to loan money, companies like Liberty Tax, Hewitt said, have agreements with banks that offer RALs. Only four major banks in the country offer these, including HSBC, Santa Barbara Bank and Trust, Chase, and Republic Bank in Kentucky.

The banks make their money by charging 60 to 80 percent for the loan and the subsequent interest. The tax preparer parent companies receive a fee from the bank for each RAL loan it feeds the institutions.

But according to the Center for Responsible Lending, the loans are offered at high interest rates, ranging from about 40 percent to more than 700 percent annual percentage rate.

"Tax preparers and lenders strip about \$1.57 billion in fees each year from the earned-income tax credits paid to working parents," CRL said on its Web site.

There were more than 12 million RAL borrowers in 2003, according to CRL.

The IRS proposal, which is open for public comment, was part of a separate ruling made by the IRS and Treasury

Department that updated regulations dealing with consumers' consent to third-party use of their tax information.

"I think it was overblown," Hewitt said of the marketplace's reaction to the proposal.

In preparing the rule change recently adopted by the IRS and Treasury, the IRS said commentators specifically recommended banning tax return preparers from disclosing or using tax return information for the purpose of soliciting refund anticipation loans and similar products.

The Treasury Department and the IRS are "concerned that RALs and certain other products may provide tax preparers with a financial incentive to take improper tax return positions in order to inappropriately inflate refund claims," according to the IRS proposal.

For example, RAL amounts are capped by the amount of the refund claimed on a tax return. Therefore, according to the IRS, "a preparer who inappropriately inflates the amount of a refund is able, directly or indirectly through arrangement with a RAL provider, to collect a higher fee."

The proposal for comments was released because the Treasury Department and the IRS are concerned that overall tax compliance suffers when tax advisers or tax preparers benefit directly from maximizing a refund in preparing a tax return.

Hewitt argues that it is not the tax preparers who push for these products.

"It is something that consumers demand," he said.

Hewitt also said the refund anticipation loans have existed in some form or another for decades. Before the advent of electronic filing, RALs used to be a shady business and unregulated.

As for whether the loans will disappear altogether, Hewitt has his doubts.

"We talked to the IRS and we're not aware of any initiative in the IRS to do something that would eliminate these

loans," Hewitt said. "It's not in the IRS charter to eliminate these loans."

Hewitt is right. The IRS doesn't have any regulatory oversight on RALs. Financial regulators and Congress would have to step in to completely do away with the products.

The Treasury Department and the IRS said they did not adopt this recommendation in the final regulations

"because of the significant policy issues that need to be considered."

The comment period will run until March, the midst of the tax season. The timing doesn't make it easy for tax preparers to say their piece.

"We do plan to submit comments," Hewitt said. "I don't have time to write long papers during this time of the season." ■