

Rocket Refund Story Missed the Mark (800 words)

By Jim Carnes

David Irvin's story last week about the surge of customers at a local tax preparation office illustrated the power of rumors, but it failed to identify the real issues at hand. The reporter attributed the crowd of several hundred people in part to hearsay about a "special disability refund." One person he interviewed was an elderly Greenville man on government disability who had come to "sign up" his dependents. Others, the article said, "just wanted their taxes done." By the reporter's account, the true causes of the January 30th rush remained a mystery.

Mr. Irvin did explain that Rocket Refund is under investigation by the federal government for transmitting allegedly false tax returns, which may explain why no one in the office would answer the phone. But the report omitted some significant facts about tax preparation services like Rocket Refund. The "Rocket" in the name indicates the speed with which such storefront services can supply their clients with cash. Through a perfectly legal transaction called a "refund anticipation loan" or RAL, the customer receives a loan at the time of filing his or her tax return, with the repayment of the loan – including fees and interest -- secured by the anticipated tax refund. Simply put, RALs essentially allow people to borrow money from themselves – at rates equivalent to interest as high as *700 percent*.

The walk-in tax preparation service is the front end of the operation. At the back end, there are big banks and the IRS. The RAL providers serve as loan brokers for banks (usually national or out-of-state ones to avoid interest regulations that apply to Alabama financial institutions). The banks, in turn, supply the cash and keep most of the profit. In addition, since the RAL transaction usually requires a bank account where the loan can be electronically deposited, the banks often sell temporary accounts to applicants who don't have a regular bank account. More banking, more fees.

In evaluating whether or not to make a refund anticipation loan, the tax preparer checks with the IRS about any outstanding tax liens on the loan applicant. If liens are present, the preparer can decline the loan, because the IRS would typically withhold the lien amount from the refund sent to the preparer. In the absence of liens, the loan goes through, and the customer pays through the nose for the refund that, under normal filing, would have come as few as five days later anyway without the extra charges.

It turns out that the IRS's participation in this (again, perfectly legal) scam leaves a paper trail that shows just how extensive and expensive RALs are. The IRS records the inquiries it receives about tax liens on each filer. The inquiries then become a good indicator of which filers are applying for refund anticipation loans (nationwide, about 10 percent of RAL applications are rejected). A handy database on the Brookings Institution website allows users to search by ZIP Code to find out how many returns in a given area show this RAL flag, among other factors. The Montgomery numbers for the most recent data available (2003) are revealing: Of the 152,044 tax returns filed in the Montgomery Metropolitan Statistical Area, 37,325 – or 25 percent – were processed for refund anticipation loans. The national average is 8 percent, according to the Consumer Federation of America.

Why are RAL applications so common in Montgomery? Aggressive marketing and easy availability aside, the answer could have something to do with income levels in our community. The Community Reinvestment Association of North Carolina, an advocacy group that fights predatory lending, reports that 86 percent of RAL applicants in that state in 2004 were low-income taxpayers. In Montgomery, 60 percent of RAL applicants in 2003 were recipients of the Earned Income Tax Credit, which reaches only a portion of low-income households. In these cases, dollars from a federal program designed to reduce poverty are going directly into the hands of predatory lenders. Most RAL applicants would be eligible for free tax preparation assistance or free online filing. (Jubilee Community Center offers tax help on Saturdays from 10 – 1 through April 14th; call 269-4698 for details.) The bottom line is that too many low-income Alabamians are paying high fees *to borrow their own money* at tax time.

The next time *The Advertiser* covers RALs or other forms of fringe finance, it should ask the real questions: How do these transactions work? How can consumers detect the scam? What fairer alternatives could Alabama's financial institutions offer? What better regulations could the Legislature provide? And, by the way, what enticement could lure a 70-year-old Greenville man with disabilities to an out-of-the-way Montgomery loan shop? You can bet there's a lot more to that story.

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