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# Refund Anticipation Loans: Less Money for Consumers Entitled to Refunds, More Profit for H&R Block

Kathryn Smetana \*

## I. Introduction

An estimated eleven million taxpayers spend more than \$800 million each year to obtain Refund Anticipation Loans (“RALs”), loans entitling taxpayers to receive their federal tax refunds ten to fourteen days earlier than made available by the IRS.<sup>1</sup> RALs are sold with the promise of getting tax refund checks to consumers more quickly, typically within two days, which is only slightly faster than the IRS promise of two weeks for electronic filers.<sup>2</sup> On average, taxpayers pay \$267 to cover the cost of tax preparation, electronic filing, to borrow the average refund amount of \$1,900, and to cash their refund check.<sup>3</sup> Once consumers qualify for the loans, they must then pay interest on the loans, which carry annual percentage rates ranging between 67% to 774%, depending on the amount of the refund.<sup>4</sup> Tax refund loans are used more frequently by low-income taxpayers than by any other demographic.<sup>5</sup> These consumers tend to use the refund loans to pay their tax filing fees.

To qualify for an RAL through H&R Block, one of the most prominent tax preparation service providers, consumers must agree to

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<sup>1</sup> Ryan J. Donmoyer, *Americans Waste \$800 Million on Tax Refund Loans*, BLOOMBERG NEWS, Jan. 31, 2002.

<sup>2</sup> *Consumer Credit and Usury Edition*, 20 NCLC REP. (Nat'l Consumer L. Ctr.), Jan./Feb. 2002, at 13-16 (on file with the *Loyola Consumer Law Review*).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> Donmoyer, *supra* note 1.

pay an electronic filing fee of up to \$40 and a loan processing fee of up to \$89.95, both of which are deducted from the refund.<sup>6</sup> In January 2002, H&R Block's refund loan fees averaged \$76.19.<sup>7</sup> By March 15, 2002, the average fee per client was \$117.03.<sup>8</sup> The average return is about \$2,000, which, with the \$76.19 fee, translates to about a 140% annual interest rate on these RALs.<sup>9</sup> Last year, H&R Block recognized a 51% profit margin on refund loans alone.<sup>10</sup> On February 27, 2002, H&R Block announced an increase of 45-50% over last year's earnings.<sup>11</sup>

At the same time, the IRS offers free tax preparation, electronic filing, and can get the refund to taxpayers within 10 to 14 days.<sup>12</sup> H&R Block advertises RALs by calling them "instant money," and by making statements such as, "You pay nothing out-of-pocket."<sup>13</sup> Another advertisement states, "Walk in with taxes and out with a check."<sup>14</sup> Consumer advocates claim that advertising for these services "overwhelms" consumer knowledge of free services offered by the IRS.<sup>15</sup>

## II. Rules Governing RALs

IRS Publication 1345 dictates that e-file providers disclose to consumers that the RAL is an interest-bearing loan, the RAL is not a faster way to receive a refund, and if the refund is received after the expected time, the consumer may be liable for additional interest on

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<sup>6</sup> Michael Liedtke, *H&R Block Boosts Profits, Takes Heat for Tax-refund Loan Program*, TELEGRAPH HERALD, Mar. 31, 2002, at D9.

<sup>7</sup> *Id.*

<sup>8</sup> *H&R Block Reports Interim Tax Season Data Through March 15<sup>th</sup>*, PR NEWSWIRE, Apr. 2, 2002, at Financial News.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> Mike Swift & Helen Ubinas, *Tax Refund Economy Thrives in City*, HARTFORD COURANT, Mar. 27, 2002, at A1.

<sup>13</sup> *Id.*

<sup>14</sup> Patricia Odell, *H&R Block Ramps Up DR in \$100 Million Campaign*, DIRECT, Mar. 15, 2002, at Newslines.

<sup>15</sup> Swift & Ubinas, *supra* note 12, at A1.

the RAL.<sup>16</sup> This may occur where the IRS disputes the return or where part of the money is captured to pay for outstanding child support, student loans, or other liens.<sup>17</sup> Publication 1345 also regulates the advertisement of RAL services, requiring an easily identifiable, legible disclosure that the funds advanced are actually a loan, rather than simply the refund itself.<sup>18</sup> Despite these rules, several tax preparers and RAL providers continue to use barely-legible print for these disclosures, and inadequately disclose the consumer's liability for the RALs interest when the refund is received later than expected.<sup>19</sup> Additionally, section 6695(f) of the Internal Revenue Code forbids tax preparers from acting as lenders by making tax refund loans;<sup>20</sup> however, smaller preparers may make such loans without using a separate financial institution.<sup>21</sup>

### III. The Debate Over RALs

Critics compare commercial tax preparers offering RALs to loan sharks, and it is claimed that they “[prey] upon low-income households, immigrants, and financially unsophisticated people.”<sup>22</sup> It is also said that because H&R Block markets itself as “America’s most trusted tax partner,” it has a responsibility to taxpayers not to push high priced services, like RALs.<sup>23</sup> H&R Block claims that it “makes it ‘as clear as possible’” that the taxpayer is engaging in a loan.<sup>24</sup> Furthermore, H&R Block states it is merely offering RAL services because clients demand them, and that they would not offer such services if the demand did not exist.<sup>25</sup>

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<sup>16</sup> I.R.S. Pub. 1345, § 12(.09), Revenue Procedure 98-50.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Consumer Credit and Usury Edition, supra* note 2.

<sup>20</sup> I.R.C. § 6695(f) (2002).

<sup>21</sup> *Consumer Credit and Usury Edition, supra* note 2.

<sup>22</sup> Liedtke, *supra* note 6, at D9.

<sup>23</sup> Kathy M. Kristof, *High Cost Loans Often Disguised as Rapid Refunds*, L.A. TIMES, Mar. 10, 2002, at 3.

<sup>24</sup> Liedtke, *supra* note 6, at D9.

<sup>25</sup> Kristof, *supra* note 23, at 3. *See also* Swift & Ubinas, *supra* note 12, at A1.

#### IV. Courts Rule Against RAL Providers

On January 10, 2002, the United States Court of Appeals for the Fourth Circuit found in *JTH Tax, Inc. v. H&R Block E. Tax Servs.*,<sup>26</sup> that H&R Block's advertising campaign for "no additional cost refund anticipation loans" ("NACRALs") was "in bad faith" where H&R Block advertised this product "as a 'refund,' 'refund amount,' and 'a check in the amount of your refund.'"<sup>27</sup> The court found that NACRALs are the functional equivalent of RALs, even though they do not charge interest or other bank fees.<sup>28</sup> This reasoning lies in the fact that any concerns over consumers' misunderstanding of the nature of the loan were not eliminated by the mere fact that the fees were not associated with the NACRALs.<sup>29</sup> The court also noted that the language of the advertisements clearly failed to comply with IRS Publication 1345 requirements.<sup>30</sup> H&R Block was required to pay damages equal to the net profits resulting from the false and misleading advertisements.<sup>31</sup>

Other legal actions have been brought against H&R Block for misleading RAL advertisements, which led to H&R Block signing consent decrees agreeing not to make misrepresentations to consumers regarding RALs.<sup>32</sup> One such consent decree states that where H&R Block advertises a RAL, "it may not directly or indirectly represent such loan as a refund" and that it must inform taxpayers that RALs are actually loans and "not a substitute for or a quicker way of receiving an income tax refund."<sup>33</sup> Another consent decree states that H&R Block must disclose the fact that consumers might be approved for a RAL in an amount "less than the

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<sup>26</sup> No. 01-1353, 2002 U.S. App. LEXIS 477 (4th Cir. Jan. 10, 2002).

<sup>27</sup> *Id.* at \*11.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at \*5.

<sup>31</sup> Thomas Long, *False Advertisements for Income Tax Refund Loan Were "Willful,"* available at [http://business.cch.com/trade\\_regulations/news/02-26-02.htm](http://business.cch.com/trade_regulations/news/02-26-02.htm) (last visited Apr. 14, 2002).

<sup>32</sup> Elizabeth Amon, *Court Calls H&R Block Ads Misleading*, NAT'L L. J., Jan. 28, 2002, at A4.

<sup>33</sup> Roger Russell, *Federal Court Sets Limits on RAL Advertising Campaigns*, 16 ACCT. TODAY, Feb. 25, at 8.

consumer's full anticipated refund."<sup>34</sup>

Additionally, the New York City Department of Consumer Affairs filed a suit against H&R Block alleging deceptive and misleading advertising practices on March 12, 2002.<sup>35</sup> The complaint alleges that H&R Block did not explain the high interest rates associated with RALs.<sup>36</sup> It is also asserted that the bulk of consumers using this service are low-income customers who may not be able to afford the rates charged.<sup>37</sup>

Finally, a Houston attorney is putting together a class action suit against H&R Block.<sup>38</sup> He calls RALs "an unconscionable scheme" that intentionally targets low-income taxpayers.<sup>39</sup>

## V. The Future of RALs

A study by the Consumer Federation of America and National Consumer Law Center states that RALs continue in the face of legal obstacles because the IRS relies on tax preparers to increase electronic filing.<sup>40</sup> The study notes that Congress has mandated an increase in electronic filing from the current 30 percent to 80 percent by 2007 because electronic returns are more accurate and cheaper to process.<sup>41</sup> For the 2000 tax year, H&R Block prepared RALs for 4.5 million taxpayers.<sup>42</sup> As the 2001 tax season began, H&R Block saw an increase of 18 percent in RALs from last year.<sup>43</sup> H&R Block claims that it plans to phase out RALs by 2005, at which time it claims that Congress has demanded the IRS have a system providing

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<sup>34</sup> *Id.*

<sup>35</sup> Jayson Blair, *H&R Block Is Sued by City Over Loan Ads*, N.Y. TIMES, Mar. 31, 2002, at 30.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> Liedtke, *supra* note 6, at D9.

<sup>39</sup> *Id.*

<sup>40</sup> Donmoyer, *supra* note 1.

<sup>41</sup> *Id.* In support of this mandate, the Bush administration will propose free electronic filing and a ten day extension for electronic filers past the April 15 deadline.

<sup>42</sup> See Liedtke, *supra* note 6, at D9.

<sup>43</sup> *Id.*

refunds to electronic filers in two to three days.<sup>44</sup>

While RALs provide significant profit to tax preparation service providers, the reason consumers choose to enter into such an arrangement is simply to get their tax refund more quickly. Presumably, then, when the IRS can get refunds out in two days, the practice of RALs will cease. Until that time, however, if consumers are willing to take the financial hit, it seems RALs will be available, regardless of how they are advertised.

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<sup>44</sup> See Blair, *supra* note 35, at 30.