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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510-6250

April 7, 2008

Internal Revenue Service
Room 5203
Post Office Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Advanced Notice of Proposed Rulemaking on Using Tax
Preparation Information to Market Tax Refund Anticipation
Loans or Similar Products CC:PA:LPD:PR (REG-136596-07)

Dear IRS Commissioner:

The purpose of this letter is to express support for the issuance of a proposed rule to restrict the disclosure of tax return information by tax preparers to prevent them from marketing tax-related products to their clients, such as refund anticipation loans (RALs), refund anticipation checks (RACs), and audit insurance, particularly in the case of unsophisticated taxpayers filing returns to qualify for the Earned Income Tax Credit (EITC).

In 2005, the U.S. Senate Permanent Subcommittee on Investigations, on which we serve, held a hearing examining the marketing and sale of RALs, RACs, audit insurance, and similar products by tax preparers to their clients.¹ Among other issues, this investigation examined whether tax preparers who sold such products were acting in the best interest of their clients, or were motivated by other considerations, including financial gain.

The hearing took sworn testimony from former employees and current representatives of two major tax preparation firms, H&R Block and Jackson Hewitt Tax Services, both of which market RALs, RACs, audit insurance, and similar products to their clients. The hearing also heard from a client who had purchased a RAL and from representatives of nonprofit organizations that help low-income families file their tax returns.

The Subcommittee obtained evidence that, in 2003, over 12 million tax-related financial products were sold, of which almost 9 million were RALs. We were told that a 2005 study found, of the taxpayers who filed EITC returns in 2003, nearly 40 percent used RALs or similar loan products. These products typically carried large fees and finance charges, with annual percentage rates (APRs) ranging as high as 400 percent. The hearing obtained testimony, for example, that in Minnesota, to obtain a RAL for an anticipated tax refund of \$3,500, a client typically paid tax preparation fees, finance charges, account setup, and administrative fees totaling about \$300.

¹"Tax Related Financial Products Can Be Costly," S.Hrg. 109-81 (April 15, 2005)(field hearing held in Minnesota).

Despite this hefty payment, most RAL loans are repaid quickly with funds from a client's tax refund which is sent directly to the lender, with the loan itself often lasting less than two weeks. A former tax preparer from one of the tax preparation firms testified at the hearing that his employer pressured its tax preparers to sell these products to their clients, evaluated their work performance based in part upon the number of products sold, and paid commissions on each sale. He stated, "The only way to make any real money working for [H&R] Block as a tax preparer is to sell those products." He also testified that, in the case of audit insurance, tax preparers were told to include a \$20 charge in every client's bill for this service and remove the charge only if the client objected. These types of practices and incentives create conflicts of interest for tax preparers, encouraging them to sell products to their clients whether or not they are in the client's best interest. The Subcommittee also learned that these products generated significant revenues for tax preparation firms, including about \$200 million in 2004 revenues alone for H&R Block and Jackson Hewitt.

The hearing witnesses raised a number of questions about the value of the products being sold. RALs are advertised as allowing a taxpayer to get immediate use of a tax refund, but one witness testified that the RAL check she received took 7 days to clear through her bank. It is also far from clear that RALs provide benefits commensurate with their costs, since IRS money transfers often take only a short while longer and are provided to taxpayers at no cost. In addition, one tax preparer described the sale of audit insurance to his clients as a "disservice," since the likelihood that this additional insurance would actually be needed was "extremely low."

Equally disturbing to the products' high cost and dubious value is the concern that tax preparers may be abusing the trust placed in them by their clients when advising them to purchase these products. Several witnesses testified that the average low-income client specifically sought out a tax preparer to ensure that their taxes were prepared correctly, and assumed that the tax preparer was operating in his or her best interest. These witnesses indicated that the clients purchasing RALs relied on the advice of their tax preparer and typically did not realize that they could have received their funds directly from the IRS in a relatively short period at no cost. The Subcommittee was told that most tax preparers did not seek to determine what was in the best interest of specific clients, such as by asking how urgently funds were needed, but routinely promoted the products to all of the clients they saw.

In addition to evidence that tax preparers routinely offered tax-related products to their clients, the Subcommittee obtained evidence that many of the clients were ill equipped to evaluate the products being promoted. The Subcommittee was told, for example, that the typical tax preparation session lasted 20 to 30 minutes, and often involved low-income, unsophisticated taxpayers who asked few questions, were anxious to obtain their tax refund as quickly as possible, and did not fully understand the terms and costs of the loan products they were being sold. The Subcommittee was told that many RAL purchasers have limited literacy skills and English proficiency, might not understand written disclosures, and rarely received oral explanations of the alternatives available for obtaining funds from the IRS. One witness testified that a December 2004 poll had determined that 70 percent of respondents who had obtained a RAL had not even realized it was a loan.

While it is conceivable that tax refund anticipation loans and similar products may benefit some taxpayers in extreme circumstances, the Subcommittee investigation and hearing record provide ample support for the concern that unsophisticated taxpayers are being taken advantage of when their tax preparers routinely promote such high-cost, low-value products as RALs, RACs, and audit insurance, and facilitate the sales by providing the necessary tax return information to the lender. The fact that many of the affected taxpayers file EITC returns is itself indicative of their dire financial need and why they should be protected from products carrying triple-digit APRs, which quickly erode the value of the tax credits intended to reward them for working.

When designing a rule to end abusive practices associated with RALs, RACs, audit insurance, and similar products, we recommend that you consider several measures. First, we recommend that the IRS consider ways to alleviate the conflicts of interest that arise when tax preparers engage in selling financial products to clients seeking tax preparation services. The IRS may want to evaluate, for example, the costs and benefits of prohibiting tax preparers from obtaining remuneration from financial institutions for supplying tax return information to facilitate the sale of a tax-related financial product. Such a prohibition might help eliminate financial incentives for tax preparation firms to advocate high-cost, low-value financial products to their clients. It might also help ensure that tax preparers are engaged in the business of providing their clients with conflict-free tax preparation services, not financial marketing.

Second, we recommend that the IRS consider restricting the assignment of anticipated EITC-related refunds as loan collateral or to facilitate the sale of a RAL, RAC, audit insurance, or similar product, since these products do not make economic sense for EITC taxpayers and consume a disproportionate amount of the funds paid to them under the EITC program. Social security benefits are already subject to similar restrictions under 42 U.S.C. 407, which has helped safeguard these benefits from a range of financial abuses. EITC credits might benefit from similar protection. The EITC program is designed to reward low-income taxpayers who work, it has proven tremendously successful, and its work incentives should not be undermined to advance the sale of high-cost financial products of dubious value.

Thank you for this opportunity to comment on IRS plans to bar the disclosure of tax return information by tax preparers for the purpose of marketing RALs, RACs, audit insurance, and similar products to their clients. The abusive practices associated with these products have hurt millions of U.S. taxpayers, and we applaud the efforts of the IRS to address this problem. We urge you to act before the next filing year.

Sincerely,



Norm Coleman
Ranking Minority Member
Permanent Subcommittee on Investigations



Carl Levin
Chairman
Permanent Subcommittee on Investigations