

# Fast Cash. Less Filling

---

Refund Anticipation Loans in North Carolina

A Policy Brief

*Executive Summary and Policy Actions*

By Adam Rust

The Community Reinvestment Association of North Carolina

March 24, 2009

## **Executive Summary**

RALs compromise the purpose of the Earned Income Tax Credit (EITC). In 2006, the EITC returned \$1,577,614,579 to North Carolina households - an average credit of \$2,012 per household. While the EITC has been lauded by experts and promoted by legislators, its take-up rate is not increasing. About 20.5 percent of households got the EITC in 2003. The share is 4/10ths of a percentage point lower in 2006. RALs and RACs take money out of EITC recipient refunds. More than 60.1 percent and 57.6 percent of EITC filers used one of these products in 2005 and 2006, respectively. Last, eliminating RALs would reduce the leading source of tax fraud.

### ***The use of RALs has declined in North Carolina.***

- About 472,000 filers took out a RAL in 2006. This is a decline from 2003, when more 625,000 used a RAL.
- Fewer low-income filers are using RALs. Whereas almost one in four used one in 2003, only 17.8 percent took a RAL in 2006. The numbers are also trending in a positive direction for EITC recipients. Whereas more than half had a RAL in 2003, in 2006, slightly less than 40 percent took out a RAL.
- Although they cost less, another product – the Refund Anticipation Check (RAC) – also drains significant money from low-income households. Approximately 336,000 North Carolina filers opted for a RAC in 2006.

### ***RALs hurt low-income and minority communities***

More than 88 percent of RALs originated in North Carolina in 2006 went to low-income households.

Majority-minority census tracts account for almost forty percent of all RALs, even though they only contain 16 percent of the state's population.

Communities with the highest rates of RAL usage are those with more people of color.

### ***This is both a rural and an urban issue.***

- Communities with the highest percent of RAL use are most frequently located in rural North Carolina. Zip codes with the highest number of RALs are in our cities. Greenville has the most impacted zip code, but cities including Charlotte, Greensboro, Raleigh, Fayetteville, Raleigh and Lumberton are all witnessing this product draw funds out of their neighborhoods.
- Communities that use RALs in the past are the ones most likely to use them in the future.
- East Spencer, in Rowan County, is consistently the community with the highest rate of RAL use.

### ***The means of addressing this issue are very attainable.***

- The RAL depends upon the complicit support of the Internal Revenue Service. There is an administrative solution. A three-day turnaround on the debt indicator would reduce RALs dramatically. More consumers would shift to less-expensive RACs.
- Some of the funders received TARP money. Treasury should place constraints against use of TARP funds for uses associated with RALs.
- VITA sites provide free tax prep, e-filing, and direct deposit. VITA sites are attracting more filers, but they are not catching on with EITC filers. They need better marketing. Develop partnerships with government, social workers, and the Employment Security Commission.
- Cease to allow EITC refunds as collateral for RALs.
- Increase disclosure rules on pricing of RALs and RACs.

## Policy Actions

- *Enhance Federal Regulatory Oversight:* The regulatory bodies governing the financial institutions that oversee these banks (OCC, FDIC, OTS) should pay attention to concerns over both consumer protections and safety and soundness. The FDIC and the OTS have led. The OCC should follow their lead.
  - The FDIC has issued an enforcement order, requiring Republic Banks to cease and desist with aspects of their refund anticipation loan business. Republic applied for an OTS charter in August 2008 and had its hearing in December 2008. There were many consumer protests. The OTS did not approve or deny the request. Republic withdrew its application in February 2009. To the extent that not approving the application reflected substantive concerns, then both the OTS and the FDIC deserve credit for providing enforcement. Going forward, the OCC (which regulates the other RAL lenders) should follow in the path set by the OTS and the FDIC.
  - Regulatory enforcement should enhance oversight actions to prevent tax fraud from a safety and soundness perspective.
- *Increase disclosure on pricing for RALs and RACs.*
- *Enhance State Regulation:* North Carolina requires RAL providers to register and disclose information with the North Carolina Commissioner of Banks. Other states have disclosure requirements. Most have nothing (United States General Accounting Office, 2003). This step should be supplemented with more oversight. Elsewhere, other states should catch up to North Carolina's leadership.
- *Shore up both the marketing and funding of VITA sites.* VITA sites are a great resource and an excellent concept. In reality, many lag in their reach in the community. Many go underutilized. The problem may be in marketing. It may also reflect the challenges with upfitting locations for tax prep with a volunteer staff. VITA sites, right now, are not part of the solution for maximizing the EITC.
  - The good news is that more people are using VITA sites. Total returns filed my VITA sites in North Carolina almost doubled from 2003 to 2006.
  - The gains have been made among low-income families, but not among those that would qualify for the EITC. In 2006, only about 10 percent of VITA returns got the EITC. This could be an issue of marketing. Perhaps more outreach needs to be done through pathways associated with working. The Employment Security Commission might have a good contact list of people. As well, county governments employ a large number of lower-income workers.
- *Pass the IRS' Proposed Rule Making on Disclosure of Tax Information.* The IRS rules that taxpayers can consent to giving their financial information to preparers. The policy focus should center on how that data is handled afterwards. Prohibit transmission of taxpayer information from tax preparers to third-party financial institutions. This data is utilized by banks (Pacific Capital, JP Morgan Chase, Republic Bank of Kentucky, River City) to generate a debt indicator report from the IRS. Subsequently, the financial institution can keep the data and utilize it for its own marketing. They can also sell the data to other parties.
- *Change the turnaround time on the debt indicator.* Federal policy could quickly impact the use of RALs. Congress could instruct the IRS to develop administrative rules that would lessen the appeal of the RAL. For example, if the IRS utilized a three-day turnaround on a debt indicator response, the immediacy of the RAL would be lost.
  - The IRS could make this change without Congressional action.

- *Do not provide TARP funds for RAL providers.* Santa Barbara Bank & Trust is one of the five banks that provide the funds for individual and corporate tax preparer's RALs. It is a subsidiary of Pacific Capital Bancorp. Santa Barbara received \$182 million in TARP funds. The company's income stream is largely dependent upon its highly profitable RAL business. JP Morgan Chase also received TARP funds. As a giant financial institution, RAL business represents a microscopic sliver of their business. Potentially, such a rule might convince them to exit entirely.
  
- *Pass proposed Federal Legislation*
  - *Prohibit the use of the EITC as collateral against RALs.* This bill has not been sponsored, but merely discussed. It is an element of policy actions supported by Charles Schumer (D-NY).
  - *Cap interest rates at 36 percent.* This bill is sponsored by Dick Durbin (S-IL).
  - *Use the workplace to encourage use of the EITC and VITA sites:* The Earned Income Tax Credit Information Act of 2008 (S3190) was sponsored by Rep. Rahm Emanuel (D-IL) and Sen. Charles Schumer (D-NY). It would simultaneously enhance VITA sites, where RALs are not provided and tax preparation is free. California has already implemented its own notification law.