

Legislative Analysis



TAX REFUND ANTICIPATION LOANS

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House Bill 4645 (Substitute H-2)

Sponsor: Rep. Steve Tobocman

Committee: Banking and Financial Services

First Analysis (1-30-08)

BRIEF SUMMARY: The bill would require certain information to be disclosed to consumers prior to obtaining a tax refund anticipation loan and would prohibit certain conduct on the part of a person facilitating the loan.

FISCAL IMPACT: The bill would have no apparent significant fiscal impact on the state. Because the bill would preempt local ordinances, it would have indeterminate fiscal impact on local units of government.

THE APPARENT PROBLEM:

In 2006, about nine million taxpayers received refund anticipation loans (RALs). RALs are short-term loans issued by or facilitated by tax preparers so that their customers can have right away the amount the customer anticipates will be refunded by the Internal Revenue Service (IRS). When the customer receives his or her IRS refund, the loan plus interest charges and any other fees charged must be repaid.

Over the past several years, RALs have generated concern among consumer advocates who feel that lenders and loan facilitators target low income individuals, who, they argue, can least afford the often exorbitant interest rates and high fees often charged. As a result, laws regulating the RAL business have been adopted by several states in recent years, and generated some interest at the federal level.

Of particular concern is that many consumers do not realize these financial products are loans that must be repaid (just a few years ago, a poll commissioned by the National Consumer Law Center, Inc. revealed that 18 percent of participants had taken out a RAL at some point of time, but two-thirds of those consumers did not realize that the RAL was a loan). Should the actual amount refunded by the IRS be less than the amount borrowed in the RAL, the consumer is obligated to repay the entire amount borrowed, plus interest and fees such as an application fee. Failure to repay the loan and fees can result in the account being turned over to a collection agency and a black mark being placed on the consumer's credit history.

Moreover, these loans are primarily used by low-income persons (about half of RAL consumers qualify for the Earned Income Tax Credit even though they represent only 17 percent of all taxpayers). According to consumer advocates, this is the segment of taxpayers who can least afford the high fees (from \$30 to \$130, not including a separate application fee of approximately \$40 charged by some lenders) and high interest rates which, when combined with the fees, can result in an effective annual rate (APR) ranging from 50 percent to nearly 500 percent. The result is that in 2006, for tax year 2005, approximately nine million taxpayers received RALs (representing about one in four tax returns) and paid almost

\$1 billion in loan fees and other fees; money that, in their opinion, could have gone for such things as needed goods or medical care.

There is great variance in the amount of fees charged, interest rates charged, and even in the types and amount of information about a RAL disclosed to customers. Some feel that if people providing RALs were required to disseminate certain information, then consumers would be better able to make informed decisions about whether to take out a RAL or wait for the tax refund through the normal process.

THE CONTENT OF THE BILL:

The bill would extend provisions of the Regulatory Loan Act (MCL 493.1 and proposed 493.16) so that they would apply to "refund anticipation loans." Refund anticipation loans are short-term loans that are secured by a taxpayer's expected tax refund. In general, the act regulates persons who engage in the business of making loans and requires lenders, unless otherwise exempted, to be licensed under the act or the Consumer Financial Services Act.

The current definition of "loan" contained in the act would be expanded to include a refund anticipation loan. A "refund anticipation loan" or RAL would be defined as a loan that a person arranged to be repaid directly from the proceeds of a taxpayer's federal or state personal income tax refund. A "refund anticipation loan fee" would mean the charges, fees, or other consideration charged or imposed by a lender or facilitator; it would not include any charge, fee, or other consideration usually charged or imposed by a facilitator in the ordinary course of business for tax return preparation, electronic filing of tax returns, or other nonloan services.

The bill would require certain actions on the part of a loan facilitator and lender when making a refund anticipation loan. "Facilitator" would mean a person that individually or in conjunction with another person processed, received, or accepted for delivery an application for a refund anticipation loan or a check in payment of RAL proceeds or in any other manner materially facilitated the making of a RAL. The term would not include persons exempted in Section 20 of the act (in general, depository institutions and business transacted under a pawnbroker's license); a person certified, registered, or licensed to engage in the practice of public accounting; and a person that acts solely as an intermediary and does not deal with a taxpayer in the making of a RAL. (Note: It would appear that as written, the bill would not require a facilitator to be licensed under the act.)

Before a taxpayer completed an application for a RAL, the facilitator would have to clearly disclose certain information in writing on a separate form. Among the information required to be disclosed would be the following:

- That the RAL is a loan and not the taxpayer's actual personal income tax refund.
- Application loan fees and the annual percentage rates charged by the facilitator or lender for at least three representative RAL amounts.
- That electronic filing of a tax return is available without applying for a RAL.
- The average time for refunds if a RAL was not applied for, as specified in the bill.
- That the amount of the anticipated tax refund may not be the actual amount refunded by the IRS or state Department of Treasury.

- The estimated time for a loan to be approved and the proceeds paid to the taxpayer.
- Fees charged to the taxpayer even if the loan was not approved.

Before entering into a RAL agreement, the facilitator would also have to disclose the estimated total fees for the loan and the estimated annual percentage rate for the loan.

A facilitator could not require a consumer to enter into a loan arrangement in order to complete a tax return; misrepresent a material factor or condition of granting a RAL; fail to process the application for a RAL promptly after an applicant applied for the loan; or engage in any fraudulent transaction, practice, or course of business with any person in connection with a RAL.

The bill also creates a right of rescission for a borrower who had a change of mind. The borrower would have until the end of business on the day after making the loan to rescind the RAL (one business day). The borrower would have to return the original check issued for the RAL or pay the amount of the loan in cash to the lender or facilitator. The borrower could not be charged a fee for rescinding the RAL and would have any fee charged for making the RAL refunded, as well. However, any fee charged to the customer for establishing and administering a bank account to electronically receive and distribute the customer's tax refunds would not have to be refunded by the facilitator.

In addition, the act requires a licensee to annually file a report with the commissioner of the Office of Financial and Insurance Services (OFIS), on a form provided by the commissioner, stating the licensee's volume and type of business activities for the immediately preceding calendar year. All reports have to be made under oath and must be in the form prescribed by the commissioner. The bill would require that, as part of this report, each lender and facilitator disclose for the preceding calendar year the number and dollar amount of RALs made, the average RAL, and the average time to dispense loan proceeds. As used in this provision, "lender" would mean a person that makes a RAL but would not include a person described in Section 20 (in general, depository institutions and business transacted under a pawnbroker's license).

Lastly, the bill would prohibit a political subdivision of the state (city, township, etc.) from adopting any rule, regulation, code, or ordinance to restrict or limit any of the bill's provisions relating to RALs. Further, the bill's provisions would supersede and preempt any rule, regulation, code, or ordinance of a local unit relating to RALs.

BACKGROUND INFORMATION:

More information on refund anticipation loans can be found at www.nclc.org, the webpage of the National Consumer Law Center, a nonprofit organization specializing in consumer issues on behalf of low-income people.

ARGUMENTS:

For:

Essentially, refund anticipatory loans (RALs) enable people to borrow against the amount they expect to be refunded from an overpayment of their personal income tax. In that sense,

a RAL allows a person to get an expected refund amount a bit sooner than if he or she had filed electronically or waited for the IRS to process the tax form and mail the refund check. However, some people don't even realize that the RAL is a loan; they think it is their actual tax refund. They may spend the full amount, not realizing that the high interest rate and other fees tacked on to the loan can significantly increase the amount that must be repaid. If the actual amount refunded is lower, or if the IRS blocks the refund for any reason, the loan plus the interest and fees must still be repaid.

House Bill 4645 will require greater disclosure of information about RALs so that consumers will have a better understanding of the costs involved. Many feel that low income individuals and military service personnel, who are the heaviest users of RALs, are the population least able to bear having a significant portion of their refunds eaten up by high APRs and other fees that can reach or exceed 500 percent if annualized.

The bill will not ban RALs, neither will it require licensure for persons who facilitate RALs for consumers. However, the disclosures required by the bill will educate all consumers as to the risks involved with RALs and the charges that will need to be repaid. This should mitigate some of the problems associated with RALs.

POSITIONS:

The Office of Financial and Insurance Services (OFIS) supports the bill. (1-29-07)

Michigan ACORN Financial Justice Center supports the bill. (1-29-07)

The Michigan Association of United Ways supports the bill. (1-29-07)

The United Way of Southeastern Michigan supports the bill. (1-29-07)

The Michigan Credit Union League indicated support for the bill. (1-29-07)

The Michigan League for Human Services indicated support for the bill. (1-29-07)

The Community Economic Development Association of Michigan (CEDAM) indicated support for the bill. (1-29-07)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.