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Pay Stub RALs: Potential Violations of Truth in Lending and the Federal Rebate Statute

A "pay stub RAL" or "pay stub loan" is a variation on a refund anticipation loan (RAL), the high-cost loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (I.R.S.). Tax preparers and their partner banks make traditional RALs when a taxpayer comes to the preparer to have her taxes prepared and filed. About 12 million taxpayers took out RALs in 2004, costing them over \$1 billion in loan fees.¹

Pay stub RALs differ from traditional RALs in that they are offered earlier in the year, even before a taxpayer receives her I.R.S. Form W-2. The loan is based on an estimate of the expected tax refund calculated from the taxpayer's "pay stub"—hence the name. Since a taxpayer cannot file a tax return without a W-2, this loan is made prior to the filing of the return and before the tax season officially starts. Pay stub RALs are made in early January after the consumer receives her last pay stub of the year, while "holiday" RALs are made during November and December. What the pay stub RAL and holiday RAL share with traditional RALs is that they are expensive, balloon payment loans expected to be repaid from the proceeds of the consumer's tax refund.

How a Pay Stub RAL Works

To receive a pay stub RAL, the taxpayer will have an estimated tax return prepared by the tax preparer based upon his last pay stub from the end of December, or an earlier pay stub if it is a holiday RAL, and also based on other criteria.

A major criterion as to whether the lender will make the pay stub or holiday RAL is the consumer's credit score.² A significant number of borrowers may be turned down based on their credit score. The head of one tax preparation chain has estimated that fewer than 50% of applicants for pay stub

loans qualify for them.³ This raises the possibility that the offer of a pay stub RAL is used in some cases as a marketing ploy to lure taxpayers into the tax preparation office early, in order to get the taxpayers predisposed to come back when the filing seasons begins.

All of the largest RAL lenders appear to be making pay stub RALs, but JPMorgan Chase Bank One does not make holiday RALs. The three major tax preparation chains—H&R Block, Jackson Hewitt, and Liberty Tax—all appear to be brokering pay stub and holiday loans. Interestingly, Block was very critical of pay stub RALs, having made a failed attempt to call upon the industry to drop the product,⁴ before announcing it too would make these loans.⁵

In addition to the major chains, independent preparers may be making pay stub and holiday RALs. While many independent tax preparers are highly competent and ethical, the lack of standards for this occupation means anyone can be a preparer, and many of the worst abuses have come from this sector (including the used car dealers, check cashing stores and furniture retailers who offer RALs).

Fees for a Pay Stub RAL

The charge for a pay stub RAL varies by the tax preparer and lender offering it. All of the preparers and lenders charge a fee that is officially labeled as the "finance charge" for the loan. This charge varies depending on the size of the loan. The following was Santa Barbara Bank & Trust's price structure for pay stub RALs offered by Jackson Hewitt in 2006:⁶

<i>Loan Amount</i>	<i>Loan Fee</i>
\$ 488.50	\$ 61
\$1119	\$ 81
\$1798	\$102

For a Santa Barbara's holiday RAL offered by Jackson Hewitt in 2006, taxpayers paid a fee of \$50 for either a \$525 loan or a \$325 loan.⁷

H&R Block's pay stub and holiday RAL, called an "Instant Money Advance Loan" (IMAL), has one fee structure that translates into an Annual Percentage Rate (APR) of 36%, if the consumer elects to receive the loan using a Block Emerald account debit card. Because the fee will depend on the size of the loan and the amount of time it is outstanding, the absolute dollar amount will vary. If the consumer does

¹ See C.Wu, J. Fox, and P. Woodall, *Another Year of Losses: High-Priced Refund Anticipation Loans Continue To Take a Chunk Out Of Americans' Tax Refunds* (NCLC and CFA Jan. 2006), at 4-5. NCLC and CFA issue an annual report on RALs, available at www.consumerlaw.org/action_agenda/refund_anticipation.

² Pay stub RAL loan agreement from Santa Barbara Bank & Trust, on file with NCLC.

³ G. Meyer, "Block Unveils Changes; Cheaper Tax Loans are among Steps to Boost its Tax Preparation Network," *Kansas City Star*, Sept. 8, 2006, at C1.

⁴ D. Twiddy, "H&R Block Calls on Competitors to End 'Pay-Stub' Loans," Associated Press, June 11, 2006.

⁵ G. Meyer, "Verdict on Block Unit to Take Time," *Kansas City Star*, Nov. 8, 2006.

⁶ Pay stub RAL loan agreement from Santa Barbara Bank & Trust, on file at NCLC.

⁷ Holiday RAL loan agreement from Santa Barbara Bank & Trust, on file at NCLC.

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