

## **Opening Statement**

### **SENATOR NORM COLEMAN**

**U. S. Senate Permanent Subcommittee on Investigations**

**St. Paul, Minnesota Field Hearing**

**Hearing On**

***Tax Related Financial Products Can Be Costly***

**April 15, 2005**

Good afternoon and thank you for attending today's hearing. As Chairman of the Permanent Subcommittee on Investigations, I have investigated and conducted hearings on a wide variety of subjects related to fraud, waste and abuse including, consumer abuses in the credit counseling industry, Department of Defense contractors who owe over \$3 billion in unpaid taxes, the safety and availability of imported prescription drugs, the abuse of tax shelters to evade paying billions of dollars in federal taxes, and the Oil for Food program in which Saddam Hussein diverted billions of dollars to reward his friends, bribe UN member states and rebuild his military. As your Senator, my primary responsibility is to represent the interests of the people of Minnesota.

I have heard and read about Minnesotans' concerns related to the financial products that are offered by tax preparers, and particularly refund anticipation loans or RALs. It is a pleasure to conduct this hearing in Minnesota so that I can determine whether there are abusive practices in the marketing of these products, what options exist to mitigate their high costs and to ensure that there are appropriate checks and balances to promote fairness and integrity in the tax preparation industry.

In addition to RALs, the other bank products include refund anticipation checks, refund transfers, debit cards, loans to pay taxes that are due, and in one case, advance loans that are offered in November and December for holiday needs. RALs are loans provided by banks through tax preparers that are secured by the taxpayer's anticipated refund. These loans are considered high risk and carry an extraordinarily high annual percentage rate ranging from 28 to 424 percent. RALs may be offered as a same day advance loan or as a payment that is made to the taxpayer within 2 days of filing their tax

return. RALs are the fastest and most costly method of obtaining a refund in the form of a loan and they may be appropriate for some taxpayers who are in extreme financial distress, lack a bank account and cannot afford to pay their tax preparation fees. On the other hand, there were over 12 million tax related financial products sold in 2003, of which almost 9 million were RALs. It is not clear whether the popularity of RALs is due to financial distress, tax payer impatience or aggressive marketing tactics.

In addition to being costly to consumers, my investigation has determined that these products are highly profitable -- generating over \$200 million in revenue in 2004 for H&R Block and Jackson Hewitt, the two largest tax preparers in the country. Let me briefly review the RAL process. **(Exhibit 1)** When a taxpayer is due a refund and wants a RAL, the tax payer authorizes IRS to send their refund to the bank that is making the loan. IRS sends the tax payer's refund to the bank. The bank deducts the tax preparation charges and the application fee and sends that money to the tax preparer. The bank further deducts a bank account set up fee, the finance charge and any outstanding balance due from a prior RAL. Whatever remains is provided to the taxpayer. To promote the sale of their products, the banks also pay tax preparers like H&R Block and Jackson Hewitt refunds, incentives and rebates.

I am concerned that these promotional activities in certain circumstances could conflict with tax preparers' ethical obligations to place their clients' interests first. This could result in selling high cost products to clients when there are less costly alternatives. The trust relationship that exists between a tax payer and a tax preparer should be no less sacrosanct than the trust relationship that exists between an attorney and client or a doctor and patient. Consider that your tax preparer probably knows more about your personal life than your best friend. We cannot allow this kind of trust relationship to be betrayed by the tax preparer or the company for a financial gain that occurs at the expense of their client. And I plan to make sure that there are adequate checks and balances to ensure that if this occurs there will be adverse consequences.

There are less costly alternatives to a RAL, but they do not have the instant gratification that is often promised by a RAL. These alternatives include lower cost financial products and free tax preparation for lower income and elderly individuals. For example, a refund anticipation check or RAC is a bank product that costs less than a RAL because it is not a loan and therefore

does not have a finance charge. RACs have account set up and application fees but can be used to defer the tax preparation fee and requires a wait of about 8 to 15 days. Most clients are not thoroughly familiar with the variety of options offered by tax preparers. Where a tax preparer offers to serve their clients' best interests by finding every legitimate deduction and credit and minimizing the taxes that their clients pay, I believe they should have no less of an obligation to recommend the refund method that best suits their clients' needs.

Another alternative to the high cost of a RAL is free tax preparation. **(Exhibit 2)** In Minnesota, a tax payer has three options. The Volunteer Income Tax Assistance or VITA program has 273 sites located through out Minnesota that are staffed by volunteers who can prepare and e-file a tax return. In 2004, Minnesota's VITA sites prepared and filed 41,018 tax returns. **(Exhibit 3)** The Internal Revenue Service operates tax assistance centers in Bloomington, Duluth, Mankato, Minneapolis, Rochester, St. Cloud and St. Paul. IRS will complete and file a tax payer's return at these centers. In 2004, these tax assistance centers prepared and filed 2,425 tax returns of which 159 were EITC returns. This past week IRS announced that it plans to close 105 of its 367 tax assistance centers nationwide and I will discuss this with Commissioner Mark Everson to ensure that the IRS continues to provide assistance to Minnesota's tax payers. **(Exhibit 4)** IRS also offers free filing to anyone with access to their World Wide Web site at [irs.gov](http://irs.gov). In 2004, 3.5 million tax payers filed their returns by using the IRS web site. While all of these options are free, it will take from 8 to 15 days to receive your refund if it is directly deposited in your bank account. Other options may take longer, but clearly this is a situation where patience pays.

Today we will hear testimony from former clients and tax preparers for H&R Block and Jackson Hewitt. They will share with us their tax preparation experiences.

We will also hear from consumer advocates based in Minnesota who will testify about free tax preparation and their outreach efforts to ensure that all Minnesotans who are eligible for the Earned Income Tax Credit file for and receive it. They will also describe the impact of RALs on low income individuals.

Finally, we will hear H&R Block and Jackson Hewitt, the two largest tax preparation services in the nation, who will testify about the products they offer, their cost, their marketing and disclosure policies and practices and their efforts to serve their clients' best interests.

Next Thursday, I will be meeting with the IRS Commissioner Mark Everson to discuss what I learn here today. I look forward to today's testimony and I want to thank all of the witnesses who have come here for their cooperation with the Subcommittee in putting together today's hearing.

#