



February 21, 2005

House Committee on Financial Institutions

79<sup>th</sup> Legislature

**In support of HB 398: Relating to the regulation of tax refund anticipation loans**

Good afternoon, Chair Solomons and the Committee. My name is Don Baylor from the Center for Public Policy Priorities, and we are testifying in support of HB 398. This legislation is necessary because it would regulate entities and practices that currently drain millions of dollars in earned income from the pockets of working families and from our state economy—mostly through exorbitant fees for tax refund loans. Equally as important, this legislation would maximize the annual infusion of federal dollars related to the Earned Income Tax Credit.

In Tax Year 2003, hard-working Texans claimed more than \$4 billion in federal funds that rejuvenated our local communities and state economy. However, almost half (46%) of these households used a refund anticipation loan (RAL) which, coupled with paid tax preparation, drained up to \$200 million annually from the EITC program in Texas.

A typical RAL costs a taxpayer about \$100—on top of tax preparation and other associated fees, can add up to around \$250. That's out of a typical refund of \$2,000. In all, these fees can impose up to a 20% tax on an individual's refund.

RALs are high-cost loans offered by commercial preparers to secure the taxpayer's expected refund. This lucrative cottage industry levies a "tax" on most Texans who file and receive an EITC refund. RALs are clearly targeted at the EITC population. Nationwide, almost 60% of RAL consumers are EITC recipients, while nearly 75% of RAL consumers have annual incomes below \$35,000.

For the past several years, Texas taxpayers have taken these high-cost loans without a full explanation of the loan terms. One of the major components of HB 398 requires complete disclosure about the tax and loan products being offered. The National Consumer Law Center surveyed RAL consumers nationwide, and found that two-thirds did not realize they were taking out a loan.

In Texas, the problem is much more severe than in other states. Nearly half of Texans receiving an EITC refund—over 900,000 filers—use a refund anticipation loan. In contrast, RAL utilization rates in other populous states, such as New York and California, hover around 25%. As a result, those states are reaping more economic stimulus from the EITC program than is Texas.

By far the most disturbing facet of RALs is the uncertainty and risk associated with these products. If the taxpayer's refund is not as large as anticipated, he or she must assume the difference, which is accumulating at a triple-digit interest rate.

You will probably hear opponents to this legislation citing the high consumer demand, along with voluntary procedures to ensure better disclosure and integrity. Despite this argument, state legislation is absolutely necessary to protect taxpayers and to make sure that the Texas economy receives the

largest boost from the EITC program. There is no evidence that this legislation would present an unfair or undue hardship upon commercial tax preparers. As long as the state sets a level playing field with impartial enforcement and common-sense monitoring, commercial tax preparers will continue to thrive, and the consumer will benefit from a better product. The industry should welcome this legislation as a way to have a uniform set of rules that apply to all players in the statewide market.