

# Legislative Analysis

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## **REFUND LOAN ANTICIPATION ACT & REFUND ANTICIPATION LOAN DISCLOSURE ACT**

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**House Bill 4166 (Substitute H-1)**  
**Sponsor: Rep. Rashida Tlaib**

**House Bill 4607 (Substitute H-1)**  
**Sponsor: Rep. Bert Johnson**  
**Committee: Banking and Insurance Services**

### **First Analysis (3-24-09)**

**BRIEF SUMMARY:** Together, the bills would create two new acts to require certain information to be disclosed to a customer before an application for a refund anticipation loan was completed and prior to entering into a loan agreement, to prohibit certain conduct on the part of a person who facilitated a refund anticipation loan, and to make a violation a criminal offense, create a right of rescission, and restrict municipalities from limiting the act's applicability.

**FISCAL IMPACT:** The bills would have an impact on local units of government. A more detailed discussion follows later in the analysis.

### **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 an 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 claim that lenders and loan facilitators target low income individuals. About half of RAL consumers qualify for the Earned Income Tax Credit even though only 17 percent of all taxpayers do. 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, critics say, 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 more and more helpful

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.

Of particular concern is that many consumers do not realize that these financial products are loans that must be repaid. 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. If the actual amount refunded by the IRS is 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, possibly affecting the consumer's credit history.

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.

### ***THE CONTENT OF THE BILLS:***

House Bill 4166 would create the Refund Anticipation Loan Disclosure Act, define terms, and require certain disclosures be made to a borrower prior to completing an application or an agreement, create penalties, and restrict a municipality from limiting the act's applicability.

House Bill 4607 would create the Refund Anticipation Loan Act to require certain actions on the part of a RAL "facilitator" when involved in providing a refund anticipation loan. The bill also creates a right of rescission for a borrower who had a change of mind, creates penalties, and restricts municipalities from limiting the act's applicability.

House Bills 4166 and 4607 are tie-barred, meaning that neither can take effect unless both are enacted. Specifically, the bills would do the following:

#### **House Bill 4166 - The Refund Anticipation Loan Disclosure Act**

Definitions. A "refund anticipation loan" or RAL is defined in the bill as an extension of credit to a taxpayer 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 non-loan services. "Taxpayer" would mean an individual who filed a federal or Michigan personal income tax return.

"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 an RAL. The term would not include a financial institution; an affiliate that was a servicer for a financial institution; or a person certified, registered, or licensed to engage in the practice of public accounting.

Required disclosure *before* an application is completed. Before a taxpayer completed an application for an 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 an extension of credit 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 an RAL.
- The average time for refunds if an 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.
- That the full amount of the RAL and fees would have to be repaid.
- The estimated time for the proceeds to be paid to the taxpayer if the RAL were approved.
- Fees charged to the taxpayer even if the RAL was not approved.

Disclosure *prior* to an RAL agreement. Before entering into an 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.

Penalty. A person, including, a facilitator and/or his employees, agent, director, etc. that violated or participated in a violation of the act, would be guilty of a misdemeanor punishable by imprisonment for not more than 93 days and/or a fine of not more than \$500.

Restrictions on local governments. 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.

## **House Bill 4607 – The Refund Anticipation Loan Act**

Definitions. "Facilitator," "lender," "person", and "refund anticipation loan fee" would mean those terms as defined by House Bill 4166.

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

Penalty. A person, including, but not limited to, a facilitator and/or his employees, agent, director, etc. that violated or participated in a violation of the act, would be guilty of a misdemeanor punishable by imprisonment for not more than 93 days and/or a fine of not more than \$500.

Consumer right of rescission. 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 the loan was made 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.

Restrictions on local governments. 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:***

Two proposals regarding tax refund anticipation loans passed the House last year. House Bill 4645 would have extended provisions of the Regulatory Loan Act to apply to refund anticipation loans and House Bill 5903 as passed by the House is virtually identical to the legislation under consideration.

Information on refund anticipation loans can be found at [www.nclc.org](http://www.nclc.org), the webpage of the National Consumer Law Center, a nonprofit organization specializing in consumer issues on behalf of low-income persons.

### ***FISCAL INFORMATION:***

Enforcement of the bills would have no impact on the state and an indeterminate, though not likely significant, impact on local units of government. The bills do not contain any provisions concerning enforcement or administration by a state agency. This generally precludes the Office of Financial and Insurance Regulation, which has general authority over consumer finance issues, from imposing fines and penalties, and taking other administrative actions necessary to ensure compliance. (See, for example, Article 4 of

the Deferred Presentment Service Transactions Act, which regulates "payday" loans, which are similar in concept to refund anticipation loans. Article 4 provides for the investigation of customer complaints; cease and desist orders; license suspension, revocation, and termination; the imposition of civil fines; and administrative hearings.) Enforcement of the bills under consideration would, instead, appear to be an activity of local law enforcement agencies.

Additionally, the bills provide that any violation would be a misdemeanor subject to a fine of not more than \$500 or imprisonment of up to 93 days, or both. As a result, the bills would have no fiscal impact on the Department of Corrections. Any local impact would depend on how the bills affected the number of misdemeanants sentenced to jail or misdemeanor probation supervision, the costs of which vary by jurisdiction. Any increase in penal fine revenues could benefit local libraries, which are the constitutionally-designated recipients of such revenues.

### ***ARGUMENTS:***

#### ***For:***

Essentially, refund anticipation 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, an 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 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.

The bills under consideration 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 tax refunds eaten up by high APRs and other fees that can reach or exceed 500 percent if annualized.

The legislation will not ban RALs, neither will it require licensure for persons who facilitate RALs for consumers. However, the disclosures required by the bills 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.

#### ***Against:***

The bills as written would not provide any governmental oversight or administrative penalties for businesses that violate the act. It would be up to a consumer to know that he or she was being denied the required disclosure information and to report the business to the local law enforcement agency. However, if consumers currently are being misled

because businesses are failing to adequately explain what RALs are, how is a consumer to know that information is being unlawfully withheld?

In addition, the penalty is so small in comparison to the high fees charged by some businesses that it is unlikely to be much of a deterrent. Moreover, with budget constraints leading some municipalities to reduce the number of law enforcement officers and staff in prosecutors' offices, such a minor misdemeanor penalty may result in complaints generated by the bills being put on the bottom of the pile, so to speak.

***Response:***

Though some consumers may not realize they were not given the required information prior to completing the RAL process, the bills would allow community advocates, or any person, to report a business that was not in compliance with the bills' requirements. The 93-day maximum term of imprisonment would trigger mandatory fingerprinting and record retention requirements on the part of local and state law enforcement agencies. Thus, it is hoped that the penalty has enough teeth to be a deterrent and be taken seriously by those sworn to protect the public.

***POSITIONS:***

The Office of Financial and Insurance Regulation supports the legislation. (3-5-09)

The Michigan Credit Union League supports the bills. (3-19-09)

The Michigan League for Human Services supports the legislation. (3-12-09)

The Community Economic Development Association of Michigan (CEDAM) supports the legislation. (3-12-09)

The Michigan Asset Building Project (ABPP) at CEDUM supports the legislation. (3-11-09)

The Michigan Advocacy Project indicated support for the legislation. (3-12-09)

AARP indicated support for the legislation. (3-12-09)

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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.