

## Beware 'Pay Stub' Tax Loans

"I got \$1,500 today. Without my W-2. I got people."

-- H&R Block's enticing ad for pay stub tax loans, placed at Nashville bus stops

"How much more do these companies (that offer pay stub tax loans) want to take from the tax refunds of working poor families?"

-- Chi Chi Wu, staff attorney,  
National Consumer Law Center

For many consumers, one of the toughest, tightest money times is right after the Christmas holidays, before employers issue W-2 statements to employees on January 31. W-2 statements are required in order to file most federal income tax returns.

Many wage earners are desperate for cash. The tax preparation industry knows this. This year, there is a new high cost, high risk loan product that is taking advantage of hard working Tennesseans. This week's column from the Legal Aid Society is about these pay stub tax loans.

### Q. What are "pay stub tax loans"?

These are a new kind of loan that hit the market in November 2006. The pay stub tax loan is a new type of rapid anticipation loan, or RAL.

Since most consumers do not receive their W-2 statements before January 31, several tax preparer companies have jumped forward and started a new kind of RAL based on a consumer's last pay check stub. These new loans can be more costly and risky than regular RALs.

### Q. How do regular RALs work?

Regular rapid anticipation loans are already a very expensive option for consumers. RALs are high cost loans that are secured by and repaid directly out of a consumer's IRS tax refund.

Tax preparers dangle these loans as "instant refunds," but interest and fees charged for RALs are equal to an APR (annual percentage rate) ranging from 40 percent to as high as 1,400 percent, according to a 2005 report by two highly respected groups that have done the math, the Consumer Federation of America and the National Consumer Law Center.

### Q. Why are pay stub RALs costly and risky?

Here is the cost problem. First, the fee charged for pay stub tax loans can be as high as \$102, which can mean an annual interest rate of 175 percent or more.

Next is the risk problem. Pay stub tax loans are made when the tax preparer has no way to know whether the consumer will receive a tax refund. A taxpayer may owe additional taxes for income not shown on the pay stub, such as a second job or unemployment compensation. Or, the IRS may plan to intercept all or part of a taxpayer's return to pay student loan debt or unpaid child support.

The loans must be repaid by mid-February, which means that pay stub borrowers risk running up new debt or a ruining their credit records.

Also, some tax preparers require pay stub borrowers to return and pay more fees for tax preparation, even if they could file at no charge using free IRS services.

### Q. What better options do consumers have?

After January 15, the IRS Free File program allows taxpayers with Adjusted Gross Income (AGI) of \$52,000 or less in 2006 to e-file their federal tax returns for free. This means that two-thirds of Tennesseans can use Free File.

Another good option in Tennessee is to call 211 for nearby locations of free VITA tax preparation services. It's a free call.

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by Jim Hawkins, Managing Attorney, Gallatin  
office, Legal Aid Society

**Note:** This column is not intended to take the place of legal advice. All cases are different and need individual attention. Consult with a private attorney of your choice to review the facts and law specific to your case.

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