



## **Don't Borrow On Your Tax Refund**

### **Q: I'm waiting for a refund on my federal taxes. Can I borrow money on that refund?**

**A:** Not a good idea. Now that you've filed your state and federal income tax---and you expect to get a refund check from the state or federal government---the Massachusetts Office of Consumer Affairs (MOCA) is warning taxpayers to be wary of tax refund loans, also known as refund anticipation loans (RALs). There were over 12 million RAL borrowers in 2003. RALs are secured by, and repaid from, a pending income tax refund. Because such loans are short term, the interest rates are usually very high. One study suggests that the interest on loans can range from 40% to over 700% annual percentage rate.

The IRS says 79% of RAL recipients have adjusted incomes of \$35,000 or less. But a refund anticipation loan is a risky proposition because it must be repaid---even if the taxpayer's refund is denied, less than expected, or frozen. If the taxpayer cannot pay back the RAL, the lender may send the account to a debt collector.

Here's how these loans work: A company will advertise that you can get money "in as little as 1 business day" after IRS acceptance. Some plans even give you a "pre-paid VISA card." The loan is from a bank in the amount of your refund. When the loan is approved, fees are deducted from the loan amount and the balance of the loan is deposited to your bank account or mailed to you by paper check. Your refund later is used to pay back the loan. A customer signs up for one of these loans in anticipation of receiving a tax refund, which they'll use to pay the loan and fees. An individual who wants to get their money immediately--without having to wait for their refund to be direct deposited or mailed--is attracted to a RAL. But their tax refund could end up being less than they anticipated, and the lender charges a tax refund account fee & finance charge. Tax preparers and lenders make about \$1.74 billion on RAL fees annually. One analyst suggested that RAL loans are just one more financial product for people with limited incomes who waste money because they don't have patience to wait two weeks to get their refund deposited electronically.

MOCA says there are at least 4 better alternatives to RALs:

1. Open a bank account (if you haven't already) and take advantage of direct deposit for both your tax refund and your paycheck.
2. If you filed your tax return electronically (E-file), and directed that your refund be deposited directly into your bank account, you should receive your refund in 3 to 4 business days.
3. Don't take your refund to a check casher. They charge fees to cash RAL checks. Cash your check at a bank.
4. If you're working, reduce how much income tax you have taken out of your check (your withholding) so you won't have to wait for a refund next year.

Whether you're getting a tax refund and/or an "economic stimulus" refund this spring---don't take out a RAL. Wait for the government to send out your check or electronic deposit.