

Improving tax preparation with a model fee disclosure box

David Rothstein

Tax time is often referred to as the "golden moment" for asset building and financial check-ups due to the availability of lump sum funds through tax refunds. Tax preparation also has economic and legal ramifications for everything from employment to homeownership. Some 75 percent of households receive a tax refund, and social policy is now routed through the tax code with housing, education, and work credits. Yet, there is very little regulation and standardization in the tax preparation industry. Only a handful of states provide oversight for storefront paid tax preparers. The federal government recently issued regulations requiring testing, registration, and continuing education, only to find them entrenched in a court battle.

This brief finds that tax preparation by commercial paid preparers, despite being important to households, suffers from a lack of transparency and disclosure in the fees charged. As tax refunds have increased, clients have become less sensitive to price, since costs are deducted from the refund rather than paid outright. Clients also struggle to compare and contrast prices and services. It is difficult to get information about credentials, history, and rates of paid tax preparers. While there are other concerns in the tax preparation process, this brief focuses on the need for price disclosure and transparency. In the sections below, we make recommendations to improve the tax preparation process for clients.

Current regulatory environment

There has been increased discussion and guidance around the regulation of paid tax preparers. The Internal Revenue Service (IRS) recently announced a program for registering and testing the estimated one million paid tax preparers operating nationwide. A recent lawsuit put this regulatory structure on hold while the case is being heard in district court. Even if reinstated, there is no fee disclosure box included in this structure. Maryland, California, and Oregon regulate paid tax preparers but do not require a fee disclosure box. At the city level, Chicago recently passed an ordinance regulating paid tax preparers and requiring price disclosure, warnings about refund settlement products, and estimates of the total cost of preparation.²

Evaluating paid tax preparers

In conducting this research project, we reviewed dozens of paid tax preparer documents across companies. Lack of requirements or standards to post or provide fee structures before or after tax preparation made analysis difficult. Phone calls and store visits yielded little data since prices were

¹ For the purposes of this issue brief, paid tax preparers refer to storefront and online software that are not Enrolled Agents (EAs) or Certified Public Accounts (CPAs). The latter have existing guidance and registration with the IRS. ² For more, visit the City of Chicago's website on paid tax preparer regulation: http://bit.ly/14xolOq.

disclosed at the end of the transaction. Some stores provided general pricing or average costs for a typical 1040 form and Schedule EITC of \$200 to \$300. We also used information from former tax preparation clients, free tax sites, attorneys representing tax clients, and visits to paid tax preparers.

Other studies provide an indication of the high price of tax preparation, the drive to sell tax loans, and a lack of transparency.³ Mystery shopper testing from consumer groups, advocacy groups, and others have found tax preparation fees as high as \$400 or \$500, as well as numerous examples of preparers giving low-ball estimates on preparation fees or even refusing to provide testers with a quote.⁴ The U.S. Department of Justice's lawsuit against Instant Tax Service is the latest example of these types of abuses. The USDOJ alleged that "Instant Tax Service's tax preparation and junk fees typically average more than \$400-\$500, and sometimes run as high as \$1,000 for as little as 15 minutes of tax return preparation."⁵

It is clear that a disclosure box is needed, with the following features:

- **Standardization.** Tax forms and preparation can be complicated for a consumer. In our analysis of typical terms and pricing used, we found a lack of consistency in how tax forms, processes, and refunds are described. For instance, it was unclear whether "document processing" fees were the same as "administrative" fees when comparing across storefronts. There was also no consistency around how tax-related financial products were described. Some stores used the term "refund anticipation loan" while others used terms like "money now" or clauses that did not mention that the money offered was a loan.
- Transparency and disclosure. We found a lack of transparency and disclosure around the tax preparation process. Clients do not know the pricing and overall cost of their return until it has been prepared. Equally concerning is that many of the returns listed an overall cost but not a breakdown of how the total was calculated. Tax preparation is one of the few consumer services in the United States for which consumers cannot obtain a price for the services before they incur them. Tax preparers assert that they charge by the form, and cannot predict which forms will be generated until they actually finish the tax preparation. Thus, consumers cannot comparison shop or predict how much tax preparation will cost them.

Disclosures are extremely useful tools for ensuring that consumers have access to the information that they need to make financial decisions. For instance, the recent changes to credit card statements in the form of disclosure have benefited thousands of families – helping them

⁵ Complaint, United States v. Fesum Ogbazion, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012).

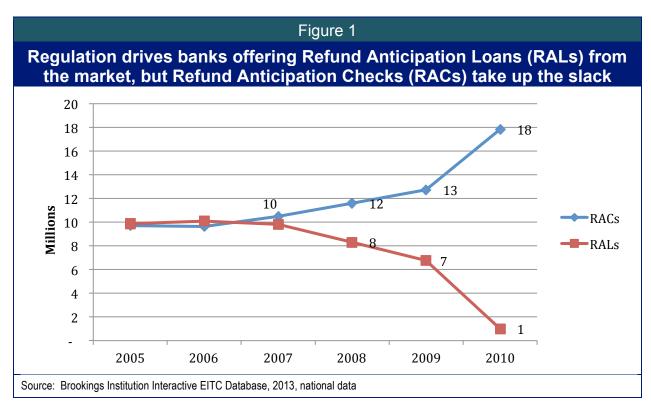
³ Gary Rivlin. (2011). "Secrets of the Tax Prep-Business," *Mother Jones* (March/April): http://bit.ly/f7w3rq.

⁴ Benjamin Marks, et al., First Nations Development Institute, More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns, 2012: http://l.usa.gov/17Cwd7b. Sara Dewees, First Nations Development Institute, Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses, Apr. 15, 2011, available at http://l.usa.gov/19tTUz8. Chi Chi Wu, et al., NCLC, NEDAP, Community Reinvestment Association of NC, Tax Time 2011: Mystery Shopper Testing In New York And North Carolina Finds Continuing Problems With Tax Preparers (Apr. 2011), available at http://bit.ly/mfCJpv. Chi Chi Wu, et al., National Consumer Law Center, Arkansans Against Abusive Payday Lending, NEDAP, Community Reinvestment Association of NC, Tax Preparers Out of Compliance: Mystery Shopper Testing Exposes Violations of Refund Anticipation Loan Laws in Arkansas, New York and North Carolina (Apr. 2010), available at http://bit.ly/12pOuvc. Chi Chi Wu, et al., NCLC, Community Reinvestment Association of NC, Community Legal Services of Philadelphia, Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia (Apr. 2008), available at http://bit.ly/10lfVtV.

pay off more debt and understand their usage. However, they cannot be the only tools available to help consumers choose and effectively use the financial products and services that work best for them. Disclosure offers a floor.

• Refund options. Tax preparation clients often have a variety of options to receive tax refunds. The most common are through direct deposit or a government-issued check. However, for more than a decade, low- and moderate-income families often have ended up paying a chunk of their refunds for tax refund anticipation loans (RALs) and refund anticipation checks (RACs). RALs are loans made by a third-party lender and arranged through a paid preparer, based on the expected refund. They used to reduce the amount of time that clients would need to wait for the IRS to issue a refund by a week or two but with more electronic filing they don't even provide that benefit. They typically carry triple digit interest rates and are dangerous if there is a delay in the refund process. RACs are similar but are not labeled as loans. RACs are a refund check (minus fees) issued by the preparer after the IRS delivers the refund. They were designed for people without bank accounts or sold as a way for taxpayers to pay preparers through their refund.

In the past few years, RALs sharply declined because of regulatory directives by the banking regulators and the IRS, which resulted in all of the RAL lending banks leaving the market. However, the use of RACs increased, mainly to allow taxpayers to pay for the cost of the preparation. (See Figure 1, below.) This is evident in the fact that many RAC-purchasing customers have bank accounts, meaning the RAC is of little functional use to them except to pay the preparer. Many RACs are now provided in the form of a prepaid debit card rather than a paper check; this presents new fee structures and challenges for clients.



Both the 1040 EZ and standard form allow for direct deposit or a paper check for a tax refund. In 2010, President Obama approved the sale of U.S. Savings Bonds on the 1040 tax form. Bonds have a rich history of being a safe, semi-liquid, and giftable savings product. Recent changes to the tax form allow filers to split their tax refund into four different bank accounts and Savings Bonds. Very few materials at storefront preparers stressed direct deposit and U.S. Savings Bonds as available refund options.

Figure 2		
Proposed tax preparation fee box		
	Service	Cost (examples)
1040 EZ return		
Basic 1040 return		\$150.00
•	Schedule A (itemized deductions)	
•	Schedule B (interest and dividends)	
•	Schedule C-EZ (self-employment)	
•	Schedule C (self-employment)	
•	Schedule EIC (earned income credit)	\$50.00
•	Other Schedules (list as needed)	
State return		\$50.00
Local return		\$25.00
	Total preparation fees	\$275.00
Processing fees		
•	Document storage and copying	\$25.00
Filing fees		
•	Electronic filing and acknowledgement	\$30.00
•	Paper filing	
Additional fees		
•	Tax refund loan	
•	Tax refund check	\$30.00
•	Audit protection	\$25.00
•	Return review	-
•	Tax planning and research	
•	Third party fees from bank or servicer	
	Total fees	\$110.00
Refund options		
Direct deposit to a bank account		
• Sp	lit refund (Form 8888)	
• U.	S. Savings Bond	
	Total Preparation Cost	\$385.00
Questions? Call xxx-xxx-xxxx		

Three policy solutions would help the disclosure and transparency aspects of the tax preparation process.

First, requiring a paid tax preparation disclosure box, similar to what the nonprofit financial services group Center for Financial Services Innovation recommends for prepaid debit cards, would go a long way toward ensuring transparency in pricing.⁶ Requiring paid preparers to use the disclosure box before tax preparation would allow customers to compare and contrast services with other preparers and online software. (See Figure 2, previous page.) It is important that the box serve as a guide, be concise and easy to read.⁷ The box should predict expected costs and help consumers how their returns and refunds are structured.

If the preparer uses an hourly fee instead of charging by schedule, the preparer should disclose "hourly" in the fee column and a row disclosing the hourly fee. This table should be in a prominent location in the preparer's waiting area and on their website, and should be provided automatically for telephone customers. Currently, it is nearly impossible to request price estimates over the phone. The table could also include a minimum of two sample tax scenarios showing the cost for the average Earned Income Credit tax return as well as another common return (Schedule A and C return).

The table should also show different refund options and the costs associated with them. This will help clients avoid refund settlement options that are unnecessary for their tax situation. In the Appendix, we provide a sample fee box scenario.

Second, allowing the IRS to regulate paid tax preparers with licensing and education components will ensure a floor for quality of tax preparation. If the IRS is deemed to lack the authority to institute paid preparer regulations, Congress should pass legislation granting that authority. The role of the Consumer Financial Protection Bureau, while undefined, is an important part of this disclosure movement. As an agency, it has not been given guidance to regulate paid tax preparers. However, the CFPB is given authority through the Dodd-Frank Wall Street Reform Act to promote the EITC and asset building at tax time. Combined with their authority to regulate financial transactions, it is clear that the CFPB has a role to play in paid tax preparer disclosures – specifically around the refund settlement options.

Third, states can play an important role in paid tax preparer disclosure. The three leading states (California, Maryland, and Oregon) could add this element to their existing regulation of paid preparers. Other states are considering legislation. Finally, localities may have more success in passing ordinances and regulation for paid preparers that include a disclosure box. Cities and counties have consumer affairs divisions that could regulate the industry, as Chicago has done.

⁶ See David Newville. (March, 2012) "Thinking Inside the Box: Improving Consumer Outcomes through better Fee Disclosure," Center for Financial Services Innovation: http://bit.ly/YdNVag.

⁷ Jeanne M. Hogarth and Ellen A. Merry. (August 2011). "Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing," Federal Reserve Bulletin 97.

Conclusion

The policy steps outlined above are critical to ensure that customers receive quality tax preparation. Disclosure establishes a strong floor for paid tax preparation. But disclosure is not enough – the overall process would benefit from registration of paid tax preparers, continued education for preparers, and better refund options. Engaging the CFPB and U.S. Department of the Treasury would provide not only more oversight but also more options for tax preparation, EITC awareness, and opportunities to encourage consumers to open bank accounts at tax time.

Acknowledgements

Policy Matters Ohio thanks the Annie E. Casey Foundation for its generous support of this project; program officer Patrick Hain, in particular, made numerous connections and suggestions. Leaders in the field of tax preparation offered comments and critiques, including Robin McKinney of the Maryland CASH Coalition, Chi Chi Wu of the National Consumer Law Center, Jackie Lynn Coleman and Sean Noble of the National Community Tax Coalition, and Tom Feltner of the Consumer Federation of America. Free tax program coordinators, volunteers, and clients helped shape the need and concepts for this report and we are grateful for their work on the front lines. Amy Hanauer and Piet van Lier of Policy Matters provided helpful edits to this report. Any errors and opinions expressed in this issue brief are the sole responsibility of the author.