Why Tax Refund Loans Should Be Avoided

January 17, 2008 - Many Americans are in the process of preparing their 2007 taxes and will file for their returns well before the April 15th deadline. Many of those who will be getting a refund from the IRS will also be solicited by their tax preparers to take out a Refund Advance Loan (RAL). Simply put, RALs can give your immediate access to your refund... but for a price.

RALs are a great deal for lenders. The risk associated with the loans is almost nothing. On the other hand, the interest rates on Ralls can range as high as 500%. It's no wonder that many of the largest tax preparation agencies are pushing these loans in their advertising and in one on one meetings with clients.

But what do you really get with such loans? Not much from the looks of it.

Tax payers who file for their tax returns electronically and allow the IRS to use direct deposit for their refunds can actually get their return in as little as ten days. On the other hand, if done incorrectly Ralls can seriously hurt tax filers. For instance, if you're tax return contains a mistake that artificially increases the amount of your expected refund, when the IRS catches the error they will reduce the amount of your refund. If you have taken out a RAL, your refund may no longer be sufficient to cover the loan. If you have already spent all of the money you borrowed, you now have a new debt that has to be repaid.

This problem has not gone unnoticed by the IRS. As a result the agency is considering banning tax preparers from offering Ralls. The loans may still be available through other sources. The fear is that some tax preparers may be tempted to inflate return amounts to increase their fees from Ralls. There is little evidence that this has been a significant problem to date, but it is clearly a vulnerability in the tax refund system.

It is unlikely that there will be any changes to Ralls before the end of this tax season. But by next year, changes are quite likely.

ACCESS advice to our readers is that Ralls, much like pay-day loans, should be avoided. The costs of these short term loans are very high and the costs associated with such loans are often buried in the fine print. Anyone considering such a loan needs to thoroughly review the loan's paperwork and make sure they actually understand the terms and the costs associated with the loan.

by Jim Malmberg

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