

MSP
#11**PAYMENT CARDS: Payment Cards Are Viable Options for Refund Delivery to the Unbanked and Underbanked, But Security Concerns Need to Be Addressed****RESPONSIBLE OFFICIAL**

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TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*

DEFINITION OF PROBLEM

As the nation's tax administrator, the IRS is responsible for processing approximately 150 million tax returns each year, issuing refunds to taxpayers in about 70 percent of the returns received.² According to IRS estimates, it costs more than \$1 per refund check issued compared to only ten cents for each direct deposit made.³ In addition to the cost savings, the use of direct deposit saves time — taxpayers who use direct deposit should be able to access their refund within one to five days after their return is processed, compared with waiting several weeks for paper checks to arrive in the mail.⁴

Even those without bank accounts can elect to receive their refunds via direct deposit. With over 68 million adults in the U.S. either unbanked⁵ or “underbanked,”⁶ taxpayers can request that the IRS load their tax refund onto a reloadable debit card, rather than to a conventional bank account.

However, the convenience offered by the IRS delivering refunds via such payment cards (which we will refer to as “prepaid debit cards”) comes at a cost — in the form of refund fraud. Because the IRS receives little information about the owner of the prepaid debit card (compared to a traditional savings or checking account), identity thieves and perpetrators of refund schemes may opt to avoid detection by

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 IRS, *IRS Ready to Start 2016 Tax Season; Encourages Use of IRS.gov and e-File; Works with States, Industry on Identity Theft Refund Fraud*, <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>.
- 3 IRS, *Direct Deposit Your Refund*, www.irs.gov/individuals/get-your-refund-faster-tell-irs-to-direct-deposit-your-refund-to-one-two-or-three-accounts (last visited Sept. 15, 2016).
- 4 IRS, *IRS Ready to Start 2016 Tax Season; Encourages Use of IRS.gov and e-File; Works with States, Industry on Identity Theft Refund Fraud*, <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>; IRS, *2016 Tax Season Refund Frequently Asked Questions*, <https://www.irs.gov/refunds/tax-season-refund-frequently-asked-questions>.
- 5 50.9 million “unbanked” households do not have an account at an insured institution. Federal Deposit Insurance Corporation (FDIC), *2013 FDIC National Survey of Unbanked and Underbanked Households* 4 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.
- 6 16.7 million “underbanked” households have used at least one of the following alternative financial services from non-bank providers in the last 12 months: money orders, check cashing, remittances, payday loans, refund anticipation loans, rent-to-own services, pawn shop loans, or auto title loans. FDIC, *2013 FDIC National Survey of Unbanked and Underbanked Households* 4 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.

requesting refunds via prepaid debit cards. By the time the IRS learns of the refund fraud, the money is already loaded onto prepaid debit cards, leaving the IRS with little chance of recouping those funds.

We will explore the advantages and disadvantages of the IRS issuing tax refunds to taxpayers via prepaid debit cards.

ANALYSIS OF THE PROBLEM

The IRS Allows Taxpayers to Load Refunds onto Prepaid Debit Cards

As noted above, a large segment of the U.S. population is unbanked or underbanked. For those without bank accounts, a prepaid debit card is a faster, more secure way to get a tax refund than to request a paper check (which may get lost or stolen). Prepaid debit cards have become disproportionately used by the unbanked and underbanked communities and can be used to pay bills, withdraw cash at ATMs, make purchases, deposit checks, and receive direct deposits. A recent study published by the Federal Deposit Insurance Corporation (FDIC) found that while only eight percent of all households used prepaid debit cards in the last 12 months, unbanked households had the highest rate of use (22.3 percent), compared with underbanked households (13.1 percent) and fully-banked households (5.3 percent).⁷

In 2011, the Department of Treasury conducted a pilot program in which it offered selected taxpayers the option to receive their tax refunds in the form of a government-sponsored debit card.⁸ The Urban Institute evaluated the results of the pilot program and found that a government-sponsored debit card could benefit both the government (reducing the cost of delivering refunds) and the taxpayers, making it faster, safer, and more reliable to access tax refunds, as well as providing a way for low and moderate-income taxpayers to access mainstream financial services.⁹ The Urban Institute did note one key design flaw that may have impacted the uptake rate — pilot participants were prohibited from using the debit card to pay for tax preparation fees, which likely made this card less attractive to taxpayers who could not afford to pay \$150 to \$400 out of pocket for preparation fees.¹⁰

The Department of Treasury now requires that all federal benefit payments be delivered electronically, and recommends that those without a bank account use the Direct Express debit card (which is issued by Comerica Bank).¹¹ For example, the Social Security Administration (SSA) promotes the use of electronic payment to deliver Social Security or Supplemental Security Income benefits. Social Security recipients no longer have the option to request a paper check. For those who do not have an account with a bank or credit union, the SSA offers the Direct Express debit card as a method of accessing benefits.¹²

7 FDIC, *2013 FDIC National Survey of Unbanked and Underbanked Households* 7 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.

8 The Department of Treasury cited low participation rates in the pilot program. Eric Kroh, *Treasury Won't Renew Debit Card Refund Program in 2012, Spokesman Confirms*, TAX NOTES TODAY (Nov. 1, 2011). However, the design of the pilot may have caused the low participation. See National Taxpayer Advocate 2012 Annual Report to Congress 334.

9 Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* (Sept. 5, 2012), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412623-Tax-Time-Account-Direct-Mail-Pilot-Evaluation.PDF>.

10 *Id.*

11 See *Frequently Asked Questions*, <https://fiscal.treasury.gov/godirect/about-faq/> (last visited Oct. 17, 2016).

12 Social Security Administration (SSA), *How Do I Sign Up to Receive an Electronic Payment*, www.ssa.gov/deposit/howtosign.htm (last visited Sept. 20, 2016).

The IRS allows taxpayers to direct deposit up to three refunds to a single prepaid debit card (unaffiliated with Direct Express), meaning that taxpayers are able to take advantage of the direct deposit program even without a bank account.¹³ However, the Treasury-sponsored Direct Express debit card does not accept tax refund payments from the IRS at this time.¹⁴

The decision to exclude tax refunds from Direct Express cards is perplexing, given that the Earned Income Tax Credit (EITC) is one of the government's largest means-tested anti-poverty programs.¹⁵ If the EITC were administered outside of the tax system, the Department of Treasury would require this federal benefit to be paid electronically, and allow the use of Direct Express cards. With the EITC, however, taxpayers are left to pay for debit cards on the market, with no bargaining power like that which the federal government has for the Direct Express cards. This is an inconsistency that negatively impacts EITC participants.

The Use of Prepaid Debit Cards Can Be Costly for Both Taxpayers and the IRS

There are some substantial downsides to the use of prepaid debit cards to deliver tax refunds. First is the cost to the taxpayer. Taxpayers can incur numerous fees to enjoy the benefits of using prepaid debit cards. A prepaid debit card can feature an enrollment fee, a monthly maintenance fee, ATM withdrawal fees, ATM balance inquiry fees, and a fee to convert the remaining balance into a bank check, among others. The Consumer Financial Protection Bureau (CFPB) recently issued a rule (effective October 1, 2017) that will help ensure that consumers can make informed decisions when choosing and using prepaid cards and will better protect consumers' funds in prepaid cards in case of errors, loss, or theft.¹⁶ Figure 1.11.1 shows some of the fees charged by several prominent suppliers of prepaid debit cards.

13 IRS, *Direct Deposit Limits*, <https://www.irs.gov/individuals/direct-deposit-limits> (last visited Sept. 20, 2016).

14 See *Frequently Asked Questions*, <https://fiscal.treasury.gov/godirect/about-faq/> (last visited Oct. 17, 2016).

15 Congressional Budget Office (CBO), <https://www.cbo.gov/publication/43935> (last visited Nov. 21, 2016).

16 See Consumer Protection Financial Bureau (CFPB), <http://www.consumerfinance.gov/prepaid-rule/> (last visited Dec. 31, 2016).

FIGURE 1.11.1, Prepaid Debit Card Fees¹⁷

Prepaid Card Fees	Green Dot	Direct Express	Mango
Purchase Price	No purchase fee online. Up to \$4.95 in store.	\$0	\$0
Monthly Charge	Up to \$7.95. Waived in any monthly period when you have loaded at least \$1,000 or have at least 30 qualifying purchases posted to your account.	None	\$3.00
ATM Fee	None at MoneyPass® ATMs nationwide. At non-MoneyPass ATMs, \$2.50, plus any fees the ATM owner may charge.	One free withdrawal with each Federal Government deposit to your Card Account. Other ATM cash withdrawals \$0.85 each, plus any fees the ATM owner may charge.	\$2.00, plus any fees the ATM owner may charge.
Balance Inquiry	\$0.50 at non-MoneyPass ATMs	\$0	\$1.00
Reload Fee	Up to \$4.95	No information available	\$0 - your bank may charge a fee
Transfer Funds to U.S. Bank Account	Not allowed	\$1.50 each time	No information available
Teller Cash Withdrawal Fee	\$2.50	\$0	No information available
Foreign Transaction Fee	3%	3%	\$2.00
Foreign ATM	No information available	\$3.00 plus 3% of amount withdrawn	\$2.00 plus 2% of amount withdrawn
Replacement Card	\$4.95	\$4.00 after one (1) free each year	No information available
Customer Service Fee	No information available	\$0	\$0

Second, prepaid debit cards can be used to help facilitate refund fraud. According to the Treasury Inspector General for Tax Administration (TIGTA), the government is losing billions of dollars each year to tax refund fraud.¹⁸ With a traditional bank account, the IRS knows the name of the account holder and can order a refund trace from the Bureau of Fiscal Service to verify that a direct deposit went through.¹⁹ The use of prepaid debit cards may be appealing to perpetrators of tax refund fraud since no information other than a bank routing number and account number is required to request that a refund be loaded onto a prepaid debit card.

17 See <https://www.greendot.com/help>; https://www.usdirectexpress.com/how_it_works.html (the Treasury-recommended Direct Express® card is a prepaid debit card payment option for federal benefit recipients who don't have a bank or credit union account); <https://www.mangomoney.com/simple-fees>. There are 25,000 participating ATMs, including in 2,000 Walmart stores. <https://www.moneypass.com/business-services.html>.

18 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2*, 7 (Apr. 24, 2015).

19 A refund trace is the name of the process used to track a stolen, lost, or misplaced refund check and replace an authorized refund to the taxpayer. A refund trace may also be used to verify a direct deposit. Internal Revenue Manual (IRM) 21.4.2.2 (Oct. 1, 2016).

The IRS is unable to differentiate between a refund that is routed via direct deposit to a bank account and one that is routed to a prepaid debit card.²⁰ For this reason, the IRS cannot provide a reasonable estimate of how much of the billions lost in refund fraud were paid out via prepaid debit cards. There is anecdotal evidence that identity thieves prefer to use prepaid debit cards, presumably because there is very little useful information provided to the IRS about the owner of the prepaid debit card.²¹

The IRS should add “Direct Express” and “Other Payment Card” as an additional refund type options in the Refund section of each of the Form 1040 series.²² The IRS should also conduct a pilot, allowing refunds to be direct deposited to taxpayers with existing Direct Express cards, and compare the results with those who use a different prepaid debit card. Using this data, the IRS can be in a better position to analyze whether the use of prepaid debit cards to deliver refunds results in a higher rate of refund fraud, and test various ways the IRS could better validate the identity of the prepaid debit card holder.

The IRS Should Explore Using Payroll Cards to Deliver Refunds

Payroll cards are a subset of prepaid debit cards. Employers may load money onto payroll cards for employees who do not have bank accounts. Employers can save money by avoiding having to issue paper checks, and employees can get quick, convenient access to their funds.

Six million payroll cards were issued in 2014.²³ By 2019, an estimated 12.2 million workers will receive their wages via payroll cards, compared to only 2.2 million who will get paper checks.²⁴

Nineteen states already offer payroll card programs for their employees, as do many retailers in the private workforce, such as Walmart, Home Depot, Macy’s, and McDonalds.²⁵ The use of payroll cards to deliver tax refunds may be a viable option for the IRS.²⁶ Because the holder of a payroll card is an employee of a known company, the IRS will have reliable information about the recipient of the tax refund²⁷ — much more reliable information than it would have for an ordinary prepaid debit card. The IRS could work with the major providers of payroll services to educate employees of participating employers about the ease, convenience, and safeguards of requesting their federal tax refunds be direct deposited onto payroll cards.

20 IRS, Wage & Investment (W&I) response to TAS information request (Sept. 22, 2016).

21 IRS, *IRS’s Top 10 Identity Theft Prosecutions: Criminal Investigation Continues Efforts to Halt Refund Fraud*, IR-2016-45 (Mar. 21, 2016), <https://www.irs.gov/uac/Newsroom/IRSs-Top-10-Identity-Theft-Prosecutions-Criminal-Investigation-Continues-Efforts-to-Halt-Refund-Fraud>.

22 We appreciate that there is no room on the Form 1040 to insert additional lines. However, adding two checkboxes should not lengthen the form.

23 National Consumer Law Center, *Rating State Government Payroll Cards* 5 (Nov. 2015), <https://www.nclc.org/images/pdf/pr-reports/payroll-card-report.pdf>.

24 *Id.*

25 *Id.* at 1, 5.

26 See SOLE Paycard, *5 Reasons to Direct Deposit Your Tax Return onto Your SOLE Visa Payroll Card* (Nov. 18, 2015), www.solepaycard.com/company/news/direct-deposit-tax-return-sole-visa-payroll-card.

27 The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) that was enacted Dec. 18, 2015, changes the due date for submitting wage information (Form W-2) and non-employee compensation (Form 1099-MISC) to the Social Security Administration. Starting in 2017, the deadline to file these information returns has been moved up to January 31, enabling the IRS to spot errors on returns and verify the legitimacy of tax returns much earlier in the filing season.

The IRS Should Consider How Other Federal and State Agencies Deliver Benefits and Subsidies

The IRS should consider how other federal and state agencies are delivering payments of benefits and subsidies. Some states give taxpayers the option of receiving state tax refunds on prepaid debit cards issued directly from the state.²⁸ As administrators of the prepaid debit cards, the states presumably will have more information about the cardholder than if the taxpayer used a third-party debit card.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Participate in a government-sponsored prepaid debit card program (such as Direct Express) offered at no cost to taxpayers.
2. Add “Direct Express” and “Other Payment Card” as additional refund type options in the Refund section of each of the Form 1040 series.
3. Conduct a pilot comparing the refund fraud rate of refunds delivered to the Direct Express card versus non-government-sponsored prepaid debit cards.
4. Work with large employers and major providers of payroll services to conduct a pilot evaluating the efficacy of using payroll cards to deliver federal tax refunds.

²⁸ See BankRate.com, *Should Your Tax Refund Go on a Prepaid Card?*, <http://www.bankrate.com/finance/taxes/tax-refund-on-prepaid-card-1.aspx> (last visited Sept. 20, 2016).