Transforming Tax Refunds into Assets:
A Panel Survey of VITA Clients in Greenville, Henderson, and Raleigh, North Carolina

By:
Jon Spader, Janneke Ratcliffe, and Michael A. Stegman

August 5, 2005

Prepared with the support of:
The North Carolina Commissioner of Banks
The Annie E. Casey Foundation

CENTER FOR COMMUNITY CAPITALISM
THE FRANK HAWKINS KENAN INSTITUTE OF PRIVATE ENTERPRISE
THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

Introduction

Efforts by low-income households to build assets are subject to numerous obstacles. Chief among these is the constraint on households imposed by daily expenses. Policymakers and policy researchers are well aware that regular expenses like rent, utilities, groceries, and child-care leave little room for saving. Furthermore, what money the poor are able to tuck away often disappears because of unexpected medical or automobile-related expenses. Nevertheless, a growing amount of evidence suggests that low-income households do save and that such saving can be encouraged with programs that create incentives and structures tailored to the needs of this group.

In recent years, Volunteer Income Tax Assistance (VITA) sites have been presented as promising vehicles for reaching low-income households. These sites offer free income tax preparation services to low-income individuals, which not only makes them effective points of access but also allows programs to reach potential participants just as they are receiving a windfall gain. Many VITA clients are eligible for and receive the Earned Income Tax Credit (EITC), which could amount to a tax credit of up to $4,300 in the most recent tax year, 2004. Although few clients receive this maximum amount, most receive refunds that constitute a sizeable portion of their income.

The goals of this study are to examine the savings attitudes and behaviors of clients at three North Carolina VITA sites and evaluate the potential of these sites as vehicles for promoting asset-building programs. In partnership with the North Carolina Commissioner of Banks, and with funding from the Annie E. Casey Foundation, the Center for Community Capitalism surveyed clients served by VITA sites in Greenville, Henderson, and Raleigh.

As part of an initiative to develop financial services for the working poor and to bring un- and under-banked households into the financial mainstream, the North Carolina Commissioner of Banks has supported efforts to build VITA capacity throughout the state. Many VITA sites encourage clients to use the often sizable refunds for asset-building. They also often partner with financial institutions that offer bank accounts in connection with direct deposit and saving of tax refunds. For these efforts to be successful, it is important to understand the banking needs and attitudes of VITA clients. Is tax preparation a good time, and is a VITA site a good place, to reach out to the un- and under-banked? Can a tax refund form the basis for a mainstream banking relationship? Can low-income wage earners be encouraged to save their refunds for asset-building?

To explore these issues, the Center used the tax refund event along with a follow-up interview to (1) document receipt and use of tax refunds, (2) gauge attitudes/behaviors toward banking status and saving, and (3) measure use of other types of financial services. The research also provided some insight into the relationship between intent and ability to save.

Key Findings:

1) V*ITA sites can provide a good access point to reach the working poor and un-banked*. Eighty-one percent of the clients surveyed earned less than $30,000 per year, some 20 percent were unbanked, and nearly all indicated that saving was important to them.
2) *Many of these clients manage to save regularly*. Almost 50 percent of VITA clients surveyed reported saving regularly from their paycheck or during times when they had extra income.
3) *VITA clients who plan to save their tax refund have mixed success*. While planning to save significantly increases the likelihood of actually saving some of the refund, 55 percent of respondents who said they planned to save their refund did not save any of it.

These findings suggest that there is potential to encourage or facilitate greater refund savings with a well-designed and targeted institutional savings program.

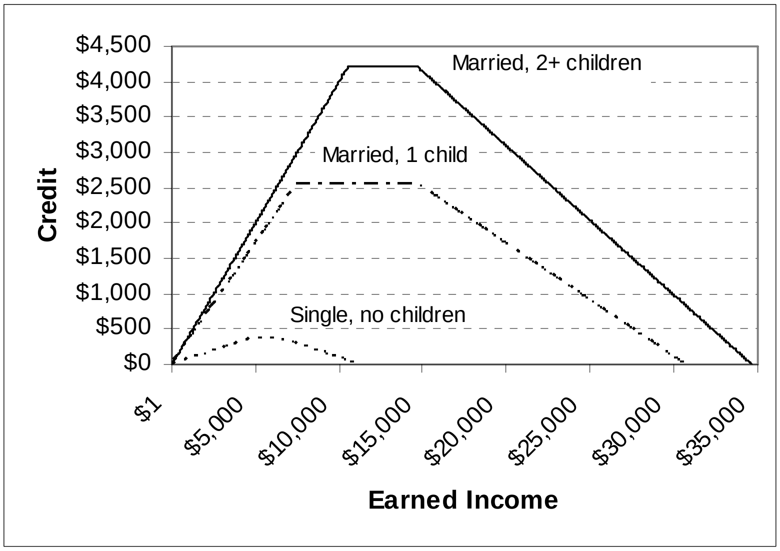
The Earned Income Tax Credit and Asset Accumulation

The promise of the Earned Income Tax Credit (EITC) as a mechanism for asset accumulation stems primarily from EITC's lump sum payment design. EITC credits are distributed as refundable tax credits, meaning that recipients receive the full amount of the credit even if that credit exceeds their tax liability. Furthermore, while recipients are allowed to receive up to 60 percent of their expected credit in advance through incremental additions to their paycheck, over 98 percent of recipients opt to receive the credit as a lump sum addition to their tax refund (Hotz and Scholz 2001). These characteristics mean that many families receive sizeable refunds that might be converted into savings or assets. In fact, anecdotal evidence suggests that families choose the lump sum payment option as a mechanism of forced saving.

Because the EITC is intended to encourage work among low-income parents, its benefits increase with work effort and are concentrated among households with children; its structure is like an inverted "U" (see Figure 1). In the *phase-in range*, the value of the credit increases at a constant rate with each marginal dollar of earnings. In the *plateau range*, the credit remains fixed at a maximum amount even as earned income increases. In the *phase-out* range, the credit's value declines at a constant rate with each additional dollar of earnings, until it reaches zero. While the shape of the benefit curve for each EITC-eligible class is similar, the size of the various ranges, and the maximum EITC benefit, differ according to family size. In particular, because the EITC is designed primarily to assist families with children, the maximum credit amount and the income range over which the credit is available are much smaller for childless workers than for families with children. In tax year 2003 (the year on which this study's analysis is based), the maximum EITC for a childless worker was $382; for a working family with one child, it was $2,547; and for a family with two or more children, it was $4,204—more than ten times that for a childless worker (Figure 1 illustrates the EITC Schedules).[1]

[1] IRS EITC Tables from 2003 1040A Instructions.

Figure 1: Earned Income Credit Schedule for 2003



At the time of its enactment in 1975, the EITC was intended to encourage low-income parents to work by refunding a portion of their Social Security payroll taxes. Since then, the program has undergone three major expansions—in 1986, 1990, and 1993—and a minor expansion in 2001. These expansions each took further steps toward realizing the EITC's underlying principles—that the poor should be exempt from income taxes and that low-income working families should be able to afford the basic necessities of life. In its current form, the EITC provides more than $38 billion each year to more than 22 million households (Blumenthal, Erard, and Ho 2005). Encouraging EITC recipients to earmark this money for savings, educational expenses, improved housing, and so on can only increase the impact of the EITC program on low-income, working families.

Besides lifting an estimated 5 million people out of poverty nationwide, the EITC delivers substantial funds to local economies. In TY 2002, 20.1 percent of North Carolina's tax filers claimed $1.3 billion in EITC.[2] Furthermore, it is estimated that 15 to 20 percent of available EITC goes unclaimed, representing at least $225 million in potential additional income to North Carolina residents.

Fees paid by low-income wage-earners to commercial tax preparers and the interest paid for expensive, short-term refund advance loans (RALs) are estimated to siphon an additional estimated $1.75 billion out of EITC benefits nationwide. (Berube, Kim, Forman and Burns 2002). More than half of EITC recipients in North Carolina took out expensive, short-term refund advance loans (RALs) in TY 2002.[2] Although the Brookings Institution found a decline overall in the percent of EITC filers using RALs in TY 2002 (possibly attributable in part to outreach campaigns mounted by some VITA sites), EITC recipients are more than five times as likely to use RALs than other taxpayers. Only 7.2 percent of all taxpayers used RALs in TY 2002, but 38.3 percent of

[2] Published data from Brookings Institution's Metropolitan Policy Program [http://apps89.brookings.edu:89/EITC/], accessed 15 July 2005.

EITC recipients used these vehicles. Interestingly, from TY 2001 to TY 2002, Raleigh was one of the 10 large cities with the greatest decrease (9.4%) in RAL use by EITC recipients—from 57.9 percent to a still-high 48.5 percent (Berube and Kornblatt 2005). In sum, with this state's relatively high rates of EITC eligibility and refund advance loan use, VITA and the EITC program represent a significant opportunity.

The prospect of promoting EITC's asset-building possibilities has not been lost on policymakers. Recently efforts have emerged to link the tax refund preparation process to bank accounts, individual development accounts (IDAs), and other opportunities for building assets (see Smeeding 2002; Beverly and Dailey 2003). More specifically, the VITA programs have provided a means for connecting EITC recipients with financial service programs and providers. One prominent example of this is the Treasury Department's First Accounts program, which encourages outreach and other efforts to bring unbanked individuals into savings and checking accounts. Several of the First Accounts demonstration programs rely on VITA sites to reach unbanked individuals. VITA sites are considered an optimal way to reach unbanked individuals and help them manage their tax refunds. Furthermore, beginning in 2007 (TY 2006), the IRS will enable taxpayers to split refunds by having one portion of their refund deposited in a bank account and receiving the other portion as a check. Early indications from a pilot program in Tulsa, Oklahoma, indicate that split refunds will encourage the unbanked to open bank accounts and to save. (Beverly, Schneider and Tufano 2005).

Such programs raise necessary questions about the financial needs and behaviors of VITA clients. While substantial evidence suggests that low-income individuals can and do save, creating appropriate mechanisms for encouraging asset development requires a more detailed understanding of this behavior. The assumption that increased access to existing financial tools will stimulate savings does not appreciate the differing incentives and needs of low-income working families. Instead, financial tools must be developed that are tailored to the incentive and institutional structures that face low-income earners (Barr and Sherraden, forthcoming). This study seeks not only to document how EITC recipients plan to use their refund, but also to better understand if and how these plans change over time.

This information is necessary to understanding the potential of linking the tax refunds, particularly of EITC recipients, to savings and asset-building programs. While it is clear that many VITA clients intend and desire to save their refunds (Smeeding 2000; Beverly, Tescher, and Romich 2004), less evidence exists on whether or not they are able to do so. At present, a large survey of VITA clients is underway in New York. Similar to this study of EITC recipients in North Carolina, it follows clients through both receipt and use of the EITC credit; however, findings from its follow-up interviews are not yet public (Rhine, Su, Osaki, and Lee 2005). The two studies examine the ability of EITC recipients to build assets as well as the obstacles to saving and investment that arise after refund receipt. Understanding both is critical to developing asset-building programs that meet the needs of EITC recipients.

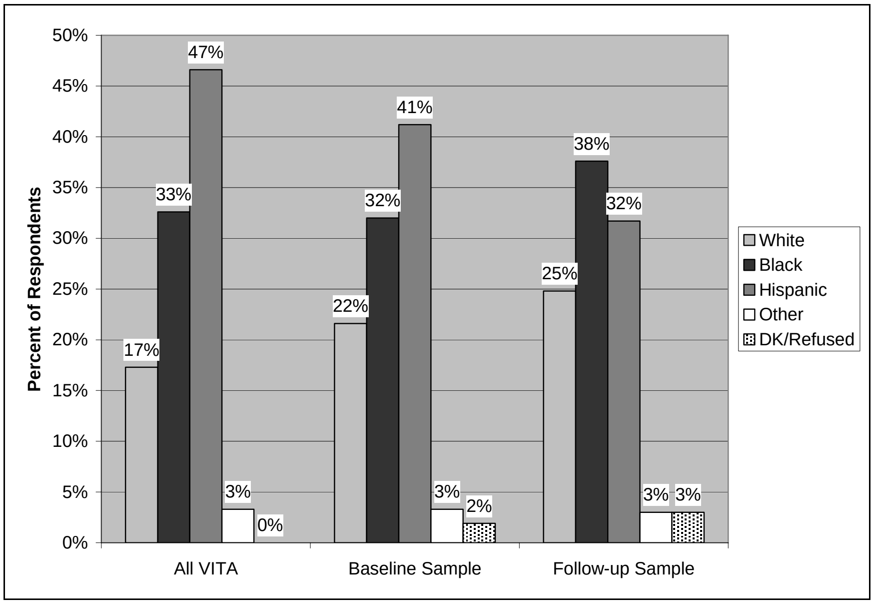
Study Design
The three VITA sites included in this survey served a total of 458 clients between February 1 and April 15, 2004 (TY 2003). The Center then contacted those clients who indicated a willingness to be interviewed. The first (baseline) interview was conducted with 153 clients in summer 2004, after the conclusion of the 2003 tax season. This interview documented clients' financial attitudes, behaviors, and planned use of their tax refund. Because this interview did not occur at the VITA site, but rather shortly after the tax refund was received, respondents' planned uses may in fact reflect some actual spending that occurred between receipt of the tax refund and the baseline interview.

Of the initial 153 clients, 101 participated in a second interview in November/December 2004. This follow-up interview established the respondents' actual use of their tax refunds and any changes in their banking status and/or savings behaviors. This research design, which documents both respondents' planned and actual uses of their tax refunds, is significant in two ways. First, the panel design allows for more precise analysis of the impacts of changes in respondents' banking status and savings behavior. Second, it examines the assumption of previous studies that planned tax refund uses accurately predict actual behavior.

Note on Graphs/Figures
This report presents findings from the baseline sample of 153 respondents and a follow-up sample of the 101 individuals with both baseline and follow-up interviews. Where statistics reflecting static characteristics or occurrences are provided, data from the baseline survey are used. Because the baseline interview includes a larger sample of clients, it should be more representative of the larger population of VITA clients. Where changes in characteristics or behaviors are displayed, the data reflect only the 101 clients who responded to both the baseline and follow-up surveys (follow-up sample). This is done to isolate changes in individual behavior. A sample size (n) is included with most graphs to ease interpretation.

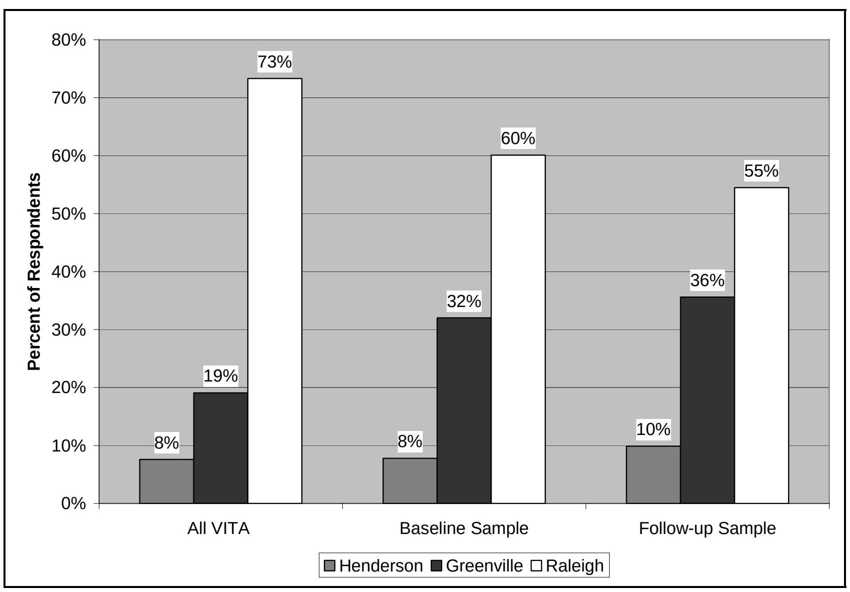
Demographic Characteristics of VITA Clients Across Samples
The basic characteristics of clients surveyed match those of VITA clients surveyed elsewhere. Clients tended to be minority, low-income, and female, and a significant proportion did not own a bank account. The unique characteristic of this sample is the high proportion of Hispanic clients. Forty-seven percent of clients at the VITA sites were Hispanic and 41 percent of baseline respondents reported Hispanic ethnicity (see Figure 2). However, only 32 percent of follow-up respondents were Hispanic.

Figure 2: Race/Ethnicity of VITA Clients and Interview Respondents



The high proportion of Hispanic respondents results from the sites chosen for this study. The Raleigh site, which specifically targeted Hispanic immigrants, served 73 percent of the total number of clients (see Figure 3). Raleigh's representation decreases to 60 percent and 55 percent, respectively, in the baseline and follow-up samples, a change likely caused by the greater difficulty of contacting Hispanic immigrants.

Figure 3: VITA Clients and Interview Respondents by Site



Note: All VITA n=458; Baseline n=153; Final Sample n=101

The baseline questionnaire recorded respondents' 2003 household incomes. The majority of baseline respondents were clustered at incomes below $20,000. Fifty-eight percent earned less than $20,000 per year and 40 percent earned less than $15,000 per year.

Respondents with lower incomes are slightly underrepresented in the follow-up sample (see Figure 4).

Figure 4: Percent of Respondents by Income

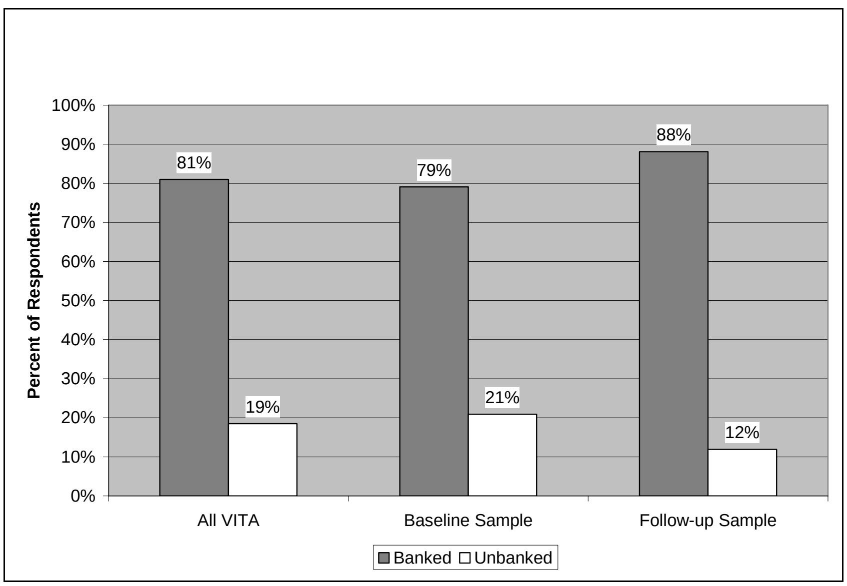
	<$10,000	$10,000-$15,000	$15,000-$20,000	$20,000-$25,000	$25,000-$30,000	$30,000-$35,000	$35,000+	Don't Know
Baseline Sample	22%	18%	18%	10%	11%	5%	7%	9%
Follow-up Sample	17%	15%	21%	12%	14%	5%	10%	7%

Note: Baseline n=153; Final Sample n=101

The baseline and follow-up samples match closely with respect to respondent gender. In both samples, just over 60 percent of respondents were female.

The proportion of VITA clients without bank accounts reflects estimates of the proportion of unbanked low-income North Carolinians. Nineteen percent of all VITA clients and 21 percent of baseline respondents did not own a bank account (Figure 5); among all low-income North Carolinians, 17 percent are unbanked, according to estimates by the North Carolina Financial Services Survey (NCFSS). Furthermore, this study reinforces the finding of the NCFSS that unbanked individuals are disproportionately minorities; none of the 32 unbanked respondents were white.

Figure 5: VITA Clients and Survey Respondents by Bank Account Ownership



The follow-up sample underrepresents unbanked clients, as only 12 percent of respondents to the follow-up survey were without accounts *at the time of the baseline survey*.[3] This difference is again attributable to attrition of Hispanic respondents. Of the

[3] This statistic indicates that 88 percent of respondents in the final sample were banked *at the time of the baseline survey*. Thus, the difference in unbanked representation in the baseline and final samples reflects

unbanked respondents that completed the baseline survey but not the follow-up survey, three-fourths were Hispanic. Figure 6 details the loss of unbanked respondents between baseline and follow-up samples by race.

Figure 6: Unbanked Respondents by Race Across Baseline and Follow-up Samples

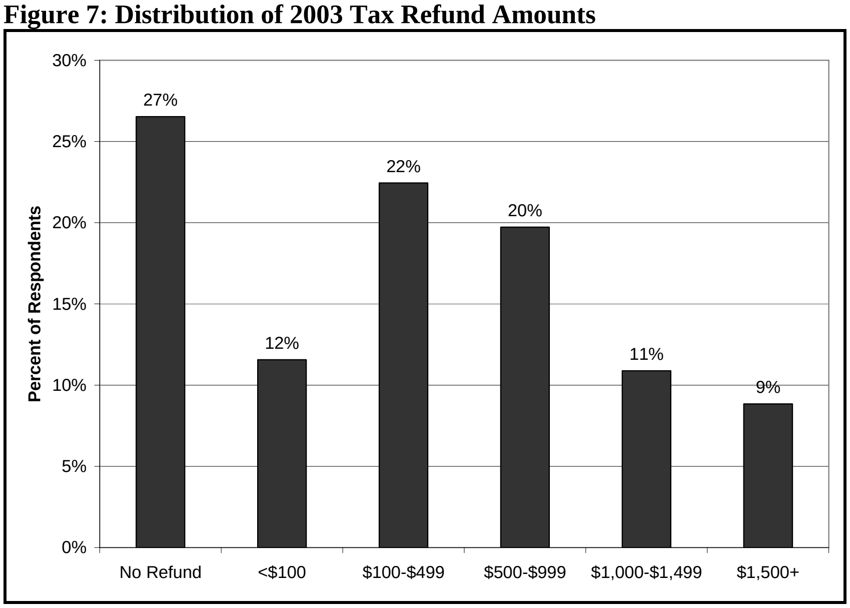
	White	Black	Hispanic	Other	Total
Baseline	0 (0%)	11 (34%)	19 (59%)	2 (6%)	32 (100%)
Follow-up	0 (0%)	7 (58%)	4 (33%)	1 (8%)	12 (100%)

Lastly, clients were more likely to elect to participate in the study if they received a refund. Seventy-four percent of interview respondents had received a tax refund, whereas only 53 percent of all VITA clients received a refund.

Receipt and Use of Tax Refunds Among VITA Clients

Seventy-four percent of interview respondents received federal tax refunds for the 2003 tax year. These refunds varied in size from less than $100 to more than $1,500, with the median refund in the $500-$999 range. Figure 7 displays a complete distribution of refund sizes.

Figure 7: Distribution of 2003 Tax Refund Amounts



Note: N=147 Respondents with a recorded refund amount.

While the EITC is designed to increase as earnings increase, this reward structure is not immediately perceptible from comparison of income and refund size (Figure 8). The absence of clear relationship is not altogether surprising, because number of children, withholding status, and other variables play such a large role in determining refund size.

---

higher rates of attrition among the unbanked. It does not suggest that unbanked individuals opened bank accounts between the baseline and follow-up surveys. In fact, two individuals became banked during this period and three became unbanked.

Figure 8: Refund Amount by Income

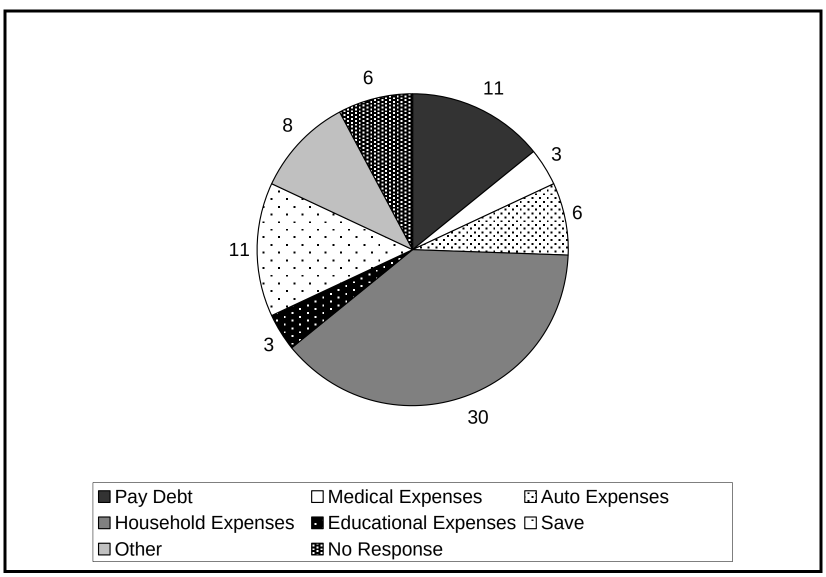
Refund Amount	2003 Household Income				
	<$10,000	$10,000-$20,000	$20,000-$30,000	$30,000+	Total
<$100	8 (33%)	6 (14%)	0 (0%)	1 (7.7%)	15
$100-$499	5 (21%)	16 (38%)	6 (29%)	3 (23%)	30
$500-$999	5 (21%)	10 (24%)	8 (38%)	4 (31%)	27
$1,000+	6 (25%)	10 (24%)	7 (33%)	5 (38%)	28
Total	24	42	21	13	100

Note: n=100 respondents (of 153) with observed values for income and refund amount.
Percentages shown are column percent.

Of the 101 respondents re-interviewed in November and December, 10 of the 74 (14%) respondents who received a refund had saved their entire refund. Another 9 respondents (12%) had saved a portion of the refund amount. Of the 19 savers, six saved toward purchasing a home; six saved for emergency needs; two saved for retirement; two saved for their child's education or daily needs; three saved for other purposes.

Respondents who spent at least a portion of their refund were asked to give their "most important" refund use. Figure 9 shows the breakdown of "most important" refund uses. Thirty respondents (42%) named household expenses—home improvement/repair or regular household expenses—as their primary refund use. Paying debt and saving tied for the second most common response with 11 respondents each (14%). Six respondents (8%) gave automobile-related expenses as their most important use. Less than five respondents named medical expenses, educational expenses, send to family elsewhere, fun/splurge, and other.

Figure 9: "Most Important" Actual Refund Uses



Note: n=78 (respondents receiving a refund, of 101 in follow-up sample)

In addition to giving their most important refund use, respondents were also asked to indicate their second and third most important refund uses. Where the follow-up survey asked respondents to indicate their three most important *actual* refund uses, the baseline survey asked respondents to indicate their three most important *planned* uses. These questions allow for analysis of planned versus actual refund use, particularly planned versus actual saving.

To simplify this comparison, responses were classified into four categories—saving, investment (in education or home improvement), expenses, and other—as opposed to the more detailed categories shown in Figure 9. Because of our primary interest in saving behavior, individuals who saved at least some of their refund or who indicated savings in any of the three most important use questions were classified as "saving." For the remaining individuals, the same process was followed for "investment," then for "expenses," and finally for "other." Thus, an individual classified as "investment" did not save any of his refund but may have used a portion toward "expenses" or "other" purposes. These broad categories better illustrate the differences between respondents' planned refund uses and their actual uses *with respect to savings behavior*. Figure 10 provides a detailed comparison of respondents' planned and actual uses.

Figure 10: Planned vs. Actual "Most Important" Uses of Tax Refunds

		Actual Use				
Planned Use		**Savings**	**Investment**	**Expenses**	**Other**	**No Response**
Savings	**29**	13	1	12	1	2
Investment	**10**	1	5	3	0	1
Expenses	**29**	5	0	22	1	1
Other	**2**	0	0	1	0	1
No Response	**8**	1	2	5	0	0
Total	**78**	**20**	**8**	**43**	**2**	**5**

Note: n=78 (respondents receiving a tax refund; of 101 in follow-up sample)

Analysis of Planned vs. Actual Saving

Comparison of planned and actual uses reveals noticeable attrition between intention to save and actually saving. Of the 29 respondents who named saving among their three most important refund uses, only 13 (45%) actually saved. This difference between planned and actual savings illustrates a more fundamental insight of Figure 10, namely that planned use may not reliably predict actual use. Of 78 respondents receiving a tax refund, only 26 (33%) reported an actual refund use that precisely matched their planned use. When these responses were categorized into the more general categories reported in Figure 10, this number improves only slightly to 40 (51%). This observation carries significant weight for the studies of Smeeding, Phillips, and O'Conner (2000), who rely only on responses regarding planned use. In fact, using their very general categorization of uses into those that help make ends meet and those that improve social or economic mobility (defined in Smeeding, Phillips, and O'Conner 2000), only 45 of 64 responses (70%) matched (see Figure 11). These findings suggest that VITA clients adjust their refund use not only within different types of investment or consumption, but also between investment and consumption.

Figure 11: Comparison of Planned and Actual Refund Uses

		Actual Use		
		Make Ends Meet	**Mobility**	**Total**
Planned Use	**Make Ends Meet**	18	7	**25**
	Mobility	12	27	**39**
	Total	**30**	**34**	**64**

Note: N=64 excludes 'no response' and 'other' responses from Figure 10.
Based on categories defined by Smeeding, Phillips, and O'Conner (2000)

To further test the relationship between planned and actual savings behavior, we estimate a multivariate model that controls for other relevant characteristics. The dependent variable ("saved all or part of refund") was coded as a dichotomous variable indicating whether the respondent saved any of her refund or not. The independent variables are income, an attitudinal scale measuring whether the respondent considers savings to be a good idea[4], and the respondent's planned use of the refund as reported in the baseline survey (also coded as a dichotomy indicating whether the respondent planned to save any of the refund).[5] Because of limiting the sample to those who received a refund and omitting cases with missing data, the sample size for our model is reduced to 52 cases, of whom 16 (30.8%) reported some actual savings.

With a dichotomous dependent variable, we estimated a logistic regression that takes the following form:

$$\ln\frac{\Pr(savedrefund)}{\Pr(notsavedrefund)}=\beta_0+\beta_1 INC1+\beta_2 INC2+\beta_3 INC3+\beta_4 SavingsGood+\beta_5 PlannedUse$$

Where INC1, INC2 and INC3 are dichotomous variables representing 2003 annual income ranges of $10,000-$20,000, $20,000-$30,000, and $30,000 or more, respectively (with income of less than $10,000 being the omitted category). Our substantive interest

[4] The scale, represented as "Savings Good" in Figure12, is calculated as the sum of respondents agreement with the following four Likert questions: (1) "Saving money is important to you"; (2) It's easier for people to save when they have a bank or credit union account"; (3) "Money in a bank or credit union account is safe"; and (4) "Having payments directly deposited into a bank account is a good idea." Scale reliability for the constructed variable is .57.

[5] The bivariate association between our dependent variable and several other variables was also tested but was insignificant. These variables were race, gender, size of refund, whether the respondent had a bank account, and an attitudinal scale assessing how difficult the respondent thinks savings is. Race and banking status were also included in multivariate models but remained insignificant. The model presented in the paper is the trimmed model.

is in the impact of the planned use of the refund, so the other variables should be considered control variables.

The results of this model are presented in Figure 12.[6] We present the coefficient estimates for the above model, the standard errors of those estimates, and the odds ratio. The odds ratio represents the multiplicative impact of that variable on the odds of the respondent saving at least part of the refund. Because of the small sample, we feel it is appropriate to use a *p*-level of .10.

Figure 12: Results of Multivariate Analysis of Planned vs. Actual Saving

	Maximum Likelihood Estimate (Standard Error)	***Odds Ratio Point Estimate***
Income $10,000-$20,000	.17 (1.18)	1.18
Income $20,000-$30,000	1.78* (1.01)	5.95
Income $30,000+	2.45** (1.18)	11.53
Savings Good[4]	.49** (.23)	1.63
Planned to Save	1.31* (.76)	3.72
Intercept	-5.24	-

* p<.10; **p<.05

As shown in Figure 12, the multivariate analysis demonstrates that planning to save significantly increases the likelihood that an individual will save all or part of the refund, even when controlling for income and attitude towards saving. In fact, the odds ratio shows that the odds of a respondent who planned to save actually saving are 3.7 times greater than the odds of a respondent who did not plan to save. Similarly, individuals with higher incomes and positive attitudes toward saving are more likely to save.

Comparing the findings from the multivariate analysis with the previous tables produces a more nuanced view of savings behavior. While the model's results indicate that respondents who plan to save are significantly more likely to do so, Figure 10 and Figure 11 also show that this increased likelihood is by no means a guarantee. Rather, many individuals who plan to save are unable to or simply do not follow through on their plans. Together these findings speak to the opportunity for well-designed programs to increase savings behavior among EITC recipients.

---

[6] The test of the overall significance of the model is noteworthy (χ^2=19.7 with 5 df, p<.01). Respondents in the two highest income categories are significantly more likely to save at least part of their refund than those who reported less than $10,000 in income in 2003. And the more positive a respondent feels about saving, the more likely she is to save at least part of their refund.

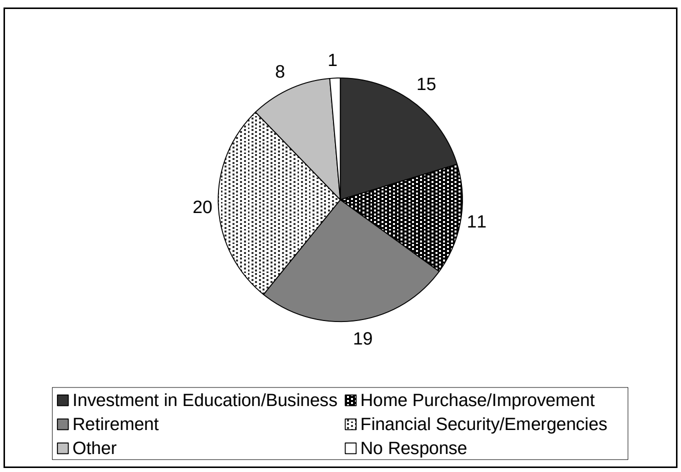
Savings Attitudes/Behaviors and Financial Services Use

Savings Behavior and Reasons for Saving

In addition to questions regarding tax refund use, respondents were asked a set of questions about their ability to save apart from their tax refund. Roughly half those in both the baseline and follow-up samples indicated that they were currently saving either regularly or when they had extra income. While this type of saving may involve only small amounts, a significant number of respondents sustained this behavior between interviews. Where 50 of the 101 respondents in the follow-up sample indicated that they were currently saving at the time of the baseline interview, 40 indicated that they were currently saving at the time of the follow-up interview.

In both the baseline and follow-up interviews, respondents who indicated that they were currently saving were asked to identify their reason for saving. The set of respondents' reasons for saving is similar to the set of planned tax refund uses. The only exception is that longer-term objectives like retirement are more prominent among the set of reasons for saving. Figure 13 shows the reasons for saving given by the 74 individuals in the baseline sample who indicated that they were currently saving.

Figure 13: Reasons for Saving Among Baseline Respondents



Note: n=74 (respondents saving; of 153 baseline respondents).

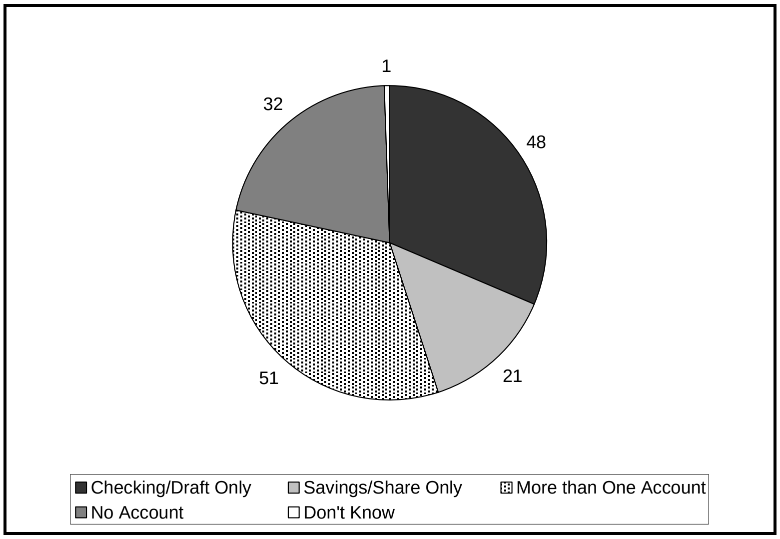
As with respondents' planned refund uses, reasons for saving were subject to change between the two interview periods. While 40 individuals indicated that they were currently saving in both interviews, only 9 of these respondents gave similar reasons for saving in both interviews. Those individuals who gave differing reasons for saving most commonly changed from long-term motivations like retirement to shorter-term goals like financial security or health care.

This change in reasons for saving between the baseline and follow-up interviews echoes the difference between respondents' planned and actual use of tax refunds. There are several possible explanations for these differences. One likely explanation is that financial emergencies and needs force many respondents to redirect financial resources and to reevaluate financial plans. A second equally plausible explanation is that respondents do not have a single or specific savings goal. If this latter explanation holds, a respondent may report different primary reasons for saving simply because she is not saving for one dominant purpose.

Banking Status and Savings Mechanisms

As shown earlier (Figure 5), roughly 80 percent of baseline respondents and 88 percent of follow-up respondents owned a bank or credit union account. Nearly one-third of baseline respondents owned more than one account**.** Figure 14 shows account ownership among all respondents.

Figure 14: Type of Accounts Owned



Note: n=153

Not surprisingly, banked respondents were more likely to indicate that they were currently saving than were unbanked respondents. Figure 15 shows the incidence of saving among banked and unbanked respondents. Where 54 percent of banked respondents indicated that they were currently saving, 29 percent of unbanked respondents saved.

Figure 15: Saving Behavior Among Banked and Unbanked Respondents

	Banked	Unbanked	Total
Currently Saving	65 (54%)	9 (29%)	74
Not Saving	55 (46%)	22 (71%)	77
Total	120	31	151

Note: n=151 respondents with responses for both banking status and saving.
Percentages shown are column percents.

Conversely, respondents who indicated that they were saving were more likely to own bank accounts. While a chi-squared test of the table in Figure 15 shows that banking status and saving behavior are significantly related,[7] inferring a direction of causation is troublesome. We might expect that owning a bank account makes saving easier;

[7] Chi-square prob=.012.

however, it is equally—if not more—likely that individuals who desire to save self-select into the banked category.

Savings Mechanisms

Among respondents indicating saving behavior, owning a bank account was by far the most popular mechanism for saving; however, these respondents also used a variety of other savings mechanisms. Multiple savers also held savings in (1) cash value insurance or whole life insurance (36% of savers), (2) pension and retirement plans (30% of savers), (3) money market accounts, mutual funds, stocks, and bonds (26% of savers), and (4) cash, jewelry, and gold (18% of savers). Several respondents also owned tax-deferred savings plans and certificates of deposit.

Attitudes Toward Saving

While just under half of survey respondents indicated that they were saving, a much larger percentage showed willingness and desire to save. Our survey instrument included multiple questions designed to gauge attitudes toward saving and financial service providers; respondents were asked their level of agreement (strongly agree, agree, disagree, strongly disagree) with provided statements. Their responses offer three basic insights into their attitudes toward saving:

1) Respondents desire to save. Ninety-seven percent of respondents agreed that saving was important to them.
2) Banks are generally seen positively. Seventy-five percent of respondents thought that saving is easier with a bank account. Eighty percent agreed that direct deposit is a good idea. Agreement with this statement varied equally among the banked and unbanked.
3) Saving is made difficult by daily needs and pressures. Eighty-six percent of respondents agreed that saving is difficult because most money goes to necessities. Fifty-three percent indicated that it is "hard to resist temptations to spend money." Nearly two-thirds (64 %) felt that they could not save enough to make a difference.

These responses help to further explain respondents' saving behavior. While 50 percent of respondents indicated that they were currently saving, an equal number did not save. The responses to these attitudinal questions suggest that members of this latter group also desire to save but are unable to do so because of daily needs and pressures.

Use of Alternative Financial Services

Multiple respondents—including those with bank accounts—used alternative financial services (AFS) in the period prior to being surveyed. Figure 16 shows the percent of respondents who purchased AFS products by the AFS product or provider.

Figure 16: Use of Alternative Financial Services

AFS Product/Provider	*Use*
Check Cashing (Previous Month)	22%
Money Order (Previous Month)	36%
Payday Loan (Previous Six Months)	12%
Pawn Shop (Previous Six Months)	3%

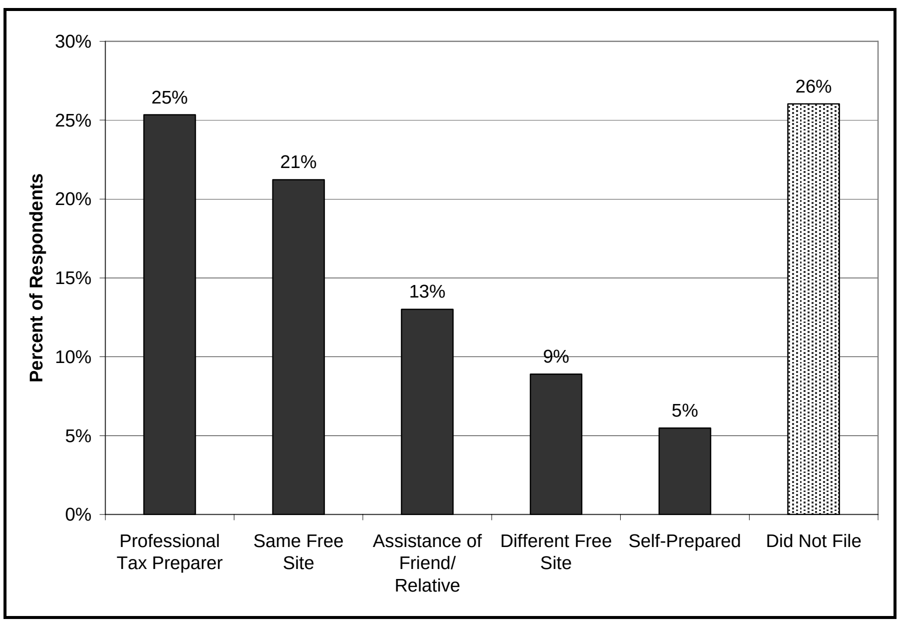
Note: n=153

While both banked and unbanked respondents used alternative financial services, unbanked respondents were more likely to use check cashers and money orders than were banked respondents. First, where 5 of 12 unbanked respondents (42%) had used a check casher, 17 of 89 banked respondents (19%) had used a check casher. Second, unbanked respondents were much more likely to use money orders than banked respondents. Where 10 of 12 unbanked respondents (83%) had used money orders in the month prior to being surveyed, only 27 of 89 banked respondents (30%) had used money orders during the same period. Small sample sizes prevented further investigation of the relationships between AFS use and banking and savings behavior.

2002 Tax Preparation
Of the 114 respondents who filed a 2002 tax return, 87 (76%) received a refund—compared to 74 percent of VITA clients. Of those receiving a refund in 2002, 38 claimed an EITC tax credit on their original return.[8]

Figure 17 displays the different methods used by VITA clients to prepare their previous year's tax return (TY 2002). Among the 108 respondents who filed 2002 returns, 40 respondents (37%) used some type of free service, followed closely by the 37 respondents (34%) who used professional tax preparers.

Figure 17: 2002 Tax Return Preparers



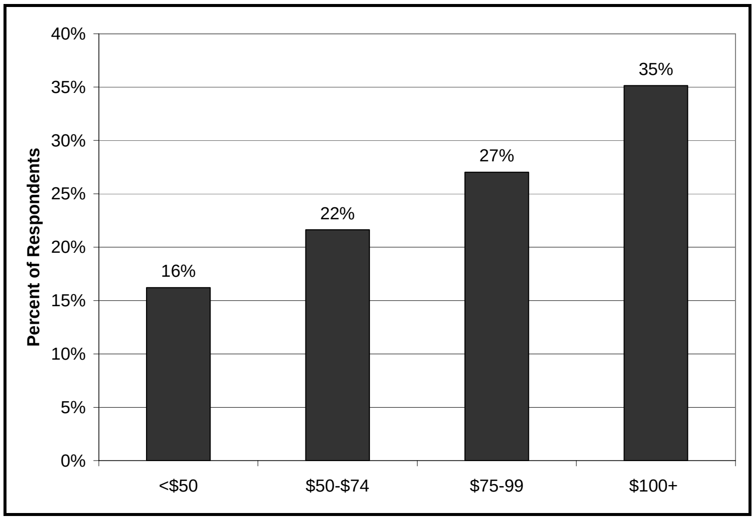
Note: n=146 (of 153) respondents with observed responses to method of 2002 tax preparation.

The cost of tax preparation for respondents choosing professional tax preparers varied widely (Figure 18). While some paid less than $50 for this service, others paid more than $100. Seven of the 37 respondents (19%) who used professional tax preparation opted

[8] Another 11 respondents could not remember whether they had claimed EITC credit, and up to 4 received EITC credit by filing at the VITA site in 2004.

for a refund anticipation loan, pushing the cost of receiving their EITC tax refund even higher. For this service, these respondents reported paying between $50 and $150—on top of the costs of tax preparation.

Figure 18: Costs of Professional Tax Preparation in 2002



Note: n=37.

Discussion and Conclusions

The findings presented in this report may understate actual savings behavior in two important ways. First, respondents may save their refunds for short term uses. Individuals who planned to save their refund towards medical expenses or security from financial emergencies may have used their refunds for these uses prior to the follow-up survey. This type of use reflects disciplined savings behavior that is not picked up in this study's findings. Such behavior would result in the findings understating VITA clients' abilities to protect planned savings.

Second, many individuals use the tax-withholding structure as a savings mechanism, effectively saving a portion of their regular paycheck towards future use. Despite efforts to spread information about the advance earned income credit, less than 1% of EITC recipients use the advance option. Many reasons have been given for why people wait to receive money at no interest or, in the case of RALs, at substantial cost. While this topic was not a subject of our survey, evidence suggests that some people use overwithholding as a forced savings mechanism. A survey of EITC eligible families in Wisconsin found that none would prefer advance EITC payments over a lump sum refund, with many respondents citing "self-control" as a reason. Also, interviewees often treated tax money as a separate mental account, and the refund was intended to be used differently from regular income (Romich and Weisner 2000). Whatever the motivations, overwithholding IS a forced savings mechanism through which low-income, liquidity-constrained households manage to build up sizable savings during the course of a year. In this case, the extent to which respondents save would be understated among the VITA client population by overlooking excess withholding.

With these potential limitations in mind, the analysis presented in this report attempts to provide a more complete image of VITA clients and their abilities to save and/or build assets. This analysis offers several important insights:

1) *VITA sites provide good potential to reach the working poor and unbanked*. The profile of the VITA clientele suggests VITA sites are good access points for reaching out to working poor and under-banked. More than half (58%) of the clients surveyed earned less than $20,000 per year and 81 percent earned less than $30,000 per year. For these individuals, an earned income tax credit, child and dependent-care credits, and over-withholding can mean a substantial refund. Some 20 percent of the clients were unbanked, and more used alternative financial services. Notably, nearly all of the VITA clients surveyed indicated that saving was important to them.
2) *Many of these clients manage to save regularly*. Almost 50 percent of VITA clients reported saving regularly from their paycheck or during times when they had extra income. Commitment to saving among this group of clients further suggests that the tax refund event provides substantial opportunity for encouraging saving among at least a subset of the VITA population.
3) *VITA clients have mixed success saving their refunds*. Twenty-six percent of clients saved some of their refund through the second interview. While planning to save significantly increases the likelihood of a VITA client actually saving a refund, 55 percent of respondents who planned to save their refund had spent all of it by the time of the follow up interview.

The major finding from these insights is that a well-designed and targeted savings program should improve the amount saved by refund recipients, particularly among those with a clear desire to save. A savings program designed to facilitate and encourage savings within this group might increase the proportion of VITA clients who are able to protect their refunds from daily needs and spending pressures.

Bibliography

Barr, Michael S. and Michael Sherraden. 2005. “Institutions and Inclusions in Saving Policy.” Working Paper 44. University of Michigan Law School, Ann Arbor, Michigan.

Berube, Alan, Anne Kim, Benjamin Forman and Megan Burns. 2002. “The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC,” Brookings Institution and The Progressive Policy Institute, Washington, DC.

Berube, Alan and Tracy Kornblatt. 2005. “Step in the Right Direction: Recent Declines in Refund Loan Usage Among Low-Income Taxpayers,” Brookings Institution Metropolitan Policy Program, Washington, DC

Beverly, S.G. and C. Dailey. 2003. "Using Tax Refunds to Promote Asset Building in Low-Income Households: Program and Policy Options (Policy Report)." Center for Social Development [http://www.cfsinnovation.com/managed_documents/beverly_oct2003.pdf], accessed 15 July 2005.

Beverly, S.G., J.L. Romich, and J. Tescher. 2003. "Linking Tax Refunds and Low-Cost Bank Accounts: A Social Development Strategy for Low-Income Families." *Social Development Issues* 25 (1/2): 235-246.

Beverly, Sondra G., Jennifer Tescher, and Jennifer L. Romich. 2004. "Linking Tax Refunds and Low-Cost Bank Accounts: Early Lessons for Program Design and Evaluation." *The Journal of Consumer Affairs* 38 (Winter): 332-341.

Beverly, Sondra, Daniel Schneider, and Peter Tufano. 2005. "Splitting Tax Refunds and Building Savings: An Empirical Test." Working Paper Draft July 2005. [http://www.people.hbs.edu/ptufano/R2A_July2005.pdf]. Accessed August 2005.

Blumenthal, Marsha, Brian Erard, and Chih-Chin Ho. 2005. "Participation and Compliance with the Earned Income Tax Credit." *National Tax Journal* LVIII (June): 189-213.

Hotz, V.J. and J.K. Scholz. 2001. "The Earned Income Tax Credit." Working Paper 8078. National Bureau of Economic Research, Cambridge, Mass.

Rhine, Sherrie L.W., Sabrina Su, Yazmin Osaki, and Steven Y. Lee. 2005. "Householder Response to the Earned Income Tax Credit: Path of Sustenance or Road to Asset Building." Working Paper. Federal Reserve Bank, New York.

Romich, Jennifer L. and Thomas Weisner. 2000. "How Families View and Use the EITC: Advance Payment versus Lump Sum Delivery." *National Tax Journal 53* (December): 1245-1266.

Smeeding, Timothy M., Katherine Ross Philips, and Michael O'Connor. 2000. "The EITC: Expectation, Knowledge, Use, and Social and Economic Mobility." *National Tax Journal* 53 (December): 1187-1210.

Smeeding, Timothy M. 2002. "EITC and USAs/IDAs: Maybe a Marriage Made in Heaven." *Georgetown Public Policy Review* 8 (1): 7-27.

Stegman, Michael A. and Robert Faris. 2001. "Welfare, Work, and Banking: The North Carolina Financial Services Survey." Center for Community Capitalism [http://www.kenan-flagler.unc.edu/assets/documents/CC_welfare.pdf], accessed 15 July 2005.

The Kenan Institute's Center for Community Capitalism engages in multi-disciplinary research and outreach activities that explore ways to apply private sector approaches to revitalization of America's distressed communities. The Center's work focuses on techniques that are both effective in building wealth and assets in disadvantaged communities and are sustainable from a business perspective.

Center for Community Capitalism
Kenan Institute of Private Enterprise
The University of North Carolina at Chapel Hill
Campus Box 3440
Chapel Hill, NC 27599-3440
www.kenan-flagler.unc.edu/KI/commCapitalism/