

Executive Summary
Building Savings for Low-Income Families:
Splitting Refunds and Opening Accounts at Tax Time¹

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Introduction

In the 2004 tax season, federal income tax refund recipients in Tulsa, Oklahoma were offered the opportunity to (a) split their refunds, directing part to savings and part to cash for spending; and (b) open a new bank savings account, if desired. This experiment was designed to test the demand for a tax-time savings program for low income families that shared some characteristics of successful work-place savings experiments which permit workers to precommit to saving a portion of their salary. Here, refund recipients were able to precommit to saving a portion of their refunds. The Refunds to Assets (R2A) experiment was carried out by a team consisting of the Community Action Program of Tulsa County; D2D Fund, Inc.; the Bank of Oklahoma (BOK); and researchers from the University of Kansas and Harvard Business School.

We believe the results of this experiment are promising and have implications for public policy. In particular, there seems to be strong demand by refund recipients to save a portion of their tax refunds, which could be facilitated through a combination of public and private efforts. Specifically, the experiment supports the idea that the IRS should allow refund recipients to split their refunds to multiple destinations, encourage private efforts to make tax-refund account opening easy, and investigate the possibility of allowing consumers to receive part of their refunds in savings bonds. Given that federal refunds to low income families totaled over \$78 billion in 2001, the potential for refund-based savings is substantial.

Results from the Refunds to Assets Experiment

The R2A experiment was conducted in Tulsa, Oklahoma in February-March 2004 at a few volunteer tax preparation sites. Approximately 500 filers, whose adjusted gross income averaged \$12,300, were studied, either as part of a treatment or control groups. Refund recipients were approached on-site and offered the opportunity to split their refunds and could specify how much to receive as a check and how much to deposit into a savings account. Filers without savings accounts were able to open new BOK savings accounts on site. No fees were charged for the splitting service or for account opening.

1. *Many filers sought to use the service:* Approximately 27% of all filers expecting a refund sought to participate. About 35% of filers without existing savings account choose to open new accounts and split their refunds.
2. *Initial savings were impressive as were participants' achievement of their own largely short-term savings goals. As these goals were met, savings account balances were depleted.* R2A participants made initial deposits to savings of 47% of their refunds, or \$606 each, on average. Three to five months later, 72% of participants were still saving, versus only 42% of a comparison group which was not given the chance to open new accounts or split. However, by the eight month mark, most participants had significantly depleted their accounts, although they claim to have used the funds to meet their financial goals.

¹ The full study results are available in a paper entitled "Splitting Tax Refunds and Building Savings: An Empirical Test" by Beverly, Schneider and Tufano" which is available at <http://www.people.hbs.edu/ptufano>. For additional information, contact Professor Peter Tufano, Harvard Business School, Soldiers Field, Boston, Massachusetts, 02163; ptufano@hbs.edu; (617) 495-6855.

3. *Participants reported high levels of satisfaction.* When contacted a few months after receiving their split refunds, 83% of participants said the R2A service helped them to save more of their refunds, 83% agreed the service helped them to spend their refunds more slowly, and 76% noted the service helped them to resist spending temptations. An overwhelming fraction of participants planned to use it again, would recommend it to their friends, and were willing to pay a nominal fee to split.

Policy Implications

1. *Refund splitting has the potential to assist low income families with better financial planning. The IRS should allow refund recipients to split their refunds and should enable private parties to offer augmented splitting services through rule clarifications.* Allowing tax filers to split their refunds could increase savings and help low income families to plan for the future. Splitting allows filers to decide ahead of time how much of their refund they will save and how much they need to spend, and then pre-commit to it. The IRS can make simple splitting services available by allowing refund recipients to specify more than one destination for refunds. The IRS can also clarify the rules so that private parties can create cost-effective splitting services. For example, the IRS should make clear rules under which private parties can use pooled accounts to facilitate splitting.

2. *Refund splitting seems most promising among families without existing accounts. Rule changes should enable filers to open new accounts or fund savings vehicles as simply as possible at tax time.* Part of the appeal of the R2A experiment was that it allowed both splitting and account opening, on site. Low-income individuals value the opportunity to open accounts at tax-time, onsite. Tax-sites may be less intimidating than bank offices, the sites may be more convenient, or tax time may be when LMI filers are thinking most clearly about financial matters. Our preliminary results suggest that splitting alone may be far less effective than when combined with new account opening. Policy rules should contemplate provisions that make it easier for financial institutions to open accounts at the same time as tax filing.

3. *Refund-based savings among the poor may be impeded by current bank credit policies. The Treasury can provide savings to all by offering refund recipients the option to receive a portion of their refunds in the form of U.S. Savings Bonds.* Perhaps as many as 7 million individuals may be blocked from opening savings accounts by the way that banks use credit screening data. For example, ChexSystems is a screening tool that tracks fraud and over-withdrawals. Some banks use bad “scores” not just to deny checking accounts, but all accounts, to prospective customers. As a matter of public policy, we must encourage all willing savers to save. A simple solution to this problem, as well as the problem of on-site account opening, would be to enable refund recipients to take a portion of their refund in the form of U.S. Savings Bonds. This could have the added benefit of encouraging longer-horizon savings, provide a cost effective source of fund raising for the Treasury, and reinvigorate the Savings Bond program.

4. *Federal and State governments should encourage research on tax-based savings strategies.* While our experiment was encouraging, it raises a host a questions about how refund-based savings strategies would work. The private sector has largely viewed tax-time as an opportune time to sell tax-advantaged products to high-income Americans facing high marginal tax rates. Neither they, nor governments, have studied the potential for using the \$78 billion in refunds received by low-income families to generate savings or better financial planning.