Vermonters Use of Tax Refunds from 2007 to 2009 to Improve Household Economic Mobility through Savings and Asset Building Expenditures

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A University-based research center located in a northeastern state partnered with the statewide network of Community Action Agencies (CAA) to study household and individual tax preparation and filing practices, including receipt of the Earned Income Tax Credit (EITC), from 2007 to 2009. This study examined how economic standing influences spending and saving patterns of tax refunds and/or credits. Data were collected annually from two sources: (1) a statewide, representative telephone survey of households (n=599-615) and (2) exit surveys completed by clients of the Volunteer Income Tax Assistance (VITA) program, a statewide free tax preparation program of the CAA network (n=1,139). Surveys gathered data on tax preparation and filing practices, receipt of the EITC, spending and savings patterns of tax refunds and/or credits, and economic standing.

Upon receiving a tax refund, individuals and families must decide whether to spend or save the money. A 2007 tax-refund survey found that 32% of consumers planned to save their expected refund, 46% planned to use it to pay obligations such as debts or car repairs, and 3% planned to use the money on non-necessities (McGrigg, 2007). Shapiro and Slemrod (2002; 2003) also found spending, saving, or paying off debt as three common uses of refunds. These studies suggest that tax refunds and credits are most often used to build assets or fulfill financial obligations. One benefit of filing taxes for low income families is the existence of the earned income tax credit (EITC). The EITC was created in 1975 to offset the social security payroll taxes paid by low-income employed parents and to encourage parents to work in the labor force (Brooks, Russell, & Fisher, 2006). Some research suggests that EITC recipients are more likely to spend this money to make ends meet or to improve economic social mobility through asset building rather than saving it (Edwards, 2004; O'Connor, Phillips & Smeeding, 2001). O'Connor et al (2001) also found that recipients with greater access to financial institutions were more likely to save part of their EITC compared to those with less access to financial institutions.

Statewide survey data from the general population shows that 11% were eligible for the EITC compared to 42% of the VITA lower-income population. Of eligible households, 4% of the statewide survey and 14% of the VITA survey did not claim the EITC as part of their taxes. The main reasons given by respondents for not receiving the EITC were that they questioned their eligibility or were not sure how to apply for it. VITA clients seem less inclined to save all or part of their tax refund compared to the statewide population. Only 7% of VITA clients reporting plans to save all of their refund compared to 31% of the statewide survey. Likewise, 10% of VITA clients planned to save a portion of their refund compared to 58% of the general population. Of VITA clients who save money, the main reasons cited by clients for saving were to purchase a house or vehicle, pay bills or property taxes, for education, a vacation, or for an emergency. Of those clients who are not saving money, the main reasons for not saving were that people are not making enough money, are living paycheck to paycheck, bills are too expensive, or they are in debt and cannot save money. VITA clients with greater access to financial institutions (i.e. savings and/or checking account) were more inclined to save their refund compared to those with less to no access to financial institutions ($p \leq .01$).

What impacts a household's tendency to save the majority of their tax refund? Not surprisingly, income plays a roll with 46% of households living approximately at or below 250% of the federal poverty level (FPL) (approximated based on income and family size) – or low to moderate income respondents -saved half or more of their refund compared to 65% of households living above this threshold ($p \leq .01$). Examining saving by households that earn at or more than Vermont's median income or not (approximately $52,000) shows a similar pattern ($p \leq .05$). However, when looking at how income is related to saving 21% to 100% of their tax refund, there is a gap only among Vermonters living at or below 250% of the FPL ($p \leq .05$).

Looking at the other side of economic mobility, how is income related to household spending of tax refund dollars towards consumption based, which can lead to a lower economic mobility, and/or investment based spending, which build assets and human capital? Use of tax refunds for consumption based spending, especially to make ends meet, is much higher among VITA clients (68%) compared to 23% of statewide respondents. Debt reduction spending is also more prominent among 31% of VITA clients compared to 26% of the statewide population. Poor, low and moderate income Vermonters from the statewide survey are also more inclined to use their tax refund on needs oriented expenses ($p \leq .01$). Regardless of income status, between a quarter and a third of all Vermonters report using their tax refund to pay down debt such as a credit card, mortgage or other loans.

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Endnotes

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