Use of Free Tax Services and the Impact of the Earned Income Tax Credit on Saving and Spending Patterns in Vermont: Vermonter Poll 2007

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Introduction

The Vermonter Poll is an annual public opinion survey of Vermont residents who are 18 years of age and older, conducted by the Center for Rural Studies at the University of Vermont, to gauge Vermonter's opinions on current issues of interest to non-profit agencies, government officials, and researchers. On the 2007 Vermonter Poll, seven questions were asked of residents to understand their tax preparation practices, use of refunds and credits, and employment status. More specifically, the Community Action Agencies of Vermmore likely to engage in certain tax preparation practices.

Literature Review: Tax Preparation and Use of Refunds

Tax preparation can cause many challenges for working families, depending on educational level, income level, or simply available time. Although technology has greatly expanded the methods by which families may complete their tax documents, families may still not file. Making ends meet is a difficult and time-consuming task for low-income families (Romich & Weisner, 2000), which increases the burden of tax preparation. One benefit of filing taxes for low income families is the existence of the earned income tax credit (EITC). The EITC is the nation's single most effective poverty reduction program for people less than 65 years old, and was created in 1975 during the Ford administration 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).

eligible to receive this tax credit, many communities offer free tax preparation service to low-income families. Brooks, Russell and Fisher (2006) found that canvassing and word of mouth were the most productive marketing tools for free tax preparation sites (2006).

Still, many others prefer to have their taxes processed by other tax professionals. Long and Caudill (1987) found that upper-income taxpayers, the elderly, and self-employed workers are more likely to use a paid preparer than other taxpayers. The reasons for this relate to the speed of refund and possible liability during an audit. For low-income families, the cost of a tax professional may be a barrier to filing, whereas a higher-income family may view the services of a tax professional as worthwhile since this cost may be relatively insignificant in comparison to their overall income. Still, many families are now opting to file their own taxes, which will maximize their net refund. Zarowin (2006)

Impact of EITC on refund use and asset building
Research suggests, however, that there is a difference in the spending of tax refunds among Earned Income Tax Credit (EITC) recipients compared to those who don't receive the EITC. One study found that EITC recipients are more likely to spend the money than save, and found markedly different seasonal consumption patterns between low-income families and EITC recipient families (Edwards, 2004). The researchers speculated that this spending pattern might have to do with the timing of EITC disbursements, which occur as an expected lump sum at tax time.

Edwards's findings differ slightly from those of a 2001 study, which surveyed low-income Chicago area tax payers (with children) who used a free tax preparation service (O'Connor, Phillips & Smeeding). Of 1,226 respondents, O'Connor, Phillips and Smeeding found that 846 or 69% of respondents expected to benefit from receiving the EITC. The study determined two important uses of the EITC: 1) to make ends meet and 2) to improve economic social mobility through asset building. In the survey the researchers asked respondents to prioritize three uses of the EITC. Across all three priorities, 83% of respondents had a priority to pay bills and 74% prioritized making a purchase of some commodity. Indicating the importance of the EITC as a source of income, only 7% said they would be able to achieve their first priority without the EITC. The study also found that the EITC plays a role in improving economic and social mobility, often through paying tuition, purchasing or repairing a car, or contributing to a move or relocation. In looking at the relationship between EITC and financial institutions, the study 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 (O'Connor, Phillips & Smeeding 2001).

Though the EITC is only available to families in the labor force, a Wisconsin study found no evidence that the EITC increased employment (either participation or hours worked). This may be due to the complexity of the program, the gap in time between performing the labor and receiving the EITC, a lack of awareness about the program, and jobs with inflexible hours (Cancian & Levinson 2006). Though the EITC may not directly impact labor supply, Cancian and Levinson note that it does support low-income working families without deterring labor supply, and so it has positive results.

Strategies to increase filing for the EITC
There are many reasons eligible families and individuals do not always file for the EITC, but there may be ways to increase the number. Kopczuk and Pop-Eleches (2006) found that the availability of state electronic tax filing in the 1990's significantly increased the amount of tax returns. Furthermore, low-income people were more likely to file electronically, and EITC recipients even more likely to file electronically and use the help of a tax preparer than a typical low-income person (Kopczuk & Pop-Eleches, 2006). This suggests that increased awareness, use of technology, and partnership between the IRS and tax preparation services may increase the number of EITC claims among eligible families.

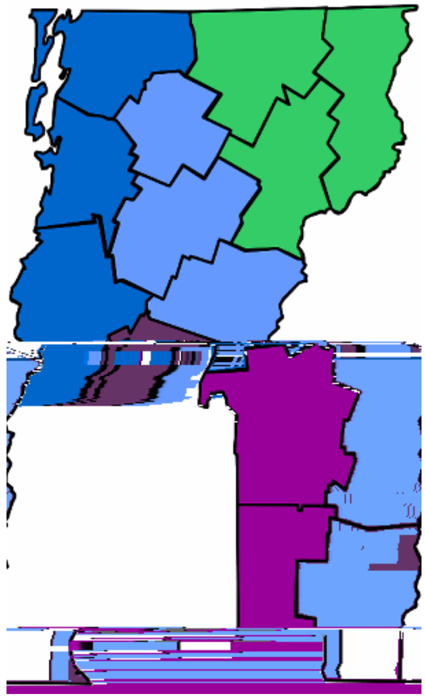
Methodology

The data used in this report were collected by the Center for Rural Studies at the University of Vermont as part of the annual Vermonter Poll. The survey was conducted between the hours of 4:00 p.m. and 9:00 p.m. beginning on February 20, 2007 and ending on February 28, 2007. The telephone polling was conducted from the University of Vermont using computer-aided telephone interviewing (CATI). The sample for the poll was drawn through random digit dialing and used all of the telephone exchanges in the state of Vermont as the sampling frame. Only Vermont residents over the age of eighteen were interviewed. The poll included questions on a variety of issues related to public policy in the state of Vermont. There were 599 respondents to the 2007 Vermonter Poll (Version I). The results based on a group of this size have a margin of error of plus or minus 4 percent at a confidence interval of 95 percent.

The following report presents a descriptive (univariate) analysis of all tax related questions and demographic variables as well as a prescriptive (bivariate) analysis of the tax questions and demographic variables. Data analysis was carried out using the Statistical Package for the Social Sciences (SPSS) 14.0. Statistical tests conducted included the chi square test (x^2), independent sample t-test (t), and a one-way analysis of variance (f). Statistical precision values (p) were determined to be significant if they ranged from .00 to .10, with three levels of significance being represented in this report, including $\leq$.01 (highest significance), $\leq$.05 (moderate significance), and $\leq$.10 (low significance).

Respondent demographic profile
The gender of respondents was evenly split, with 50% (295) of respondents being female and 50% (292) male. The age of respondents ranged from 19 to 89 years with an average of 54 years (Std. 14.4) and median of 55 years. Respondents had between one and nine members in their household, with a median of two members. Thirty-one percent (178) of respondents had children in their household, while 69% (399) did not. Of those households with children, the number of children present ranged from one to five with a median of two children and mode of one child. The number of years that respondents lived in Vermont ranged from 1 to 86 years with an average of 35 years (Std. 19.9). The majority of Vermonters surveyed (52%, 304) had achieved an associate's degree or more education and 48% (277) had taken some college courses or less education, including the completion of their high school education. Fifty-four percent (270) of those surveyed reported earning at or above the median income in Vermont ($50,000 or more), while 46% (230) earned less than the median income. Based on county groupings, Figure 1 shows that 40% (226) of respondents live in the Champlain valley area, 20% (118) live in central Vermont, approximately 15% (84) live in the Southeastern part of Vermont and 15% (82) in the southwestern area, and 10% (57) live in the northeast kingdom (NEK).

Figure 1. Geographic location of respondents



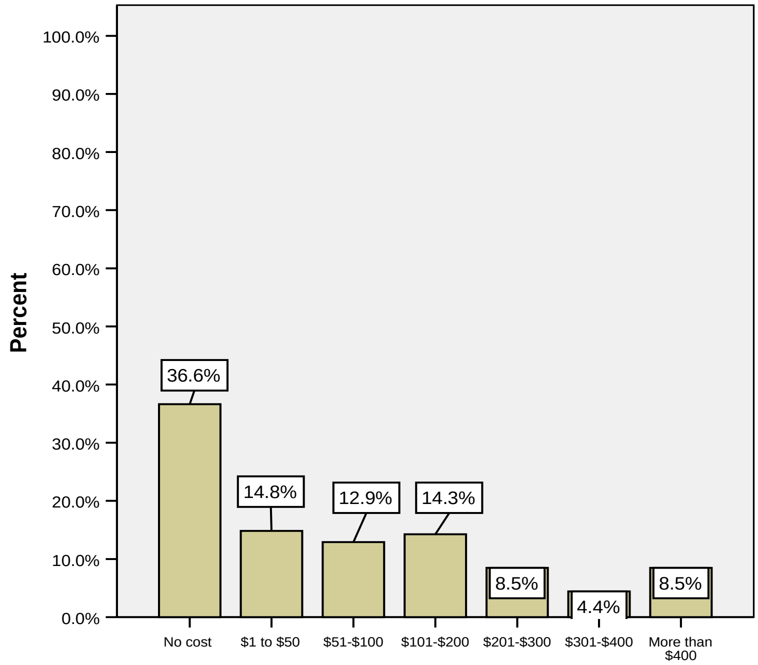
Findings

or lawyer and 21% did them themselves. Further, 12% filed their taxes with a national chain and 8% had a friend or family member work on their taxes.

Table 3. Tax preparation resources used compared by whether or not a respondent used a free tax service

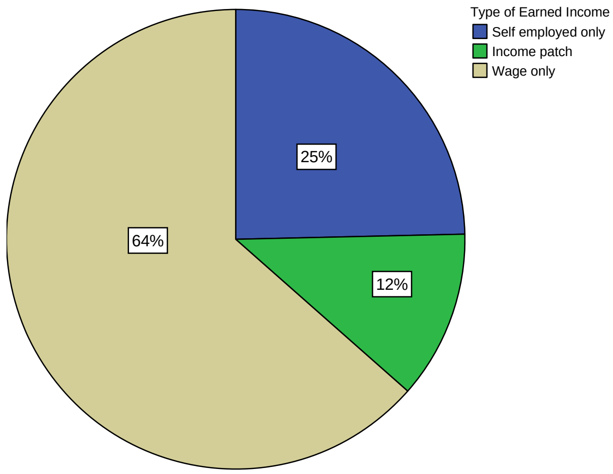
	Used Resource and *did not use* free tax service, %(n)	**Used Resource and *did use* free tax service, %(n)**
A paid accountant/Lawyer	44% (239)	23% (12)
Self-prepared, including the use of a software program like Turbo Tax	36% (193)	21% (11)
A friend or family member	13% (71)	8% (4)
A national tax preparation chain such as H & R Block	4% (19)	12% (6)

Figure 2. Categorized dollar amounts that respondents paid for tax services



(59%, 91) than female (41%, 63) compared to wage earners and income patchers combined, where males and females are equally represented (50% each) (x^2=3.11 p$\leq$.10). An independent sample t-test showed that self employed persons are more likely to be older (average age of 53; p$\leq$.01), have lived in Vermont for a longer period of time (average number years of years is 34; p$\leq$.10) and have fewer members in their household (average number is 2.6; p$\leq$.10).

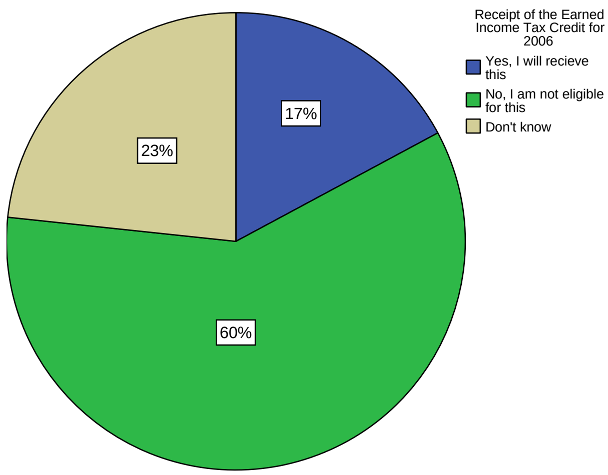
Figure 3. Types of earned income, categorized



Tax practices compared by types of earned income
The chi square test showed that wage earne

Vermont (<$50,000) (22%, 50) compared to 13% (34) of household that earn at or above the median income in Vermont (x^2=7.42 p≤.05). An independent sample t-test showed that receipt of the EITC was also related to being younger (average age of 51; p<.01) and having more household members (average number is 2.7; p<.05). Receipt of the EITC was not related to the demographic variables of education level achieved, gender, geographic location, number of years lived in Vermont, and type of earned income reported.

Figure 4. Whether or not respondent received the EITC for the 2006 tax year



Use of Tax Refunds and Credits

Respondents were asked what they did with their tax refund or credits that they received in their previous or current tax years. In total, 25% (147) indicated that they used their tax refunds or credits to save money in some form, through a savings account, retirement account, or an Individual Development Account (IDA). Thirty four percent (202) of respondents used their tax refunds and credits to pay of debt and bills, while 7% (42) spent this money on a non-necessity item for themselves or family members or donated the money to charity.

Looking at the categorized options, Table 4 shows the percentage of respondents who indicated that they used their refund or credits for the specific purpose given in the far left column. The most commonly given response was to pay off debt (27%, 158), including a loan, house or car payment, home improvement, education, or reinvest into a business. This category was followed by 25% (145) of people who put the funds into savings account, with three people specifying saving the money in an Individual Development Account or an IDA. Nine percent (55) paid off household bills or the cost of fuel and 7% (43) spent the money on a non-necessity item or “luxury” type item such as a vacation or a television. Twenty-one percent (123) reported that they did not receive a tax refund this past tax year.

items or discretionary items) compared to 42% (21) of income patchers and 28% (29) of the self-employed ($x2=14.96$ $p<.01$). Wage earners were also more likely to spend their refund or credit on bills and debt along and non-necessity items alone, compared to income patchers and the self-employed (significance was at the .01 level).

Impact of the EITC on spending and saving patterns of tax refunds

Chi square tests were conducted to determine if receipt of the EITC impacted respondent's spending and saving patterns of tax refunds and credits. Respondents who have hired a paid accountant to do their taxes. Specifically, the self-employed were more likely than those who patched their income or had a wage job only to have paid $101 or more to have their taxes filed by a professional.

Reasons for not using a free tax preparation service

Three central themes surrounded why respondents did not use a free tax preparation service: 1) respondents preferred to pay an accountant, had a friend or family member prepare them, or self-prepared their taxes; 2) were not aware of this service or did not feel eligible; and 3) did not trust a free tax service or felt their taxes were too complicated for a free service. These themes are consistent with the findings of other researchers on why people do not use free tax services (Long & Caudill,1987; Zarowin, 2006).

More specifically, the most commonly given response for not using a free tax preparation service was that respondents preferred to pay for their tax preparation or preferred to use a paid accountant (38%), which is consistent with the findings of Long and Caudill (1987). Many respondents also indicated that they prepared their own taxes, with several noting that they used turbo tax, an online tax program, or another tax software program. Within this category of respondents, some indicated that because their taxes were so simple, they did not need to take advantage of a free tax service. This finding echoes

Predictors of spending and saving tax refunds and credits

A significant relationship was found between saving one's tax return and not having children. On the contrary, spending one's tax

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