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Refunds to Savings Pilot Program

Promoting Tax Time Savings

OVERVIEW
California should amend its state income tax forms to allow filers to purchase savings bonds -- for themselves or their children -- with a portion of their refunds. By making it easier for Californians to save part of their hard-earned refunds, policy makers can help families build the personal safety nets they need to thrive in today's economy. With this change, California would lead the nation in harnessing tax time savings to build families' economic security.

WHY DO THIS?
It's imperative that the State explore new ways to make it easier for Californians to save. Californian's savings may be at their lowest levels ever. Nationally, the savings rate recently dipped below zero and stayed there for over a year. The last time it was that low was during the Great Depression.

Thirty percent of California families don't have enough savings to get by at the poverty level for three months if they were to lose their source of income. That's the fourth highest "asset poverty" rate in the country. Without savings, these families may be one divorce, layoff, or health care crisis away from the streets and government dependence.

For the eight million Californians who receive an average $800 state income tax refund, these tax windfalls present one of their best opportunities to save. California can make it easy for people to save, right on their tax forms, before their refunds are in hand and spending temptations set in.

Linking tax forms to savings bonds makes sense, especially for lower and modest income tax filers. Twenty-eight percent of California adults do not have checking or savings accounts, according to the US Census. Savings bonds—a simple affordable financial product that does not require the buyer to own a bank account—could be appealing to un-banked Californians.

Tax time savings bonds will make it easier for California families to save for their children. Over time, these initial tax time investments could grow into a resource for California youth to draw on to finance education, put towards a down payment on a home, or purchase a car to get to a job. These nest eggs will provide a crucial leg up as these young people enter adult-hood and strive to succeed economically.

HOW WOULD IT WORK?
The goal of this program would be to make it as easy as possible for California tax refund recipients to invest all or some of their tax refunds in a US Savings Bond. Since California would be pioneering this savings opportunity, there are complexities that the California Franchise Tax Board (FTB) and Bureau of Public Debt (BPD)—the federal agency that administers the Savings Bond program-- would need to resolve.

There are essentially three stages to bond purchase:

1) Tax Filer Purchase Decision
The first step would be completed by the filer on the state tax return. Filers anticipating a California state tax refund would be able to purchase a savings bond with their tax refund dollars. This option would be incorporated in the state paper and electronic forms. Filers would provide three pieces of information:

- The name of the bond holder: This could be the name of the individual filer or their child, grandchild, or other family member. Or, the purchase could be limited to the tax filer himself for simplicity's sake.
- The amount of bond purchase: California's split refund option will allow refund recipients to direct their refunds to two destinations. Using this tool, filers will be able to designate the portion of their refund to use for bond purchase. This amount could be stated as a proportion of the refund or an absolute number.
- The series of the bond: Filers will be able to purchase either series I or series EE bonds. Or, only one series could be provided for simplicity's sake.

Address information (for where the bond should be mailed) would be culled from the tax return. Additional information would need to be collected on the tax form if the preference is to send bonds electronically to filers. Filers would also need bank accounts to receive the bonds electronically.

2) State Processing.
The second step would involve a simple collaboration between the FTB and the BPD. The FTB would submit a batch file to the BPD including the name of the bond purchaser, amount, series, and address. At roughly the same time, the FTB would remit sufficient funds to the BPD to fund the bond purchase.

3) Delivery of the Savings Bonds.
Finally, the BPD would then mail the actual savings bonds, in the name of the designated bond holder, to the tax refund recipients at the address provided. This mailing would likely take place 2 to 4 weeks after the tax return was received by the FTB. Or, bonds could be sent electronically.

WOULD PEOPLE TAKE ADVANTAGE OF THIS?
Recent academic research, and much common wisdom, suggests that people will be more likely to save if saving is made easy. This tax time savings initiative aims to apply this logic in order to facilitate the savings of tax refunds. We hope to learn whether in this case facilitating bond purchase will in fact lead to increased saving. We hope to answer the following questions: What is the actual demand for U.S. Savings Bond purchase out of tax refunds? What is the dollar value of the demand? Who opts to purchase Savings Bonds?

Based on a very small pilot study conducted in TY2005 with H&R Block, we estimate that demand could be approximately one percent, roughly equivalent to the national demand for H&R Block's savings products. We expect that the California initiative's differences from the pilot (placing the savings bond option on all tax returns and providing some public information, but not personally selling bonds) will effect demand, pushing it slightly higher or lower.

HOW WOULD THE PROGRAM BE EVALUATED?
A team from Harvard Business School would study the implementation and program outcomes. The evaluation team would document take-up rate and bond investment amounts. In addition, the team would hope to work in co-operation with the FTB and the BPD to analyze tax return data to distill the

characteristics of bond purchasers. Specifically, by analyzing tax data the team would seek to answer a number of questions with policy relevance:

1. Are lower income, EITC eligible, filers more likely to purchase bonds?
2. Are filers without reported dividend or interest income more likely to purchase bonds?
3. Are filers who didn't use direct deposit in TY 2005 (last year) more likely to purchase bonds in TY 2006?
4. Are self-preparers more or less likely to purchase bonds? Is the use of paid preparers associated with higher or lower take-up rates?
5. How long do bond purchasers hold their bonds?

This analysis could be used to inform program improvement and revision and to inform policy in other states and at the national level.

WHAT WOULD THE FTB NEED TO DO?
The FTB needs to take action on five issues:

- Revise the California tax return to include a savings bond option,
- Work with free tax preparation sites and commercial preparers to spread awareness of the new option,
- Develop public information about the bond purchase option,
- Collaborate with the BPD to create a batch file transfer system for bond purchase information,
- Establish a mechanism for remitting bond purchase funds from tax return dollars to the BPD

WHO SUPPORTS AND OPPOSES THIS CONCEPT?
This pilot is supported by the state's largest retail tax preparer—H&R Block—as well the National Community Tax Coalition, the network of free and community tax preparers.

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