



REFUND SPLITTING--

A Low-Cost Way to Encourage Savings and Expand Californians' Control Over Their Tax Dollars

By Anne Stuhldreher, California Assets Fellow

PROPOSAL

To encourage savings, California state income tax forms should be amended to allow households to split their tax refund and direct portions to up to three accounts. The income tax forms would need to be changed to include three "boxes," where tax filers could input account numbers to which they could direct parts of their refunds. Currently, there is only one "box," on the form, allowing tax filers to direct their refund to only one account. New research indicates this simple change can increase personal savings, even for low income people.

OVERVIEW

California sends out refund checks to 8.8 million taxpayers. These tax windfalls often provide families their best opportunity to save. Right now, taxpayers have one choice: the entire refund comes back in a lump sum. If we make it easier for people to save right on their tax forms, to split their refunds into "money to save" and "money to spend," people will save more - perhaps much more.

When a tax filer learns that she's getting a \$600 refund from the state, she should be able to use her income tax form to direct \$300 of it to her IRA, and send the rest to her checking account. She should be able to make these choices before her refund money is in hand and spending temptations are too hard to resist.

The state income tax forms would need to be altered to allow people to direct their refund to more than one account. Taxpayers should be able to split their refunds into at least three accounts. This would permit married couples filing jointly to divide their refunds between a tax-preferred savings vehicle for each spouse and a shared account.

RATIONALE

Tax time is the right time to build savings and assets. For example, sixty percent of California tax filers receive state income tax refunds with a median refund of \$659. The cash infusions California families receive through annual tax refunds are often the best chance they have to save money. However, Californians may spend rather than save their refunds because they lack an easy way to convert a portion of their refunds into savings. Research has consistently shown that the easier it is for people to save, the more they will save.

GIVING CALIFORNIA TAX PAYERS MORE OPTIONS

Refund splitting would give California taxpayers more choice and control over their refund dollars -- while encouraging much-needed savings. People could deposit a portion or all of their refund into an IRA, 529 college saving plan, or a variety of other savings programs. This would give Californians more options for saving their refund dollars and would improve savings rates.

A PROVEN APPROACH: OKLAHOMA PILOT SUCCESS

Community programs in Tulsa, Oklahoma recently launched a refund splitting pilot program. The experiment proved that even low-income tax filers -- those least expected to save, but who have the most need to do so - would use this "splitting" option to save more. Nearly 500 tax filers with average annual incomes of \$13,440 were offered the opportunity to split their refunds -- some could be put in a savings account and the rest would come back in a refund check for their immediate needs. Of the people who were offered the opportunity, about one-third wanted to participate. People deposited \$583 on average -- 47 percent of their refunds -- into savings accounts; 75

percent of these individuals had no prior savings. This research was conducted by the Harvard Business School and the University of Kansas.

FEDERAL ACTIVITY

The federal government has already committed to allow splitting by the 2007 tax year. California could lead the nation by enacting this proposal at the state level now, thereby allowing families across the state to take advantage of a proven strategy to increase savings and give taxpayers more choices for their tax dollars.

The IRS is taking immediate steps to ensure that all appropriate tax forms and their programming, processing, and testing system are revised to support the splitting of tax refunds. To accomplish this, several policy and technical issues must be addressed and resolved in the near future to permit changes to tax forms for use during the 2007 tax filing season

FOR MORE INFORMATION:

Anne Stuhldreher.

California Assets Fellow

New America Foundation – California Program

(415) 596-6138 phone

Stuhldreher@newamerica.net

www.ca-assets.org