

# Tax Time and Beyond

Future Directions for Advancing Financial Security



## Summary

Tax time is a unique and critical opportunity for financially vulnerable people to build financial security. While there have been some efforts to build financial security at tax time, more can be done to help people take advantage of the tax time moment. Tapping a wide range of perspectives, Commonwealth conducted research to better understand the opportunities and challenges for achieving large-scale, positive impact on people's financial lives at tax time. Our research uncovered promising directions for future efforts, including opportunities to:

- Broaden our definition of financial security at tax time.
- Consider interventions focused on behavior outside the tax preparation moment.
- Build a business case for financial security at tax time.
- Engage partners that have not typically been involved in people's experience at tax time.
- Re-purpose familiar, high-quality consumer experiences towards building financial security at tax time.
- Consider state policy opportunities in the short-term to address pain points and demonstrate the viability of federal policy change.

This report first provides an overview of the tax time landscape to illustrate the importance of the tax moment to building financial security. Then, it summarizes our research process, details the insights we generated, and explains how these insights might inform future approaches to advancing financial security at tax time.

## Background

### Why tax time?

Come January each year, millions of American households prepare to file their income taxes. Financially vulnerable households—who may have limited or no tax liability and/or qualify for tax credits—commonly file for and are due tax refunds. In 2017 the IRS issued more than \$300 billion in refunds, which represents a huge volume of funds flowing through the financial system and the economy.<sup>1</sup> At the household level, these refunds are often the single largest lump sum people will receive all year. This significant windfall, happening at the same predictable time each year, presents a unique opportunity for financially vulnerable people to build financial security.

### The state of tax time

Americans filed over 150 million federal income tax returns in 2016.<sup>2</sup> Over 85% of tax filers submit their returns electronically. Most people seek out professional assistance for tax filing; in 2017, about 60% of e-filed returns were filed by tax professionals and about 40% were self-prepared.<sup>3</sup> Despite the fact that over 70% of tax filers are eligible for free tax filing assistance from IRS-provided resources like its Free File partnership, Volunteer Income Tax Assistance (VITA), and Tax Counseling for the Elderly (TCE) programs, only a combined 6 million people file through these free methods.<sup>4</sup> Across all return types and preparation methods, the average cost per return is \$210.<sup>5</sup> Some evidence suggests that recipients of the Earned Income Tax Credit (EITC), the federal government's largest anti-poverty program, are charged more on average; one study found that low-income EITC filers could expect to pay between \$309 and \$509—or between 13% and 22% of their refund total.<sup>6</sup>

Over 70% of taxpayers (111 million) received refunds from the IRS in 2017.<sup>7</sup> The average refund amount was \$2,860 in 2016.<sup>8</sup> Consumers face a complex landscape of messages and decisions about what to do with this windfall. Commercial tax preparers, retailers, and consumer product marketers spend millions of dollars on advertising about ways for people to quickly receive and spend their refund. This advertising is often centered on instant gratification and a “get money now” message, which may work against efforts to build financial security. Tax time decisions are further complicated by their close connection with other dynamics in people's lives, as tax status and eligibility for tax benefits are tied to household or family structure, educational and healthcare needs and access, and immigration status.

The tax preparation industry is dominated by a few large players and is otherwise highly fragmented. Around half of industry revenue is generated by the four largest companies (H&R Block, Intuit, Jackson Hewitt, and Liberty Tax), while 75% of all tax preparation firms are non-employers—mostly neighborhood operators serving a small number of filers in their communities.<sup>9</sup> New players like financial technology companies have yet to meaningfully disrupt the industry but may represent a credible threat to established large companies. For example, Credit Karma recently began offering free federal and state tax return filing.<sup>10</sup>



## Commonwealth's past work at tax time

Commonwealth's work on tax time financial security, which spans over a decade, informed our research process. One major stream of this work has been advocating for the availability of high-quality tools that facilitate saving directly through the tax filing process. Our test of giving tax filers the ability to split tax refunds into multiple accounts helped lead to the creation of IRS Form 8888, which is now available to every tax filer.<sup>11</sup> Commonwealth also piloted and supported "tax time savings bonds": Series I U.S. Savings Bonds that can be purchased through Form 8888 using a portion of a filer's refund.<sup>12</sup> Tax time savings bonds are safe, fee-free, interest-bearing, and giftable, making them a good option for tax filers without a bank account or for those who wish to save for a loved one's future. Since 2009, tax time savings bonds have been purchased over 200,000 times and generated over \$100 million in savings.

*"SaveYourRefund uses the excitement of prizes to motivate filers to save and gives tax preparers a fun way to start a conversation about saving."*

Commonwealth has also used prizes as an engagement strategy for tax time savings. For six years, we have operated SaveYourRefund, which offers the chance to win a prize for any tax filer who splits and saves at least \$50 of their federal tax refund using Form 8888.<sup>13</sup> SaveYourRefund uses the excitement of prizes to motivate filers to save and gives tax preparers a fun way to start a conversation about saving. Over 15,000 entrants have saved nearly \$13 million in its first six years. In 2018, building on the lessons of SaveYourRefund, Commonwealth partnered with another nonprofit, EARN, to test a prize-based tax time savings promotion on their digital platform, SaverLife.<sup>14</sup>

## Our tax time research process

Drawing on these tax time experiences, Commonwealth set out to think expansively about the tax time opportunity and potential strategies for broader-scale impact. We conducted secondary research to identify learnings from past initiatives, consumer and industry challenges, and outstanding questions. We interviewed eleven experts including representatives from community tax preparation, commercial tax preparation and software, and leading research and policy organizations. We convened an advisory group with experts from a range of perspectives—including human-centered design, venture capital, community tax preparation, and FinTech—to provide more in-depth expertise and guide our efforts in a series of working meetings over a six-month period.<sup>15</sup> The following sections detail what we learned and how these insights might inform future approaches to advancing financial security at tax time.

## Key research on financial security at tax time

Past research has sought to 1) better understand tax time financial behavior and 2) help people leverage this moment when they have the resources to act and are already thinking about their finances to meet financial goals, like building savings or paying down debt. Below are a few initiatives and findings relevant to our research process:

- **Refund to Savings (R2S)** is a large, randomized controlled trial conducted on TurboTax Online Freedom Edition. R2S studies the impact of embedded prompts in tax software that use behavioral economics techniques like choice architecture, anchoring, pre-commitment, and goal setting. Among many other findings, these nudges increased the rate and amount of saving and the likelihood of a refund still being saved after 6 months.<sup>16</sup>
- The **U.S. Financial Diaries** project tracked the financial inflows and outflows of 235 low- and moderate-income households for a year. It provided insight into the volatility these households experience—including at tax time—and the varied ways, both formal and informal, that people save.<sup>17</sup>
- **Common Cents Lab and Digit** conducted an experiment studying the effect of "pre-commitment" on refund saving. The test asked one group of Digit users what percentage of their refund they would like to save before they received the refund and another group at the time the app detected the refund in their checking account. Pre-committers were more likely to save and saved more than those in the control condition.<sup>18</sup>
- Since 2015, the **Consumer Financial Protection Bureau (CFPB)** has worked with VITA and commercial providers to identify ten "promising practices" to promote tax time saving and worked with a VITA cohort to implement them.<sup>19</sup>
- **Prepare and Prosper, Center for Economic Progress, and Holt Solutions** partnered to conduct an extensive evaluation of best practices for helping VITA tax filers to save. The evaluation found, among other things, that many people choose to save their refund after they receive it, and that larger refund size, past refund saving, and greater integration of financial capability services within a tax site were all associated with greater likelihood to save.<sup>20</sup>





Several themes about the opportunity to impact financial security at tax time emerged from our expert interviews, secondary research, and advisory group meetings.

**1. Defining and measuring “savings” is a persistent challenge.** Time and again, we heard about the different ways that people can choose to set aside money and different ways people understand their own savings behavior. Is there a certain amount of time that money must be kept aside to be considered “saving”? Or does money even need to be formally set aside at all? Pre-paying bills, giving money to a trusted neighbor to hold, keeping extra funds in a checking account, or buying in bulk can all be forms of saving, and these behaviors would not be captured in any easily trackable bank statement or data feed. Further, a focus solely on savings may be insufficient, as there are many other activities, like debt repayment, that improve financial security.

**2. The complexity of tax preparation makes introducing financial security topics difficult.** Taxes can be intimidating and complicated. During the filing process, tax filers may be focused on completing the task at hand and may have scarce cognitive resources to think about saving or other financial topics not immediately relevant to their taxes. Private preparers and paid software often introduce products and offers that are not relevant to financial security. Therefore, the tax preparation process might not be the right moment for these interventions.

**Tax time and the changing nature of work:** The complexity of tax preparation may increase as more workers participate in the “gig economy” or other non-traditional earning arrangements, which can drastically change the meaning and experience of “tax time.” A recent Commonwealth study, however, found that among low-wage workers surveyed, those in non-traditional arrangements were actually less likely than those in more traditional arrangements to express concern about filing their taxes.<sup>21</sup> More research is needed to better understand the challenges and opportunities related to the changing nature of work and tax time financial security.

**3. The increasing reliance on software means that it is a key pathway to impact at scale; at the same time, tax software “real estate” is costly and hard to gain access to.** Across all channels, and in part due to the complexity described above, software is increasingly essential to tax filing. As such, access to software is critical to achieving impact in the tax moment. R2S has shown how low-touch, low-cost nudges in tax software can influence behavior and change the structure of decisions to promote financial security. Software changes also have the advantage, as one of the subject matter experts put it, of “taking the human out of the equation” and are scalable across entire platforms.

On the other hand, tax preparers and software providers have a business interest in maintaining simplicity and minimizing “friction” to keep filers moving through their user flow as quickly as possible. They may be unlikely to adopt changes that do not have both direct and immediate business value (by generating profit) and demonstrated customer demand.

**4. Framing and messaging matter.** Communication strategies can impact behavior. Since consumers are bombarded with messaging about how to spend their refund at tax time or told that spending is saving (e.g. save money on your next purchase), the framing of a tax time financial security offer or incentive must be effective to compete. While motivators are not universal, some messages have been more effective than others. For example, encouraging people to set savings goals can help them actualize desired behavior. Messaging about emergency saving was most effective in the R2S experiment. Children can be a powerful savings motivator for parents. The timing of communication is also important, as many filers have decided what to do with their refund before arriving at the tax site or beginning the filing process.

**5. The current federal policy environment is challenging, but policy issues intersect with tax time in important ways.**

Commonwealth’s experience with Form 8888 and the passage in the past decade of legislation such as the Affordable Care Act, the PATH Act, and the Tax Cuts and Jobs Act demonstrates how federal policy changes can have a major impact on people’s experience at tax time. Experts noted that the current environment at the federal level may be challenging for initiatives promoting tax time financial security, but it is still a powerful mechanism for impact at scale and an active thread of work for many advocacy organizations. Meaningful state-level policy change is another possible and promising avenue for change.



## Future Directions

Based on this research, we designed conceptual solutions to better understand how the above insights might play out in the real world. These “paper prototypes” tested out ways to intervene outside the tax filing process, to leverage new players in the tax time moment, and to reframe the financial security “offer” at tax time. We sought feedback from financially vulnerable consumers and from our advisory group on the prototype solutions. This feedback helped us identify and refine the following promising opportunities or approaches for future efforts to build financial security at tax time.

As a field of stakeholders interested in tax time financial security, we can:

- 1. Broaden our definition of financial security at tax time.** Interventions that expand the traditional definitions of “savings” and test new ways to define and measure financial security can foster innovation. New interventions could target behaviors like paying down debt or pre-paying bills. We see opportunities to test new tools to understand tax time behavior and measure impact, like bank account transaction data or the CFPB’s Financial Well-Being Scale.
- 2. Consider interventions focused on behavior outside the tax preparation moment.** The tax preparation process is crowded with information, decisions, and offers. There are opportunities to intervene at other times, such as before tax season begins or when their refund lands in their account. For example, a well-framed pre-commitment offer that links to the refund’s eventual arrival to the consumer leverages both time points. An area ripe for additional research is exploring what might be the most effective timeframes for intervention. How far in advance of the filing process can you talk about taxes? How long after a refund lands is an effective moment to prompt action? What messaging might resonate at these different time points?
- 3. Build a business case for financial security at tax time.** A successful tax time financial security intervention through the tax preparation or financial services industry must demonstrate a business case strongly linked to the business objectives of individual industry players. While some providers might be looking for short-term profit only, others may be open to a broader approach. For example, it might be beneficial to encourage tax prep companies to move beyond a one-time “compliance” approach to tax time to view it as an on-ramp to a year-round relationship, or even a consistent annual moment happening across decades of someone’s life. With this perspective, it might be easier to argue that a customer’s financial security is in the company’s business interest as well as a social good.
- 4. Engage partners that have not typically been involved in people’s experience at tax time.** While tax preparation and software providers have an obvious connection to tax time financial security, they are not the only option. Financial institutions and FinTech companies should have an interest in being part of a consumer’s tax-time journey. Instead of only selling or referring software or acting as a passive receptacle for refunds, these actors could take a more active role in helping their customers use tax time and their refunds to meet their financial goals. The field should think more creatively about the role these prospective partners could play.
- 5. Re-purpose familiar, high-quality consumer experiences toward building financial security at tax time.** Retail and technology companies create user experiences that successfully drive sales and keep consumers coming back for more. How might we apply insights from these industries towards the goal of building financial security? For example, what might it look like to use a tax refund to “buy” financial security? How might we use text messaging to enable people to set goals prior to filing and allocate their refund once it arrives? How might the ability to digitally “gift” saving drive tax time financial security? Testing different user experiences around building financial security at tax time – including the timing, framing, and tangibility of offers – could yield impact and insights.
- 6. Consider state policy opportunities in the short-term to address pain points and demonstrate the viability of federal policy change.** State policy opportunities could include pursuing regulation to require price transparency for tax preparation services, enabling the “splitting” of state tax refunds into multiple accounts, or advocating for explicit links between existing statewide initiatives aimed at wealth-building, like child savings accounts or state-administered “auto-IRA” retirement programs (such as Secure Choice in Illinois and California), and the tax time moment (e.g. state tax credits for contributing to child savings account). If successful, these state policy changes could lay the groundwork for national reforms.



## Conclusion

Tax time is a unique opportunity for millions of financially vulnerable people to build financial security. We set out to better understand this opportunity from the perspective of many different stakeholders, and our efforts uncovered promising insights that can inform and strengthen future approaches to promoting tax time financial security. We look forward to working with cross-sector partners in the field to continue to design, test, and scale solutions to drive greater impact at tax time.



## Appendix

### Advisory Group Members:

<i>Name</i>	<i>Organization</i>	<i>Title</i>
Marla Blow	FS Card	Chief Executive Officer
Arlyn Davitch	Walmart Brand Incubation	Brand President/GM
Carsten Erner	FS Card	Senior Director, Credit Risk & Research
Tim Flacke	Commonwealth	Executive Director
Haydee Moreno		Independent Consultant
Karama Neal	Southern Bancorp	Chief Operating Officer
Jimmy Zhu	Citi Ventures	Vice President, Venture Investing

### Subject Matter Experts:

<i>Name</i>	<i>Organization</i>	<i>Title</i>
Steve Holt	Holt Solutions	Principal
John Thompson	CFSI	Chief Program Officer
Rebecca Thompson	Prosperity Now	Project Director
Ross Yednock	CEDAM	Program Director
Stephen Roll	Center for Social Development	Research Assistant Professor
Krista Holub	Intuit	Program Manager
Dan Turrentine	H&R Block	Vice President & Chief Government Affairs Officer
David Marzahl	Center for Economic Progress	CEO
Dave Sieminski	CFPB	Policy Analyst
Justin DiTrollo	Jackson Hewitt	Head of Financial Products & Marketing Analytics
Ida Rademacher	Aspen Institute, Financial Security Program	Vice President & Executive Director



## Notes

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3. <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-29-2017>
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13. [www.saveyourrefund.com](http://www.saveyourrefund.com); for the past three years of the promotion, Commonwealth has partnered with America Saves, a campaign of the Consumer Federation of America, [www.americasaves.org](http://www.americasaves.org)
14. See forthcoming publication on our pilot test with EARN
15. See Appendix for list of subject matter experts and advisory group members and their affiliations
16. R2S is conducted by the Center for Social Development at Washington University in St. Louis and Duke University. <https://csd.wustl.edu/OurWork/FinIncl/financialbehavior/R2S/Pages/Refund-to-Savings1.aspx>
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