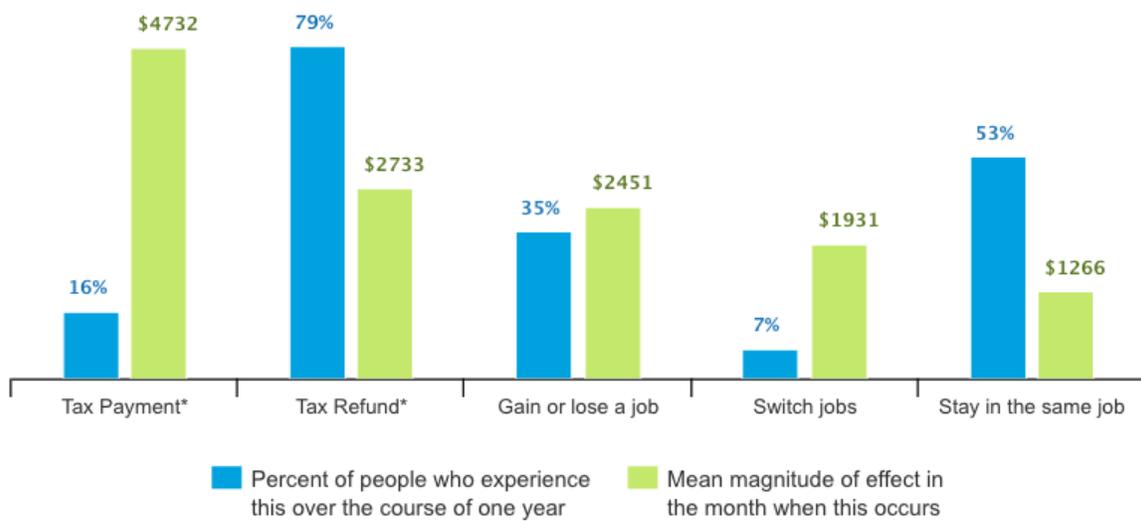


## Taking the financial stress out of tax time

Tax time is a stress on family finances. It requires many of us to sum up our finances and fill out a myriad of forms by April 15th (or April 18th this year). But the process of filing a tax return is only half the stress. The actual financial transaction of receiving a tax refund or making a tax payment is often the single largest financial transaction families experience in a given year and a significant contributor to financial volatility.

The JPMorgan Chase Institute recently analyzed the financial impacts of tax time using an anonymized sample of core Chase checking account customers, and this yielded a surprising insight: on average, tax payments and tax refunds are even larger in magnitude than the absolute change in income individuals experience when they gain, lose or switch a job (Figure 1 below). Tax payments and refunds explain a significant amount of the volatility in income and spending on an aggregate basis (Figures 2 and 3 below). This volatility matters because it is hard to manage.

Figure 1: Frequency and Magnitude of Impact of Tax-Related Transactions Compared to Employment Outcomes



\* Tax payment and refund data calculated based on Brookings Institute EITC Interactive data 2013

Source: JPMorgan Chase Institute

Figure 2: Sources of Volatility in Aggregate Per Capita Monthly Consumption

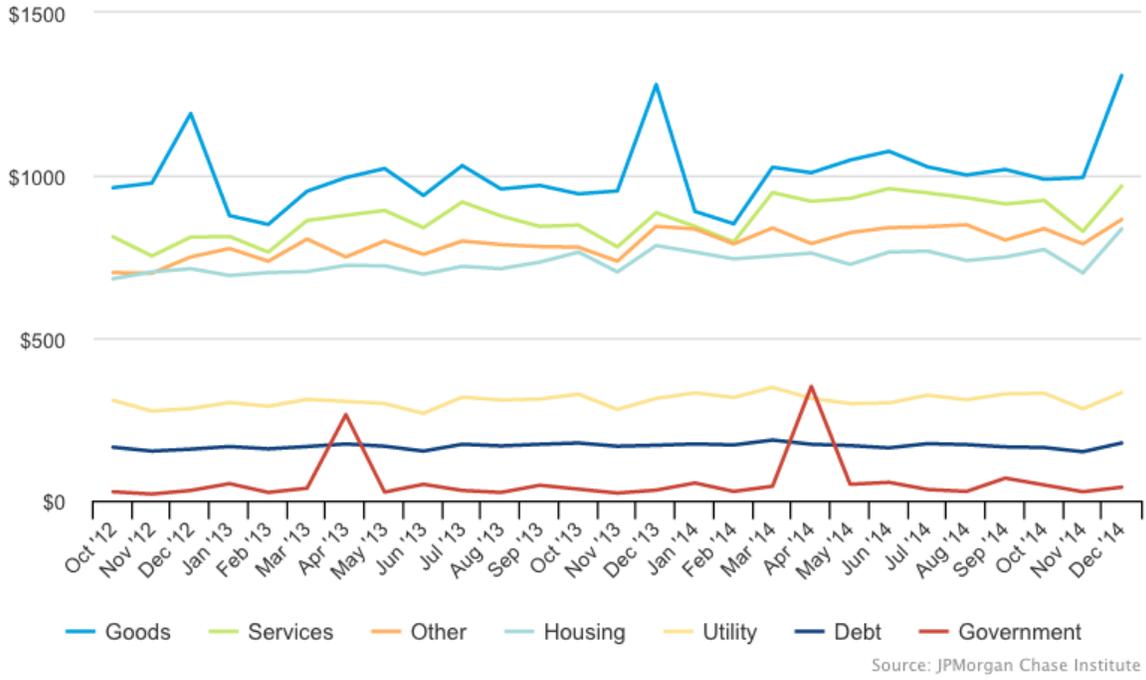
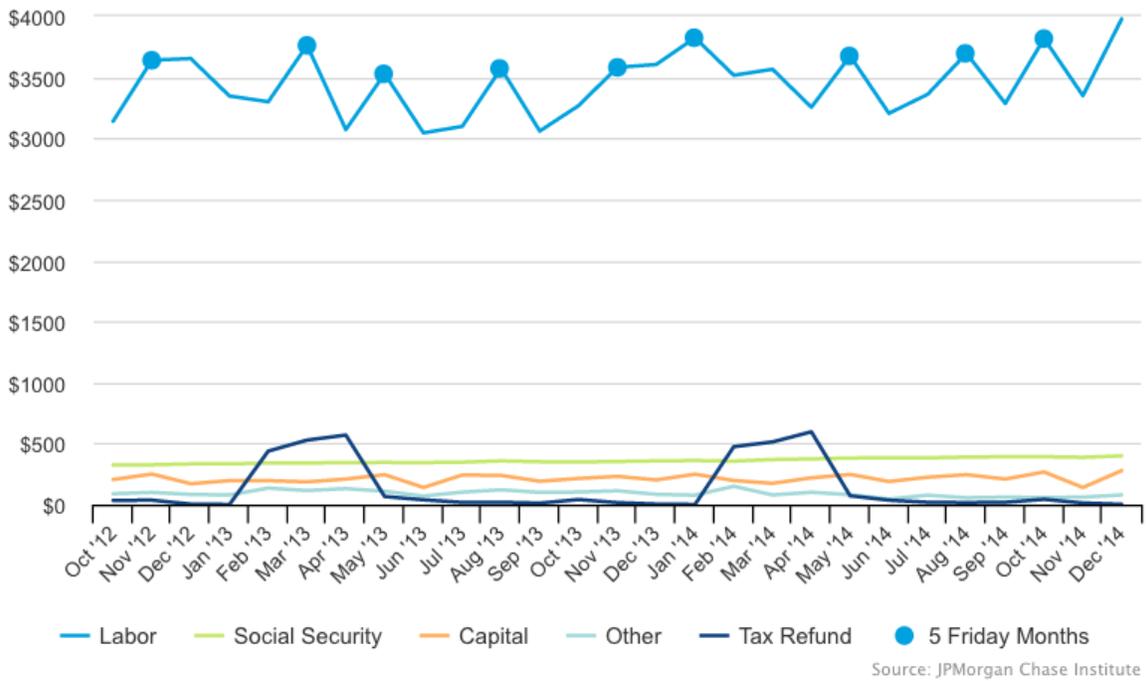


Figure 3: Sources of Volatility in Aggregate Per Capita Monthly Income



Tax payments, which often represent a large portion of individuals' incomes, can be difficult for people to make. Even if we assume only families in the top two income quintiles make tax payments, a tax payment of \$4,732 represents almost 4 percent of total income for these families, and they have to pay it out in one go.<sup>1</sup>

The [rapid growth of the Online Platform Economy](#) and [alternative work arrangements more generally](#) further complicate this story. Labor platforms, such as Uber and TaskRabbit, tend to attract lower income individuals, and these employment opportunities do not typically withhold taxes from take-home pay. As a result, [more lower- and middle-income individuals might find that they have to make tax payments and might even owe tax underpayment penalties](#). Innovations to predict and automatically withhold or save taxes owed could help contingent workers avoid owing significant payments at tax time.

Even tax refunds are stress-inducing, however. With an average refund for all tax filers of \$2,733 in 2013 and a maximum EITC refund of \$6,143 for a family with three or more dependents, tax refunds are often the single largest lump-sum payment that households receive all year. According to [2013 tax year data](#) and the [Consumer Financial Protection Bureau](#) (CFPB), 79 percent of tax filers received a tax refund—including 27 million households who received the Earned Income Tax Credit (EITC) and 85 percent of households with incomes less than \$50,000. Many used the extra cash to pay for school, replace a home appliance or even take a vacation. But a recent [study](#) showed that low- and middle-income families spend less than half (43 percent) of their tax refunds within the next six months. They save 57 percent of their tax refund, using 43 percent to pay down debt and otherwise saving the remaining 14 percent. Not surprisingly, individuals with more unsecured debt were significantly less likely to save any of their tax refund.

These statistics are striking for two reasons. First, they suggest that people need the money they receive from tax refunds to cover their daily expenses. And, it is important to note that if individuals had access to those funds at more regular intervals, they might be able to mitigate their debt obligations.

Second, these statistics indicate that, despite the debt overhang, saving at tax time is a major opportunity: for the average individual who saves 57 percent of their tax refund, that represents over \$1,500 of savings. To put this number into perspective, [we found](#) that median income households fall \$1,800 short of the \$4,800 liquid asset buffer necessary to withstand 90 percent of the adverse income and spending shocks they experience, and households in the lowest income quintile are \$1,000 short of the \$1,600 liquid asset buffer they need. At a time when [real wages have been in decline](#) and [income volatility has been increasing](#) for most workers, tax refunds are a great opportunity for many low- to middle-income families to start—and maintain—a level of savings that could provide a lifeline to weather financial storms.

It is one thing to demonstrate the opportunity to save, but it is quite another to encourage people to put money aside. To that end, a number of innovative public sector and nonprofit programs, neatly

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<sup>1</sup> This assumes a family income of \$129,006 for the 80th percentile family according to the 2014 Current Population Survey.

summarized in a [toolkit](#), encourage families eligible for the Earned Income Tax Credit (EITC), and other low- to middle-income recipients, to save rather than spend their tax refunds. But getting people to save their tax refund has proven difficult. Even in successful programs, participation rates are often low and the size of the impacts often small, especially given the amount of resources dedicated to changing behavior.<sup>2</sup>

While behavioral economists and nonprofits work together to identify the most effective ways to encourage tax-time savings, it is also important to consider alternative paths. Why not reduce the volatility by paying out tax refunds in installments rather than in a lump-sum payment?

Two notable proposals already exist along these lines. The Corporation for Enterprise Development (CFED) has proposed a nudge in this direction with their [Rainy Day EITC](#), whereby individuals can elect to receive 20 percent of their EITC payment six months later, with a 50 percent match. Similarly, the Center for Economic Progress piloted the [Chicago EITC Periodic Payment Pilot](#), in which individuals received half of their estimated EITC refund in four payments during the EITC tax year. They found that 90 percent of individuals who received the periodic payments preferred them over a lump sum.<sup>3</sup> Moreover, individuals who received regular payments accumulated less debt; paid fewer late fees; and, most importantly, experienced lower financial stress.

Instructively, it is worth noting that the Advance EITC, in which individuals could receive a portion of their EITC in every paycheck, was eliminated with the passage of the Education Jobs and Medicaid Assistance Act of 2010. An [analysis of the program](#) documented that only 3 percent of eligible individuals had opted into this program and that compliance with program requirements was low. Key lessons and design questions emerge from this failed experiment. Should we make periodic tax refund payments the default option for individuals with an opt-out option? Should the periodic refunds come during or after the tax year? Should all or some people be eligible for periodic installments? Should there be a savings incentive attached? A simple opt-out program to pay tax refunds in installments could give four-in-five families a substantial, recurring income stream that might be a promising way to get low- to middle-income earners on a path to greater financial resilience.

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<sup>2</sup> For example, [Refund 2 Savings](#), the largest saving experiment and evaluation in the United States, encouraged savings by using motivational prompts (e.g. “Do you have enough money for an emergency?”) and prepopulating saving allocation fields to anchor individual’s response (e.g. 50% of the tax refund) within the TurboTax application. This increased the percentage of people who saved any portion of their tax refund by roughly 1 percentage point (from roughly 8% to 9%). The CFPB allied with Volunteer Income Tax Assistance programs to provide tax preparers with materials and strategies to encourage filers to save. The [CFPB reports](#) they were able to double the percentage of filers who deposit a portion of their tax refund into a savings account from 1.5 percent of filers in 2012 to 3.1 percent in 2014 and 2.5 percent in 2015. Not surprisingly, providing incentives to save seems to increase the percent of people who save their tax refund. [SaveUSA](#) increased the percentage of individuals with any short-term savings 18 months after tax time by 7 percentage points by rewarding participants with a 50 percent match at the end of a year if they maintained a minimum balance in a separate savings account.

<sup>3</sup> This result contrasts with [historical evidence](#) that individuals prefer a lump sum tax refund over regular installments, but, given the low take-up rates in the Advance EITC, which used to pay out refunds in regular installments, most individuals surveyed have never received their refund in installments.

*The JPMorgan Chase Institute is committed to delivering data-rich analyses and expert insights for the public good. Our reports, [Weathering Volatility](#) and [Paychecks, Paydays, and the Online Platform Economy](#), highlight the demographics and sources of income and consumption volatility and how Americans are prepared to weather these changes.*