Convenience May Be Necessary for Widespread Pension Participation by the Poor

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Introduction

How hard will low-income taxpayers work to increase their tax refund? Apparently, not very hard. With limited effort, low-income taxpayers could often increase their overall tax refund by using the deduction for an IRA or other qualified retirement plans in conjunction with the Retirement Savings Contribution Credit, or "Saver's Credit," but this would require setting up and funding a separate pension account if one did not already exist. Funding this account is relatively simple because by using Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*, the funding can be directly allocated from the current year's tax refund if that return is filed and the account is funded by the regular April due date.

In the first 6 weeks of the 2011 filing season (for Tax Year 2010), some 83 taxpayers at a Southwest Texas Volunteer Income Tax Assistance (VITA) site operated in a publicly open credit union were offered the opportunity to receive two stages of tax planning with regard to increasing their tax refund through the use of IRA deductions and the Saver's Credit before filing their tax returns and before the April deadline. Only five people (6 percent) accepted the second, specific stage of free counseling and of those, three (4 percent of people, 60 percent of those counseled) opened a retirement account. Of those who were eligible for a pension deduction but did not further fund a retirement account, (11/48 =) 23 percent did not fund a retirement account because it was too inconvenient to open an account at their bank or to keep track of an account at the credit union *where they were having their tax return prepared*. This phenomenon existed even with taxpayers who had windfall refunds, defined as refunds in excess of the amount of the refund that they expected to receive.

Following this field experiment, convenience was examined further. A controlled exercise was performed where accounting students in the treatment condition could choose between getting a hypothetical tax refund of $270 or funding an IRA of $1,000 and receiving a larger hypothetical refund of $1,370 with one extra step—acquiring the signature of the college department secretary, a task that normally takes about 5 extra minutes. Students should choose the larger refund, ceteris paribus, yet a significant number of students whose instruments required initials to select the higher refund chose the lower refund or did not acquire the required initials, even at the vague risk of less extra credit.

Literature Review

Neo-classical Economics, Behavioral Economics, and Pension Savings

Discounted utility theory predicts that taxpayers act rationally, as though market friction exists (Bohm-Bawerk, 1970). So, people will always optimize their overall wealth, except where individual random error occurs. Benartzi and Thaler (2007) challenge the idea that people make strictly rational choices and have the willpower to carry them out; instead, they assert that people use heuristics and welcome help with self-control. Bodie and Prast (2009) find that a combination of multiple behavioral biases and the complexity of life-cycle savings models often lead to suboptimal decision making for pensions. In pension plans, making participation in 401(k)s the default option increases participation sig-

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nificantly (Madrian and Shea, 2001; Choi, 2004, 2002). Madrian and Shea (2001) found, for example, that enrollment of new employees with an opt-out plan reached 90 percent, versus 20 percent under the previous, opt-in plan.

Benartzi and Thaler (2007) discuss education to improve savings rates, but find little evidence that education is effective in increasing participation or savings rates. Carroll, *et al.* (2005), while offering a single asset allocation and holding the savings rate constant at 2 percent, were able to increase the participation rate in 401(k)s from 9 percent to 34 percent by making the enrollment extremely simple.

In 2005, participants of the Urban Institute roundtable on retirement policy called for more research on low-income savings behavior (Bell, *et al.* 2005). Camp, *et al.* (2009) found that on average, those with low income prioritized retirement savings above entertainment and clothing, but below travel and cable/cell/internet—even with the Saver's Credit in place. Culture may be one factor in the retirement savings rate. Bell, *et al.* (2005) found that a large percentage of Hispanics do not participate in pension plans. Weinberger (2005) notes that (at that time), the U.S. had a spending—not savings—culture. However, that paradigm shifted somewhat in the Great Recession (Spencer and Chambers, 2012).

Weinberger (2005) asserts that people do not save for retirement because many households lack the available funds to begin saving. But, citing Hogarth and Anguelov (2001), Gale, *et al.* (2004) state that "60 percent of households at or below the poverty line indicate that they save at least something." Further, Sherraden (2001) finds that poor families will save something if presented with appropriate incentives. Even the very poor frequently save, although their portfolios of assets and debts are more complex and volatile than those with more resources (Collins, *et al.,* 2009). Still, the scarcity literature ties being poor to a number of suboptimal conditions, and actually reduces the cognitive function of individuals (as we are in that condition) from how we would otherwise function (Mani, *et al.,* 2013). Scarcity is stressful, and has been linked to poor decisions in many areas of life. Mullainathan and Shafir (2013) assert, "[t]he poor fall short in many ways. The poor in the United States are more obese. In most of the developing world, the poor are less likely to send their children to school. The poor do not save enough. The poor are less likely to get their children vaccinated. The poorest in a village are the ones least likely to wash their hands or treat their water before drinking it. When they are pregnant, poor women are less likely to eat properly or engage in prenatal care" (p. 153). Being poor is hard work. The poor have to make more financial trade-offs (Spiller, 2011) and those trade-offs do not necessarily pay off (Van Ittersum, *et al.,* 2010). The poor in the United States, however, do have federally sponsored programs to assist them in life, including free federal income tax preparation.

The Volunteer Income Tax Assistance (VITA) Program

VITA is a program sponsored by the Internal Revenue Service (IRS) in conjunction with community partners to encourage federal income tax compliance among low-income taxpayers. Taxpayers bring their tax information to a VITA site, and if they qualify for the program, a trained volunteer prepares the current year's tax return based on the information provided by the taxpayer, and (once approved by the taxpayer) electronically files the return and prepares a copy for the taxpayer. The amount due is remitted to the IRS by the taxpayer, or a refund due is calculated. If a refund is due, the taxpayer has the option of directly depositing that refund into one or more accounts, including an IRA account if the taxpayer has one established. If the taxpayer has provided information on contributions to a retirement account (either directly, or as shown on the W-2), a retirement savings credit ("Saver's Credit") is automatically calculated, which increases the amount of refund (or decreases the amount of tax currently due).

The VITA program is increasingly active in the Coastal Bend. In the 2009 Tax Year (2010 Calendar Year), the VITA partnership in the Coastal Bend filed 1,289 low-income tax returns (compared to 806 for the previous year), with refunds returned to the community of $1.9 million (up from $1.1 million for the previous year).

The Saver's Credit

The Retirement Savings Contributions Credit or "Saver's Credit" was enacted in 2001 for the 2002 Tax Year as Internal Revenue Code (IRC) Section 25B to encourage middle- and low-income taxpayers to save for retirement. Specifically, "[t]he credit was designed to address the fact that more than 75 million workers and their spouses have no employer plan coverage, to help correct the top-heavy distribution of benefits in our current pension system, and to counteract what might be the central defect of our pension tax incentive structure: that the incentives—whether exclusions from income of contributions and earnings or tax deductions—are based mainly on the individual's marginal income tax rate or tax bracket," (Iwry, 2003).

Taxpayers contributing to employer-sponsored plans, traditional IRAs, Roth IRAs and/or self-employed qualified retirement plans get a nonrefundable credit of up to 50 percent on the first $2,000 of contributions to this plan *in addition to* applicable tax deductions (or exclusion from income if the plan is administered by an employer). The percent of credit available is tiered, and is reduced as income increases. The contribution used to figure the Saver's Credit is reduced by any (taxable or nontaxable) distributions in the current year, two previous years, and following year from qualified retirement plans that are not rolled over (IRS, 2012). To receive the Saver's Credit, a taxpayer must be 18 or older and cannot be a full-time student or claimed as a dependent on another's return. The credit is nonrefundable. So, those in very low tax brackets or in the zero income tax bracket cannot financially benefit from the credit. While the Saver's Credit applies where a taxpayer has invested in any of a number of retirement savings vehicles, there are a number of qualifying programs and the provisions of each are complex and often confusing. This confusion may extend by association to the Saver's Credit itself. Weinberger (2005) testifies that "savings incentives are most effective when they are clear and understandable, coupled with low-cost, accessible savings vehicles, linked to refunds and facilitated by a knowledgeable tax professional" (p. 8).

Awareness of the Saver's Credit is low (Spader, *et al.,* 2011). Camp, *et al.* (2009) surveyed 105 taxpayers entering a VITA site and found that only two were familiar with that credit. According to Duflo, *et al.* (2006), education alone is insufficient to optimize taxpayer adoption of retirement plans. Referencing a matching experiment they performed, they say, "a simple model of fully informed, rational savers is incomplete. Take-up rates were not only far below 100%, they never exceeded 20%, even among tax filers (whose pension contributions were matched at 50% and) who had substantial refunds, participated in other savings vehicles, or had higher incomes" (p. 1314).

The Saver's Credit is historically underutilized (AARP, 2008). Koenig and Harvey (2005) found that 34 percent of eligible taxpayers failed to claim up to $496 million dollars in Saver's Credits. For the 2007 Tax Year (the most recent year available from the IRS at the time of the field experiment), approximately 65.6 percent of the population had a small enough Adjusted Gross Income (AGI) to qualify. In that year, 5,862,206 individual taxpayers (4.1 percent) filed for the Saver's Credit. Therefore, 61.5 percent of all individual taxpayers are eligible for this credit but do not claim it. This percentage is staggering, and represents a key opportunity for improvement of individual savings. However, since the credit is nonrefundable and does not carry over to other tax years, individuals may not receive the Saver's Credit at the full rate. Those making between $20,000 and $50,000 in AGI had the highest Saver's Credit participation: 10.2 percent of individual taxpayers in this income bracket received a Saver's Credit that averaged $167.87 per taxpayer. For the 2010 Tax Year, taxpayers claimed just over $1 billion in Saver's Credit on more than 6.1 million individual income tax returns. Saver's Credits averaged $204 for joint filers, $165 for heads of household, and $122 for single filers (IRS, 2012). The Saver's Credit may interact with other credits. In some cases, additional pension savings reduce AGI, which increases the amount of the refundable Earned Income Credit. However, this benefit may be offset at least in part by the nonrefundable portion of the Child Tax Credit.

Ramnath (2014) finds that taxpayers are good about not gaming the credit by setting up a retirement plan, taking the credit, then withdrawing the pension. However, he finds that some taxpayers bunch deductions for AGI to maximize the percent of credit, but this phenomenon may occur after taxpayers realize they are eligible for the credit.

Spader, *et al.* (2011) studied the Saver's Credit in a VITA site. In their study, researchers attempted to partner with employers and VITA staff to educate employees about this credit and enroll them in suitable pensions. Ultimately, one employer participated, enrolling about the same number of employees that the employer normally enrolls during a comparable time period. The authors also attempted to recruit local financial institutions to provide suitable retirement savings accounts at the VITA site, but were unable to do so in time for filers to claim the credit until the following tax year. The authors conclude that "[a]lthough respondents were interested in both saving for retirement and the incentives associated with the credit, limited resources and uncertain incomes created obstacles to building and protecting retirement savings" (p.1). Finding an appropriate investment vehicle is potentially tricky. H & R Block "put on a full-court press to advise our tax clients and develop a low-cost 'Express IRA….' As a result….nearly a quarter of a million clients opened a new IRA through [Block]. A majority were first-time savers with an average income of $27,000 a year; two-thirds were Earned Income Tax Credit recipients; and half were considered 'unbanked'" (Weinberger, 2005, p. 6). That firm was subsequently sued by the State of New York, accused of fraudulent business practices involving those IRAs because of the high fees and very low interest rates on those accounts, making them almost certain to lose money (Ellis, 2006). Block subsequently settled the suit by refunding all fees on Express IRA accounts beginning with the 2000 tax year and paying $750,000 in fines and other costs to the state (Lipka, 2010).

Duflo, *et al.* (2006) performed a large-scale field experiment that measured the adoption rate and amount of contribution to an IRA when, unlike the Saver's Credit, a 0-percent, 20-percent or 50-percent match was immediately deposited directly into an IRA (rather than reducing income tax liability) as an incentive to save for retirement. They find that "taxpayers were much more responsive to variation in matching rates in our experiment than to equivalent variation in the incentives embedded in the Saver's Credit" (p. 1314). When a retirement savings amount was matched at 20 percent or 50 percent, the take-up rate for retirement savings was 10 percent and 17 percent respectively, and the average amounts of contributions were 4–8 times higher than for those whose savings were not matched. They believe that taxpayers prefer the matching to the Saver's Credit because it is simpler and more salient than the Saver's Credit. The authors conclude that tax preparer assistance, financial incentives, and information are likely influential factors in taxpayer adoption of pension savings plans at tax time, although the one-time aspect of matching in their experiment may also be significant. Subsequent to that experiment, the law changed to allow all taxpayers the opportunity to use part of their income tax refund to save for the prior tax year's retirement, increasing the refund immediately if the refund is directly deposited before the regular tax filing deadline.

In this paper, two experiments are performed. One provides the taxpayer with knowledge of these tax breaks and manipulates the ease of accessibility to savings vehicles over the normal population. The ease of accessibility comes in two forms: (1) the counseling and tax preparation physically took place in a credit union that accepts new accounts and where opening an account generally took about 15 minutes; and (2) counseling was framed toward savings from refunds, and especially saving from the nonbudgeted, refund windfall that happens when refunds are higher than what a taxpayer originally expects. The second experiment studies the effect of convenience on choosing to receive a hypothetical tax refund.

Examples of Saving from a Windfall Tax Deduction and Saver's Credit

Low- and middle-income families may have very little disposable income, and may have budgeted how they will spend their expected tax refund. However, a tax refund in excess of the budgeted amount would seem to be a natural opportunity for additional savings, because this money would not represent a planned sacrifice on the part of taxpayers. For example,

Scenario 1:

Suppose a taxpayer with no qualified retirement plan (hereafter, "IRA") expects a $2,000 refund, which he plans to spend. (Note: the average refund for taxpayers up to $50,000 in AGI was $2,005 for 2007.) Suppose after preparing the tax return, the taxpayer is due $2,200; this is a $200 windfall to the taxpayer. The taxpayer could receive $2,200 in the current tax filing season, and spend at least $2,000 of it as planned.

Scenario 2:

Suppose instead, the same taxpayer is encouraged to put the extra $200 windfall into an IRA for next tax year, spending the original $2,000 as planned. (That is, there's no real sacrifice from what the taxpayer expected to spend if the taxpayer saves the windfall amount.) The taxpayer will receive and spend $2,000 in the current tax filing season, and receive both a tax deduction and a Saver's Credit on $200 for next tax year. If the taxpayer is in a 15 percent marginal tax bracket (as most in the $20,000—$50,000 AGI bracket are), then the taxpayer receives a (15%*$200=) $30 tax deduction and up to a $100 Saver's Credit,[2] for a total of $130 additional refund for next year. Notably, of the $200 set aside in savings, the taxpayer gets $130 back next year; he's lost only $70 of spending power but has an extra $200 in savings for retirement—and it was from money he never originally expected to receive. Further, if the taxpayer was prepared to file early, he could make a refund allocation for a $200 IRA for the current year instead of next tax year, and that $130 would be returned to him this year (almost immediately) instead of next year.

[2] 50 percent of $200 = $100. The Saver's Credit ranges from 10 percent to 50 percent, decreasing with income. For 2013, the 50-percent credit applies to joint filers with income up to $34,500; the 20-percent credit applies to joint filers with income between $34,500 and $37,500; and it is 10 percent for those between $37,500 and $57,500.

Scenario 3:

Suppose instead, the same taxpayer saved not only the original $200 windfall for retirement, but also the additional $130 tax refund from the windfall. He can still spend the anticipated $2,000, but his retirement savings would increase to $330 with no material sacrifice to his expected spending. This additional Savings may in turn qualify for more deductions/credits.

Hypotheses

The Field Experiment

An experiment was designed to educate low- and middle-income taxpayers about pension deductions and the Saver's Credit immediately prior to tax preparation, with customized counseling available after the preliminary draft of a taxpayer's return was prepared. Those receiving additional education should save more than they were planning on saving before the counseling. Expressed as a hypothesis:

H_1: Counseled taxpayers will increase their retirement savings significantly.

To control for the efficacy of the counseling, those not saving will be asked why, and their answers will be used to answer the research question:

R_1: Among those eligible for tax deductions (and potentially the Saver's Credit) who do not increase their retirement savings, why did they decline to increase their retirement savings?

The Class Experiment

Additionally, a controlled experiment among college students currently enrolled in the federal tax classes were provided with an extra-credit assignment near the end of their semester. Students were given a choice between getting a hypothetical tax refund of $270 or funding an IRA of $1,000 and receiving a larger hypothetical refund of $1,370 with one extra step: acquiring the signature of the college department secretary, located in the same building as the students' class, who was available during normal working hours (including Tuesday hours until 7 pm for night students). This task normally takes an additional five minutes. Students in the control condition received the same instrument, except that they simply chose which refund they wanted, without needing to procure the secretary's initials. (See Appendix 2 for both instruments.) The null hypothesis is:

H_2: There will be no significant difference in the number of participants electing the higher refund between control and treatment groups.

Methodology

The Field Experiment

In the first 6 weeks of a 12-week tax filing season in 2011, in an urban credit union (open to new members) serving as a VITA location, VITA was run as normal with an additional free service: taxpayers could, on a voluntary (and as available) basis, receive education on the Saver's Credit as it specifically applied to their particular income tax situation for the current tax year.[3] When early-filing taxpayers walked in to the appointed site(s) at the available time(s), they were offered free counseling on pension deductions and the Saver's Credit, with a (second-stage) chance to demonstrate the specific dollar amount on the individual's tax return prior to electronically filing that return. Duflo, *et al.* (2006) found that the level of enthusiasm in counseling (and who the tax preparer was) mattered. To avoid this complication, the same counselor was used for all taxpayers. Those not wanting the additional level of service were asked why, and these reasons were aggregated based on frequency. Those accepting the additional level of service were asked their expected level of refund, then had their initial federal income tax return prepared without additional pension savings, and then received tailored counseling based on their savings goals and amounts available (generally from their tax refund) for funding additional pension contributions during the current year. These sessions were generally meant to take about 15-20 minutes and answer the question, "what if I saved $x?" Because refunds may take 6 weeks to process and tax

[3] See Appendix 1 for details.

refund allocations to pensions must be made before the April filing deadline, this counseling offer ended 6 weeks before the April filing deadline. If taxpayers wished to pre-fund retirement savings for the next year, then they were advised to set up the IRA, and return to have their 1040 recalculated and filed timely. Unlike Spader, *et al.* (2011) this set-up process took an estimated 15 minutes, and could be done in the same building on the same floor as the income tax return preparation. Also unlike Spader, *et al.* (2011), taxpayers could receive their credits on the income tax return being prepared at that time. It was also possible for taxpayers to use refunds to fund savings for the next tax year, but no taxpayers openly elected this option. All participants' files were subject to strict nondisclosure protections, consistent with the more stringent of the applicable AICPA or IRS rules. The number of taxpayers electing a tailored round of counseling was ultimately too small to be analyzable, and one of the primary reasons for not electing to save for retirement was convenience. To investigate convenience more deeply, a second experiment was developed using college students at a mid-sized public university as respondents. While low- and middle-income taxpayers are different from college students, both may value convenience, and Walters-York and Curatola (1998) have validated the use of students for experimentation.

The Class Experiment

At the end of the spring semester in 2011, an extra-credit experiment was distributed in class where 41 tax students in three classes (two junior classes and one masters' level class) could choose between getting a hypothetical tax refund of $270 or funding an IRA of $1,000 and receiving a larger hypothetical refund of $1,370.[4] Both the $270 scenario and the $1,370 were realistic, rounded estimates of a particular hypothetical taxpayer in a position to benefit most from the tax incentives provided for pension savings, based on the tax law in effect in 2011. The clear choice for students is a refund of $1,370: with a $1,000 IRA investment, tax liability was reduced $1,100, meaning that if $1,000 of this amount funded the IRA, the cash refund available to spend still increased by $100. Students in the control condition merely returned the document with their choice. Students in the treatment condition needed to take one extra step to secure the higher refund amount—acquiring the signature of the college department secretary, a task that normally takes about 5 extra minutes. The students were given enough time in class to complete the instrument and up to 1 week to turn the instrument in. The amount of extra credit offered was left an intentionally vague, "up to 10 points" to motivate making the obvious (larger refund) choice among all groups. Ultimately, all students who participated received the 10 points (2.5 percent of the final grade), regardless of response. Differences between the responses of the two groups were analyzed using t-tests.

Results

The Field Experiment

Eighty-three taxpayers at a Southwest Texas VITA site housed in a publicly open credit union were offered the opportunity to receive tax planning to potentially increase their tax refund through the use of IRA deductions and the Saver's Credit before filing their tax returns and before the April deadline. Sixteen people originally agreed to counseling. Of these, 58 percent were female (with one nonrespondent), 60 percent had a high school degree, and 40 percent had some college (with 4 nonrespondents), their self-reported experience level averaged 2.7 on a 5-point scale. Fifty-eight percent of them were aware of the IRA tax deduction but only 15 percent were aware of the Saver's Credit. All were banked (with one nonrespondent). Five people (6 percent) accepted the free counseling and of those, 3 (4 percent of people, 60 percent of those counseled) opened a retirement account. Of those who qualified but did not open a retirement account, many did not because it was too inconvenient to open an account at their bank or to keep track of an account at the VITA location credit union *where they were having their tax returns prepared* (Table 1).

[4] See Appendix 2 for details.

TABLE 1: Results of VITA Counseling Field Experiment

	Number	Percent
Taxpayers Approached	83	100%
Less: Taxpayers Ineligible for Pension Deduction (Retired, Disabled, Student, Over Income Limit, Unemployed)	32	39%
Eligible Taxpayers Approached	51	61%
Counseled Taxpayers Who Increased/Opened (New)Pension Savings Account[1]	3	4%
Eligible Taxpayers Declining Additional Pension Funding	48	57%
Reasons Taxpayers Did Not Want Additional Pensions:		
1. Happy Savers: Pension Already Maximized or Happy with Current Pension Savings Level	12	14%
2. Inconvenient to Set Up/Increase Funding for Pension	11	13%
3. Destitute/Large Bills	10	12%
4. Nonspecific Reasons	5	6%
5. Owed Tax/No Tax Liability	3	4%
6. Miscellaneous Reasons for No Counseling @ 1 Answer Each	7	8%

[1] Five taxpayers went through two stages of counseling, but only three increased funding for pensions.

The Class Experiment

A total of 96 students participated in the experiment; 46 were in the control condition where they could claim the higher refund conveniently, and 50 were in the treatment condition, where they could claim the higher refund only by taking an extra step of securing initials from the department secretary, which added inconvenience. In the control condition, 44 of the 46 (96 percent) opted for the higher refund, but in the treatment condition where a minor inconvenience was required, 58 percent chose the higher refund. In the treatment condition, 8 of the 50 (16 percent) claimed the larger refund but did not secure initials; 21 of the 50 (42 percent) claimed the larger refund with the initials, complying with the experiment instructions. There was no significant difference between the results of day students and night students.

The difference between conditions in choosing the higher refund is significantly different from zero at $p \leq .05$, before considering whether initials were also included where necessary, thus refuting (the null) H_2 (Table 2).

TABLE 2. Effect of Convenience on Students*

Treatment Group	Low refund	High refund	High refund and initials	Total respondents
Convenient Condition–no initials needed	2	44	N/A	46
Inconvenient Condition–initials needed to legitimately get higher refund	21	29	21	50

* Difference in those choosing a Low Refund by condition is significant at $p \leq .05$. One respondent in the Inconvenient Condition checked both the Low and High Refund box, and had no corresponding initials. This response is excluded from the table above.

That is, only 42 percent of the treatment group (versus 96 percent of the control group) chose the higher refund *and* did the 5-minute paperwork to legitimately get the extra-credit as applicable, indicating that like in the field experiment, even minor inconveniences seem to matter.

Discussion

The IRA deduction requires an account in a bank (or bank-like) institution, which is a deterrent to the unbanked. While an employee who funds pensions through payroll withholdings is eligible for the Saver's Credit, the establishment of a pension account is generally facilitated by the employer. The continuing contributions generally require little, if any, effort on the part of the employee because they are automatically withheld and accounted for by the employer or the employer's designee. Discomfort with bank accounts or distrust of banks may be a reason for underfunding pensions among the poor, but less credible among tax students. Distrust of banks may be due in part from experience with banks that are perceived to be charging numerous high fees, eroding the benefit of (sometimes meager) interest

on savings through a formal institution. Fields and Jackson-Randall (2012) note that 8.2 percent of households are unbanked. Those households cite irritation over banking charges and a loss of confidence in traditional institutions as reasons for eschewing banks. In this experiment, however, none of the respondents admitted to being unbanked, so through circumstance rather than design, being unbanked should not be a significant factor in these results.

It is possible that the education on the Saver's Credit and pension deductions increased savings for a subsequent year. Perhaps taxpayers changed course, but wanted time to digest the information presented without delaying their refund. A limitation of this study is that the author did not measure the effect of savings on future years. However, people have a bias toward immediate gratification (Bodie and Prast, 2009), so a delayed savings may be unlikely to be frequent or large in amount.

The income tax effects of pensions are complex and hard for many to understand. Many taxpayers may be unaware of the credit, or, if aware, not understand the size of the impact this could have on their return. For this reason, a general counseling session was offered to taxpayers, after which they were aware of the credit and the general range of benefits. If the taxpayers then elected a second, tailored counseling session, they were shown the size of the impact that pension tax breaks had on their current-year return.

Taxpayers may already have plans for their refund money. The field experiment controlled for this by asking taxpayers what their expected refund for the year was. Once an amount was given, taxpayers were asked how much was earmarked for a specific use. Arguably, the rest of the refund was discretionary and could be used for pension savings. Where refunds exceeded the budgeted amounts, it makes sense to financial professionals that taxpayers would be open to funding pensions with at least the excess "windfall" amount because taxpayers do not have plans for this portion of the refund money yet and their overall wealth generally increases. Even so, eligible taxpayers as a rule did not additionally fund pensions.

Some of the taxpayers appear to be living hand-to-mouth. No encouragement to save for the long run is likely to be more persuasive than the need to buy medicine, pay rent, or put food on the table today. Ten of the 83 people we approached (12 percent) answered that they were in this category. While that is a sizable percentage, it is still a minority reason for not funding pensions. Further, 12 respondents (14 percent) of the 83 not only saved for retirement, but met their retirement savings goals, indicating that it is possible for many low- to middle-income taxpayers to be frugal, and perhaps "rich enough" in their own eyes when it comes to retirement savings.

Eleven of the 83 (13 percent) cited the lack of convenience for not saving. This reason does not appear to be remedied by education, either through counseling at the VITA center or in a classroom setting. Lack of convenience appears to be a significant deterrent to savings even among those students specifically educated in accounting, finance, and taxation. Taken together with the field results, this finding adds to literature that challenges the long-held wisdom that the poor do not save simply because they can't afford to. They also apparently do not save because it is inconvenient. Spader *et al.* (2011) list "little effort required to set up or make ongoing contributions" (convenience) as the fourth most important factor influencing whether savers saved (7.7 percent). They then note that among those *not* already saving, convenience was listed as more important than savers had listed it. Perhaps tolerance for this type of inconvenience is a significant factor distinguishing savers from nonsavers. Complexity can appear at many points in the account process. Gale *et al.* (2004) assert that the lack of easily accessible bank routing numbers for many pension investments is a barrier to contributions. Spader *et al.* (2011) find that too many asset-building choices overwhelm clients. Lack of simplicity has indirect effects as well. In Brookings (2004), Goldberg notes that Saver's Credits would be marketed more aggressively if they were not complicated.

Some might consider lack of savings if inconvenient as laziness or exhaustion or being already overwhelmed with the demands of life. *Why* convenience was important was not measured but it appears to be more important than may be commonly thought and appears to impede savings even when the poor can afford to save. Levitt and Dubner (2011) predict that respondents will act irrationally. The key is to determine if they are acting predictably irrational, and to leverage that irrationality. Scarcity theory suggests that all people, in a condition of scarcity, are more myopic and less able to make good (long-term) choices due to "limited bandwidth," or bounded discretionary intellectual capacity to make difficult decisions. Mullainathan and Shafir (2013) cite examples of how poorer farmers are less likely to purchase insurance and poorer Americans are hesitant to purchase health insurance (Medicaid), even though these populations

are least likely to be able to withstand negative economic shocks without this insurance. The reduced capacity presents as both diminished intellectual capacity and depletion of self-control. Education is of limited usefulness in the presence of limited bandwidth, but "economizing on bandwidth can yield high returns" (p.175).

Applying scarcity theory to saving from tax windfalls, lack of savings would be expected, and tailored education would be expected to have only a limited effect on the decisions of poorer households. The takeaway from this may be that in a time of reduced corporate and governmental pension sponsorship, poorer taxpayers have both a greater need for private pension savings *and* a reduced capacity to meet that need. Any tax policies designed to assist this group in saving for their retirement may work best if the savings account for contributions were very convenient to set up, funded in times of financial excess (if any), and funded at small, frequent interim deadlines.

The convenience effect, however, is not limited to the poor; university student participants also place a high premium on convenience by possibly forgoing real extra credit and hypothetical money for convenience sake, indicating that like in the field experiment, even minor inconveniences seem to matter.

Why Do People Value Convenience So Highly?

These experiments show that respondents value convenience in the extreme—not *why* they value convenience so highly. There is literature in psychology and in marketing that, while not tested in accounting domains, may explain this behavior. Maybe the rewards seem distant to respondents. Trope and Liberman (2000) predict that people will make the high-level choice when thinking about the distant future, but make the convenient (low-level) choice when making choices for the near future. McCrea, Liberman, Trope and Sherman (2008) find that events that are distant in time are construed more abstractly, and result in more procrastination than proximal, concrete events. This theory would account for the low retirement savings, but perhaps not the extra credit results.

Framing may come into play. Pension availability becomes affordably available at the end of a working life, and extra credit becomes useful at the end of the semester. Chandran and Menon (2004) found that the temporal framing matters: "day framing" makes risk appear closer and more concrete than "year framing," which increases the perception of self-risk, and precautionary behavior, anxiety about the behavior and effectiveness of risk communications. However, what works for risk (which increases anxiety about behavior) may not be as effective for rewards. That is, day framing effects of behavior might be more effective in stopping negative behaviors than in inducing positive ones.

While gaming was not found by Ramnath (2014) on a large scale, Camp *et al.* (2009) note that such an opportunity is available: if a $1,000 contribution results in a $500 tax credit, then the taxpayer immediately withdraws the $1,500 total at a 10-percent penalty (plus 10-percent FIT rate), the taxpayer is ahead by ($1,500 - $150 penalty - $150 FIT - $1,000 original investment =) $200. Similarly, taxpayers may be gaming the government systems in other ways by keeping their traceable savings low because some social programs like Food Stamps and Temporary Assistance for Needy Families reduce aid for IRAs, but not for employer-sponsored retirement plans.

Muravan, Tice and Baumeister (1998) argue that self-regulation is a limited resource subject to depletion. Prior exertion of self-regulation leaves less strength for future self-regulation. Baumeister, Vohs and Tice (2007) find that this phenomenon exists across many domains including spending, intelligent thought, and decision making. It is also influenced by blood glucose levels. Similarly, Vohs, Baumeister and Schmeichel (2008) found that making many choices impairs subsequent self-control, including reduced persistence in the face of failure and more procrastination. So, assembling documentation for tax preparation (or attending class/filling out extra credit surveys) may deplete one's tolerance for any extra effort or decision making. This explanation is consistent with low take-up rates for Saver's Credits and extra credit work. Lee and Zhao (2014) found that consumers preferred highly desirable products for the long run and convenient products for the short run, but reminding consumers of the convenience premium in the short run leads consumers to better short-run decisions; and framing convenience as added value leads consumers to more convenient long-term decisions. Karlan *et al.* (2010) find that reminders also increase savings.

MyRA and State Initiatives

In early 2014, President Obama announced that the U.S. Treasury will develop "My Retirement Account" (MyRA) for low- and middle-income employees to safely, simply, and affordably save for retirement. These retirement savings accounts are expected to be available in late 2014.

While the final details were not yet announced as of the writing of this paper, several key account features are public. Account principal will be made by after-tax dollars, and plan rules will mimic those of Roth IRAs, except that there will be no account fees. Principal will initially be guaranteed by the full faith and credit of the United States and interest will be paid at the same variable rate as the Government Securities Investment Fund of the Thrift Savings Plan for federal employees. Accounts will be available to anyone with an annual income of less than $129,000 a year for individuals and $191,000 for couples. Participating employers may distribute MyRA information. Employees will sign up online and fund the account with a minimum contribution of at least $25. Additional regular contributions of at least $5 per paycheck will automatically be withheld and deposited into the individual employee's account by the employer, but otherwise the employer will not contribute to, be charged for, or administer the retirement program. After the plan is established, employees may rollover MyRAs to private-sector retirement accounts, and *must* roll it over once the MyRA reaches $15,000 or has been in place for 30 years. Principal contributions can be withdrawn tax free at any time, but earnings will generally be taxed unless the taxpayer is at least 59 ½ years old.

Several of these features would appear to facilitate pension saving among low- and middle-income taxpayers. The security of the principal and lack of fees ensure that, even at a low interest rate, amounts set aside for retirement will be available for retirement as long as they are in the public program. The MyRA employees forgo the discouragement that many employees saw when they actively saved in the stock market, but lost principal in the market decline of the Great Recession. Nor do they lose principal to fees. While contributions do not incur an exclusion or tax deduction up front, they will still often qualify for the Saver's Credit, and, as a Roth IRA, will generally be financially better for participants than traditional IRAs. As an IRA account (instead of a company-sponsored pension plan), the savings are portable in an economic environment where job changes are common. Further, the ability to make principal withdrawals without taxation is attractive, because the funding of the pension does not require a long-term sacrifice to liquidity that may be needed to sustain a subsequent financial shock. For taxpayers who are more risk-taking, the MyRA can be rolled over into a private plan, although private plans generally have higher initial account balances. Both mental and tax accounting for the plan are simplified. Mental accounting is facilitated because the money is saved before it is even seen. Employees also commit ahead of time to future contributions; the commitment has been shown to increase the amount saved in the mental accounting literature. Further, contributions in small, regular amounts match the receipt of income, consistent with mental accounting theory. Tax accounting for the Saver's Credit is arguably simplified, because an employer-sponsored plan may be shown in Box 12 of the W-2 reporting as a Roth IRA contribution, although such details are not yet certain. However, tax software products will need to be sensitive to this new account and automatically calculate the Saver's Credit (much like the Earned Income Credit is calculated automatically) in order for taxpayers to receive the maximum benefit from this plan.

Some states are also investigating whether to offer retirement accounts to private sector employees without current access to pension plans (Bradford, 2014). In 2012, California and Massachusetts enacted legislation to create state-sponsored IRAs that required no employer contribution for at least some employees not currently covered by employer plans. The idea is being studied in Oregon and Colorado. State involvement is supportive of continued federal government efforts.

Third-Party Tax Preparation Changes May Help

Tax software programs have been historically capable of this, as shown by their ability to maximize such complicated tax breaks as education exclusions/deductions/credits. It would be a feasible step for the software companies to include the MyRA calculation, and it's also feasible that some may similarly calculate how much more a taxpayer would need to contribute to a qualified retirement plan (perhaps up to the original refund amount) in order to minimize their tax liability for the year. A prompt could be added to the program (at least for early filers) that compares the taxpayer's current results with those of the tax minimization with an additional retirement credit and asks if the taxpayer would like to split their refund to accomplish that result.

Weinberger (2005) declared the Saver's Credit a success in part because "it leverages tax time to promote savings" (p. 6). In Brookings (2004), Weinberger calls tax time for many clients "a once-a-year financial check-up when they have their records…" (p 22). Spader *et al.* (2011) also suggests prescreening taxpayers at VITA sites who are potentially eligible for the Saver's Credit by having such parameters integrated into existing tax software.

Limitations and Extensions

This study has several limitations and possible extensions, including possible extensions to the Saver's Credit in general. This study used a field experiment. Field experiments can be very useful for validating theory in real life. Goldberg (Brookings, 2004) said that when we think about tax incentive programs, "we tend to pay a lot of attention to the theory and, at least in my view, not enough attention to how it's going to work out there when you're interacting with real folks trying to cope with real rules" (p. 15). On the other hand, such experiments tend to have a low sample size—undermining the extent to which they truly represent the diversity of the real world. In this experiment, 83 taxpayers were approached, and only 51 were eligible for the Saver's Credit. In Spader *et al.*'s (2011) experiment, only 15 employees enrolled in the retirement plan following the start of the intervention. Additionally, in field experiments, it's more difficult to control for extraneous factors than in a lab experiment. In Duflo *et al.* (2006), the authors felt that the framing of the presentation by the tax professional to the taxpayer was very important. In this experiment, the same CPA presented to all the tax professionals, minimizing (but not eliminating) the variation in the presentations. The presentation included information on qualifying retirement investments, including traditional and Roth IRAs available at the credit union where the tax returns were being prepared, but no specific investment was recommended. If the taxpayer elected to open an account at the credit union, that deposit would have been federally insured, but other accounts may not be. Weinberger (Brookings, 2004) finds that taxpayers highly valued deposit insurance.

Taxpayers may have found the VITA site intimidating, or have been mistrustful of researchers at VITA sites. While no clients raised this issue in this study (and similar settings seem to have worked for Duflo *et al.* (2006) and Spader *et al.* (2011)), it's possible that taxpayers distrusted the research so much that they would not tell the researcher that they distrusted her. It's also possible that while the take-up rate for qualifying retirement accounts was low in the current year, it was higher in a subsequent year. Spader *et al.* (2011) observe that the optimal use of the Saver's Credit at VITA sites requires a relatively long time frame. One limitation of this study is that subsequent years of taxpayer behavior were not measured. And, because inflation somewhat outpaced the prevailing interest rate of financial institutions at that time, the financial environment might have been influential.

It's also possible that saving for retirement would adversely affect some taxpayers applying for federal benefit programs. Weinberger (2005) recommends that such retirement savings not be considered in determining eligibility for such programs. Were that the case, retirement savings would be treated in those contexts similar to how such savings are treated in bankruptcy, where they are generally not considered as available for satisfying current debts and treated as part of a largely impenetrable trust.

Several other changes in the Saver's Credit policy have been suggested. Many have suggested making the Saver's Credit refundable (Bell *et al.*, 2005; AARP, 2008; Gale *et al.* 2004; Iwry, 2003; Weinberger, 2005; Brookings, 2004), but there's limited data on how that would affect pensions savings and overall savings. In part because of its simplicity, others recommend matching dollars of savings rather than extending a credit (Duflo *et al.*, 2006; Spader *et al.*, 2011). Mensah *et al.* (2012) recommend replacing or supplementing the Saver's Credit with a refundable Freedom Savings Credit to save for all major life steps, not just retirement. This recommendation is consistent with Spader *et al.*'s (2011) finding that 33.6 percent of taxpayers named the ability to withdraw funds in an emergency as the most important factor in their retirement savings decision and provisions in the MyRA that allow for withdrawals of principal without tax penalty.

One limitation of this study (and the rationale for some of the recommendations to change the Saver's Credit) is that an increase in retirement savings does not necessarily increase overall savings. Bell *et al.* (2005) notes that "[h]ouseholds often borrow on one side of their ledgers (i.e., through a mortgage or home equity loan) what they deposit in tax-subsidized accounts on the other" (p. 6). Overall, the conclusions drawn from this study are more suggestive than definitive, and the alternatives discussed in this paper are not mutually exclusive from those proposed by others.

Conclusion

In developing promising incentives for retirement savings, we might want to consider the level of convenience associated with the incentive, as even small amounts of inconvenience (such as are generally associated with setting up an IRA) appear to discourage pension savings. Such pension products can be designed by software companies and tax preparation businesses, and it is probably worthwhile to fund studies on what configurations work. While the reason

why convenience is needed for taxpayers to accept money (or students to accept extra credit) was not examined, further studies could explore whether respondents found these exercises relatively depleting. The study findings are important during a period when incentives like the Saver's Credit are given to individuals, because they work more poorly than the general public might expect. The convenience phenomenon also has pervasive implications in the efficiency of tax provisions when considering tax reform for low- and middle-class individuals.

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Appendix 1

Field Experiment Instructions

Principal Investigator's Note

The instrument that respondents will see will come in multiple parts:

1. Pre-tax-preparation instrument. Willing participants will also get (free) information at the end of this instrument regarding the tax breaks generally available to those funding IRAs. This is followed by an independent (non-investigator) preparation of preliminary tax return
2. Post-preliminary tax preparation instrument, including several "what if" scenarios. This will be generally followed by an independent (non-investigator) final preparation and electronic filing of the tax return.
3. And, if possible, post-return filing instrument.

Pre-Tax Preparation Survey

1. What amount of tax do you expect to owe $_____ or be refunded? $_____
2. If you expect to receive a refund, how much (in dollars), if any, do you have pledged or promised or earmarked for a specific use? $_____
3. If you expect to receive a refund, how much of the refund do you plan to (skip this section if you expect to owe money):

a.	Invest (in stocks, bonds, savings account, etc.)?	$
b.	Use to pay off credit card debt?	$
c.	Use to pay off notes (e.g., mortgage, car note, etc.)?	$
d.	Use up about evenly every month for expenses? _____/mo. x 12 mo.=	$
e.	Use to buy a durable asset (e.g., car, boat, washing machine, furniture)?	$
f.	Use to save for an infrequent expense (e.g., vacation, bigger holiday gifts)?	$
	Amount must total your refund amount----------→	

4. Are you aware of the Retirement Savings Contribution Credit? ____ Yes _____No
5. Are you aware that most people can deduct an IRA that they've funded on their income tax return? _____ Yes _____No
6. Do you have a bank account? _____ Yes _____No
7. Which term best describes your business experience level?

_____High _____ Fairly High _____Moderate _____Fairly Low _____Low

Please list your: Zip Code_____Highest education level:_____Middle School_____

High School_____Undergraduate_____Graduate or above_____

Occupation: _____Gender: Female____Male____Industry where you work_____

THANK YOU FOR YOUR PARTICIPATION!!

Post-preliminary Tax Preparation Instrument

	Current 1040	Higher of windfall or bank minimum as IRA	Full refund	Taxpayer designated amount (optional)	Taxpayer designated amount (optional)	Full eligibilty record per taxpayer
Cash refund (liquid)	(From preliminary 1040 prepared)	Estimated from "what if" program	Estimated from "what if" program	Estimated from "what if" program	Estimated from "what if" program	(Left blank for further analysis)
IRA	(From preliminary 1040	Higher of windfall[1] or bank minimum as IRA	(Cash refund amount from preliminary 1040)	Client-generated amount	Client-generated amount	(Left blank for further analysis)
Total wealth	Sum of 2 preceding rows in column	Sum of 2 preceding rows in column	Sum of 2 preceding rows in column	Sum of 2 preceding rows in column	Sum of preceding rows in column	Sum of preceding rows in column

Note: Above are three IRA funding options, but you may pick a separate amount between the highest IRA # above and the lowest, (if you'd like). Based on these calculations, how much of an IRA, if any, would you like to fund? (If any, instructions on setting up an IRA will be provided to the taxpayer.)

Post-filing Tax Preparation Instrument

1. Observation # (assigned)
2. How much of an IRA did you finally fund for the 2010 tax year?
3. How much of an IRA did you finally fund for the 2011 tax year?
4. What is the final tax due/refunded to you for the 2010 tax year?

[1] Windfall amount is the difference between the taxpayer's originally expected refund, and the refund from the preliminary tax return.

Appendix 2

Extra Credit—Behavioral Tax Research Exercise

Tax faculty members also do tax research. Sometimes this is legal tax research, often with recommendations for new laws. Sometimes this is archival research, where we try to make sense of past income tax filing data. Another area of tax research is behavioral—how do people respond to Code provisions. This type of research is usually done either by using surveys or experiments. To familiarize you with academic tax research, the following extra-credit exercise is offered for up to 10 points.

Assume you are married filing jointly with no children and have $2,000 in a bank savings account and currently have the following federal income tax results from the preliminary 1040:

Total Income	$30,000
IRA Deduction	0
Adjusted Gross Income	30,000
Less: Standard Deduction and 2 Exemptions	(18,700)
Taxable Income	11,300
Income Tax	1,130
Saver's Credit	0
Tax Liability	1,130
Federal Income Tax Withholding	1,400
Refund	270

Now assume you are eligible to make an IRA contribution and qualify for the Saver's Credit. If you convert $1,000 (half) of your savings account to an IRA, your preliminary 1040 federal income tax results would be:

Total Income	$30,000
IRA Deduction	1,000
Adjusted Gross Income	29,000
Less: Standard Deduction and 1 Exemption	(18,700)
Taxable Income	10,300
Income Tax	1,030
Savers Credit	1,000
Tax Liability	30
Federal Income Tax Withholding	1,400
Refund	1,370

Which would you rather do? Check one box:

☐ File the current return resulting in a $ 270 refund, or

☐ Take out a $1,000 IRA and file the income tax return resulting in a $ 1,370 refund.

If you pick the second ($1,370 refund) option, have [Department Secretary's name] in the Dean's suite of [this] building initial in the grey box here =>

(Author's Note: the sentence and box immediately above are omitted for control group participants.)