

# **Self-Employment Tax Initiative: Tax Preparation and Assets Formation Practices of Self-Employed Vermonters**

Michele C. Schmidt, MPA  
Center for Rural Studies, University of Vermont – July 2009

## **INTRODUCTION**

The Self-Employment Tax Initiative (SETI) expanded the services of the Community Economic Development Program at Central Vermont Community Action Council, to connect the 1,000 business owners served by the program with free tax preparation and filing services. The grant funded by the National Fund for Enterprise Development expanded the services of the Volunteer Income Tax Assistance (VITA) Program at CVCAC that it has offered to their service area since the 1990s. Since a drop off method of filing taxes and the preparation of Schedule C forms is not allowed through the VITA program, the funding from SETI has allowed this operation to occur, which has shown to be the most beneficial method to meet the needs of self-employed persons.

SETI's goals for this past year were to accomplish the following:

- Increase CVCAC's capacity to prepare more Schedule Cs and increase marketing of the program commensurately.
- Help self-employed taxpayers better understand their year-round business record keeping needs by offering pre- and post-tax season training and assistance.
- Train customers to do their own Schedule Cs.
- Encourage the self-employed to build assets through the use of refund splitting and referrals to asset building programs.
- Provide data to the field about the characteristics of self-employed tax customers.
- Evaluate our effort and learn from and improve our practice.

This evaluation report informs the goals of SETI through two areas of data collected: 1) Vermonter Poll 2009 statewide data collected on tax preparation practices and asset development, analyzed by self-employment status and 2) a survey of self-employed clients served through the statewide VITA (Volunteer Income Tax Assistance) program operated by the network of five Community Action Agencies including CVCAC who received free tax preparation services on their tax practices and use of refunds. Some of the self-employed clients "served through the statewide VITA program" were part of the SETI program.

**TABLE OF CONTENTS**

**INTRODUCTION ..... 1**

**METHODOLOGY ..... 3**

**FINDINGS ..... 5**

*Vermont Poll 2009* ..... 5

        Respondent demographic profile ..... 5

        Use of free tax preparation services ..... 6

        Tax preparation services used and cost of service ..... 7

        Awareness and receipt of the Earned Income Tax Credit ..... 8

        Status and use of tax refunds ..... 9

        Spending and saving patterns with tax refund ..... 10

*VITA Client Survey* ..... 11

        Previous and current tax preparation services used ..... 11

        Receipt and use of tax credits and refunds ..... 12

        Bank Accounts, Savings, IDA, and Retirement ..... 14

        Debt ..... 15

        Assets and business outcomes ..... 15

**Conclusions ..... 16**

**Recommendations ..... 19**

## METHODOLOGY

### **Vermont Poll 2009**

The Vermont Poll is an annual public opinion survey of Vermont residents who are 18 years of age and older, conducted by the Center for Rural Studies (CRS) at the University of Vermont, to gauge Vermonters' opinions on current issues of interest to non-profit agencies, government officials, and researchers. Questions on Vermonters' tax preparation and filing practices, awareness, and use of refunds and credits, and employment status that were asked in 2008 were repeated during the 2009 Vermont Poll. More specifically, CVCAC was interested in learning if self-employed respondents (distinguished by the types of income they reported earning) used the free tax preparation services, offered by the five Community Action Agencies statewide, and if not, why not. Questions were also asked to gather data on other sources of tax preparation services, approximate cost of these services, receipt of the Earned Income Tax Credit (EITC), and amount and use of refund, including spending and saving patterns.

The Vermont Poll is a statistically representative, statewide telephone poll conducted annually by CRS. Responses are limited to Vermont households with telephones and do not include cell phones<sup>1</sup>. Households were selected randomly using a list of telephone numbers generated from Vermont telephone directories. The 2009 Vermont Poll was conducted between the hours of 4:00 p.m. and 9:00 p.m. from February 18, 2009 through February 27, 2009. The survey was conducted from the University of Vermont using computer-aided telephone interviewing (CATI). There were 615 respondents to the 2009 Vermont Poll. The results based on a group of this size have a margin of error of plus or minus 4 percent at a confidence interval of 95 percent. For the purposes of this report, 26% (154) of Vermonters reported being self-employed, either by having filed a Schedule C for self-employment income, a 1099 for subcontractor income, or both for their 2008 tax return<sup>2</sup>. This subgroup is the focus of this analysis. Data analyses were carried out using the Statistical Package for the Social Sciences (SPSS) 15.0. Bi-variate analyses, including T, F, and Chi Square ( $\chi^2$ ) tests, were also conducted to further understand relationships between two variables. P values less than or equal to .10 were deemed significant. Where appropriate, being self-employed compared to all other types of employment/income generation (using the entire sample) was cross tabulated with various variables to further understand tax practices and use of refunds by self-employed persons.

---

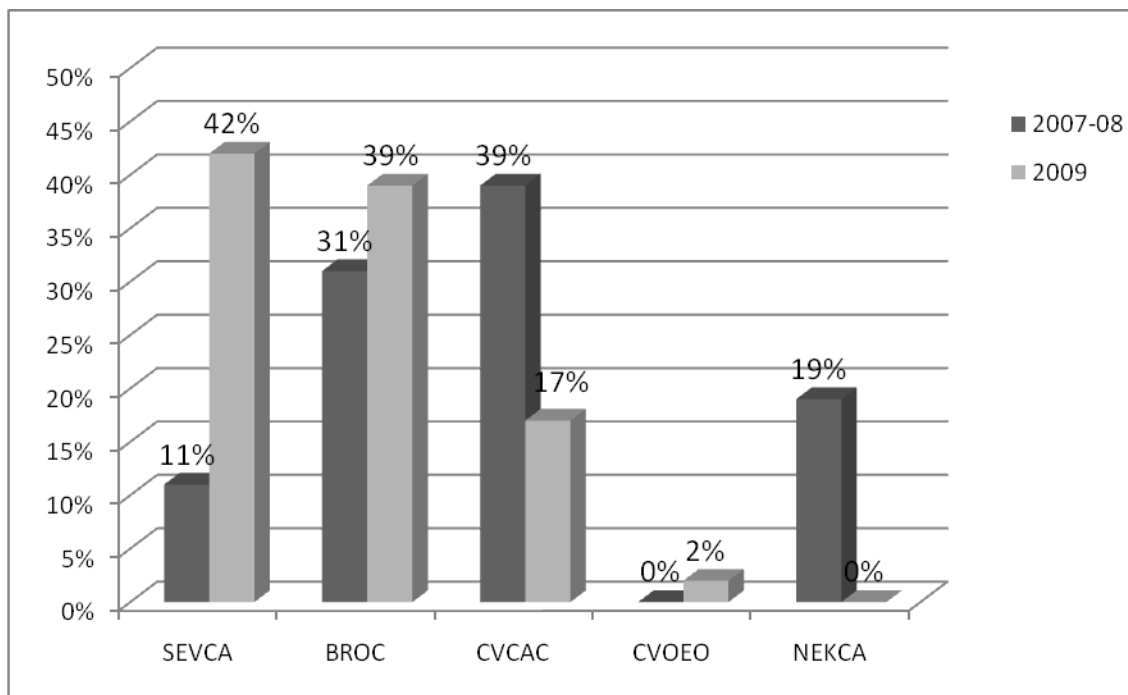
<sup>1</sup> According to the most recent estimates, 5.1 percent of Vermont households have at least one wireless cellular phone, but no landline telephone. As a state, Vermont has the lowest level of "wireless-only" households in the country. Blumberg et al. (2009). Wireless Substitution: State-level Estimates from the National Health Interview Survey, January – December 2007. National Health Statistics Report, 14.

<sup>2</sup> 22% of Vermonters being self-employed corresponds with national statistics on Vermont's self-employment rate determined by Kelly, K., & Kawakami, R. (2007). *Microenterprise employment state level analysis: 2000-2005*. [Data file]. Arlington, Virginia: Association for Enterprise Opportunity.

### VITA Client Survey

All clients who utilized the VITA sites at the statewide Community Action Agencies (CAA) through the months of January–April 2009 were asked to complete a survey on former tax preparation practices, receipt of tax credits, use of refunds, savings practices, debt, and asset formation. A total of 356 persons completed this survey in 2009, of which 23% (83) were self-employed based on their reported income earned. Survey data was also collected from clients in 2007 (n=285) and 2008 (n=498). In total, 1,139 surveys were completed by clients who utilized the free tax preparation services offered statewide through the five CAAs over the past three years. Of these survey respondents, 18% (207) reported being self-employed (filed a Schedule C or C-EZ) and/or having received a 1099 as a subcontractor and are the focus of this analysis.

Figure 1 shows the breakdown of SETI survey respondents by CAA office over the two years. The office that has provided the most consistent percentage of surveys is BROC—Community Action in Southwestern Vermont. This year, the majority of surveys (42%, 35) were completed by clients from Southeastern Vermont Community Action (SEVCA), followed closely by clients of BROC (39%, 32). Central Vermont Community Action Council (CVCAC) collected data from 17% (14) of clients served. The Champlain Valley Office of Economic Opportunity (CVOEO) provided VITA surveys to CRS in 2007 and 2009, however only two clients from 2009 and none from 2007 were self-employed. Northeast Kingdom Community Action (NEKCA) did not provide CRS with any VITA surveys in 2009 as they have done in the past.



**Figure 1 Percentage of self-employed VITA survey respondents by location and over time**

## FINDINGS

### Vermonter Poll 2009

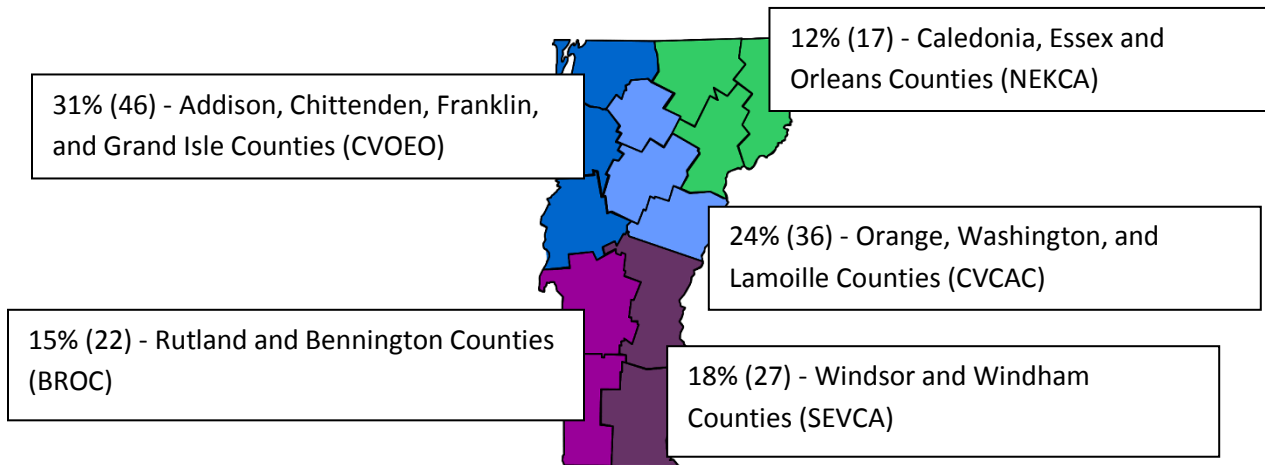
A total of 26% (154) of Vermonters surveyed (N=615) reported being self-employed in 2009, either by having filed a Schedule C for self-employment income, a 1099 for subcontractor income, or both for their 2008 tax return. This percentage is slightly higher than the 22% (134) who reported being self-employed during the 2008 Vermonter Poll. Table 1 compares the types of income earned reported only by self-employed respondents (all data reported herein is from self-employed respondents only unless otherwise noted). While the proportion of Vermonters reporting the different income types from each year shifts, the overall trend is that the majority of self-employed persons (87% from the 2008 Poll and 75% from the 2009 Poll) reported filing a Schedule C during the past tax season and about half also work at a wage job. At the time of the survey in February 2009, 19% (27) of respondents had already filed their taxes compared to 64% (80) of those surveyed in 2008. This discrepancy is most likely due to the timing of the survey as the 2008 Vermonter Poll was conducted in mid March, which gave respondents more time to have filed their taxes. Of the 2009 respondents, 52% (70) had filed or planned to file their taxes electronically or by e-filing (57%, 73 in 2008) and 48% (66) had filed or planned to file by mail (43%, 56 in 2008).

**Table 1 Types of income earned in 2007 and 2008 by the self-employed**

Income	% (n)	% (n)
	2007	2008
Self-employed, Schedule C	87% (117)	75% (116)
Wages, W-2	45% (60)	51% (78)
Subcontracted work, 1099	20% (27)	36% (56)
Dividend/Interest income, unearned income	18% (24)	23% (36)
Farm income, 1040	4% (5)	10% (15)

### ***Respondent demographic profile***

Self-employed respondents to the 2009 Vermonter Poll were almost evenly split by gender with 42% (65) being female and 56% (75) male. The age of respondents ranged from 20 to 83 years with an average and median age of 54 years. Respondents have between one and six members in their household and a median of two household members. Thirty-three percent (50) have children living in their household, with a range of one to four children and a median of one child. The number of years that respondents have lived in Vermont ranges from one to 74 years, with people living in Vermont an average of 33 years and median of 32 years. Eighty percent (123) have completed some college or more education while 20% (30) have a high school education or less. Sixty percent (80) reported earning a household income that is at or above the median income in Vermont (\$50,000 or more), while 40% (53) earned less than the median income (\$49,999 or less). Figure 2 shows the breakdown of household residence categorized by the five CAA service areas. Overall, 73% (112) of self-employed respondents self-reported living in a rural area, 14% (21) live in an urban area and 13% (20) said they live in a suburban area.



**Figure 2 Geographic location of respondents by Community Action Agency service areas**

***Use of free tax preparation services***

Consistent with the results of the 2008 Vermonter Poll, 5% (8) of 2009 self-employed respondents (5%, 6 in 2008) reported using a free tax preparation service to file their taxes. Also consistent over time is that self-employed respondents (5%, 8) were significantly less likely to have used a free tax service compared to all other respondents (11%, 46) ( $x^2=3.99$ ;  $p=.05$ ). The most commonly given reasons for not using a free tax preparation services in 2008 (see Table 2) was a preference for working with a professional preparer (47%) followed lack of awareness (21%). However, in 2009 responses were more evenly spread across the categories. More than a quarter (26%) self-prepared their taxes and 23% felt their taxes are too complicated for a free service to prepare them. Thirteen percent each indicated that they prefer professional assistance or are loyal to their current service after having worked with them over time. Additionally, roughly 10% each was not aware of or did not trust a free service. A few open response comments indicated that some people felt free services were not legitimate because the services “are not by the IRS” or “are not liable for mistakes.” A few respondents also felt they were not eligible to use a free resource specifically because they were not retired.

**Table 2 Reasons why Vermonters polled do not use a free tax preparation service**

<b>Reason</b>	<b>% (n) 2007</b>	<b>% (n) 2008</b>
Self-prepare my taxes	14% (18)	26% (37)
Feel taxes are too complicated	13% (16)	23% (33)
Prefer to work with a professional tax preparer	47% (60)	13% (19)
Loyalty to current tax preparer	2% (3)	13% (18)
Not aware of free tax preparation services available	21% (26)	10% (15)
Do not trust a free tax service	2% (3)	9% (13)
Prefer to pay for tax preparation	7% (9)	8% (11)
Not eligible	2% (3)	7% (10)
Family member or friend prepares my taxes	5% (6)	6% (9)
Feel taxes are too simple	1% (1)	1% (2)

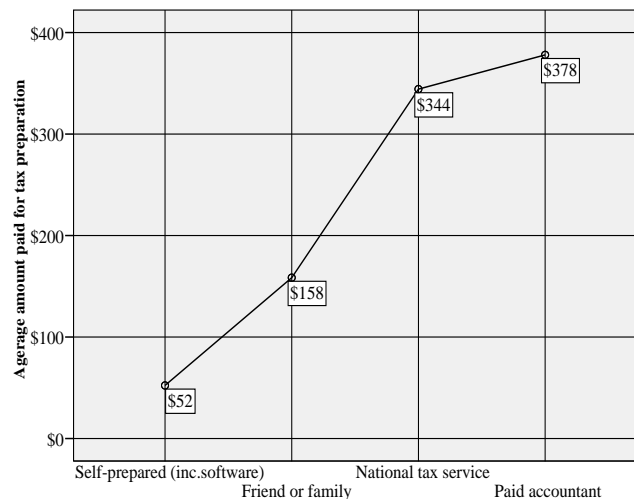
**Tax preparation services used and cost of service**

Table 3 displays the tax preparation services/resources that respondents used in 2007 and 2008. More than half of self-employed respondents from both survey years used a paid accountant or private service, not including a national chain, to prepare their taxes; additionally, a quarter in 2007 and 29% in 2008 self-prepared their taxes. Also consistent over time was that self-employed respondents were significantly more likely to use a paid accountant (55%, 84) compared to 39% (159) of those who earned other income ( $\chi^2=14.20$ ,  $p=.00$ ). Possibly related to this finding is that self-employed persons are significantly more likely to feel their taxes are too complicated for a free service (23%, 33) compared to the larger respondent pool (8%, 29) ( $\chi^2=23.62$ ,  $p=.00$ ). Interestingly, the use of a family member or friend to help prepare one’s taxes is a more popular choice in 2008 compared to using a national chain service. Of respondents who did use a free service in 2008 (n=9), four also worked with a paid accountant, three self-prepared their taxes, and two used the assistance of a family member or friend.

**Table 3 Source of tax preparation service of Vermonters polled**

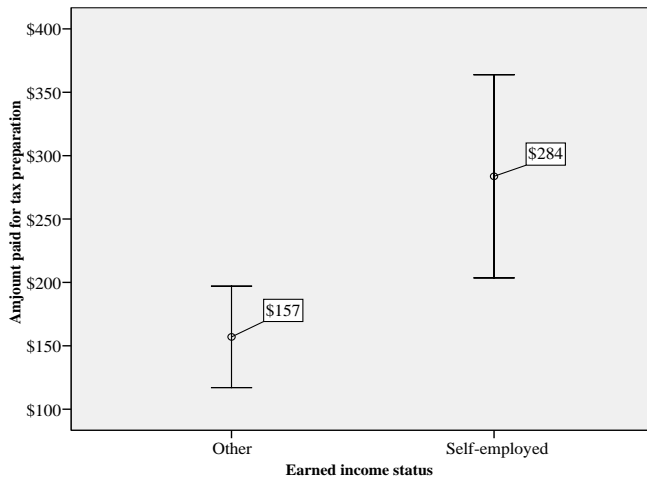
Source	% (n) 2007	% (n) 2008
A paid accountant	58% (77)	55% (84)
Self (including use of software)	25% (33)	29% (44)
Friend or family member	6% (8)	13% (19)
National tax preparation service	11% (14)	3% (5)

Self-employed respondents paid between \$0 and \$3,000 on their 2008 tax return preparation. A strong majority, 93% (118), paid less than \$1,000 for their tax preparation while 6% (7) paid between \$1,000 and \$1,500 and 2% (2) paid \$3,000. Likewise, in 2007 Vermonters paid a range of \$0 to \$2,000 for preparing their tax returns; 96% (118) paid less than \$1,000 while 3% (3) paid between \$1,000 and \$1,500 and 2% (2) paid \$2,000. The average dollar amount spent on tax preparation in 2008, including those who did not spend any money preparing their taxes, was \$284 (\$252 in 2007), the median was \$150 (\$195 in 2007) and mode was \$0 spent (\$0 in 2007). Of those who spent any dollar amount (range of \$40 to \$3,000), the average amount spent was \$396 (\$330 in 2007) and the median was \$250 in 2007 and 2008. Figure 3 displays the average dollar amount spent on filing 2008 tax returns compared by the four types of preparation resources (not including those who only used a free tax service). A significant difference in the average amount of money spent was found between those who self-prepared their taxes and those who used a paid accountant ( $f=-325.76$ ;  $p=.00$ ) and a national tax preparation service ( $f=-292.04$ ;  $p=.02$ ). No other significant differences were found between groups.



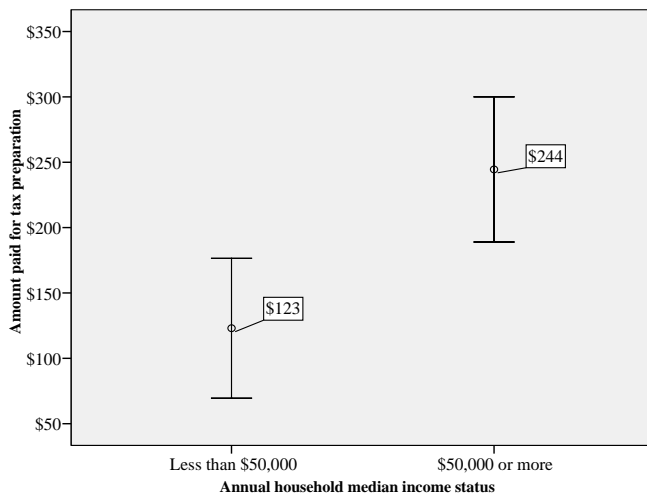
**Figure 3 Plot of average dollar amount spent on tax preparation by resource used**

Although some Vermonters surveyed spent a lot of money on their tax preparation, looking at amount spent (including \$0) by eligibility for the EITC and annual household income earnings show that households with less income paid less money for tax preparation. EITC eligible respondents spent less money, an average of \$215, to have their taxes prepared while those who are not eligible for the EITC paid an average of \$303 for this service. Though the averages differ depending on EITC eligibility, no significant results were found. Comparing the average dollar amount spent on 2008 tax filing (including \$0) by household income status of earning at or above/below median income in Vermont (approximately \$50,000) showed significant results (Figure 4). Vermonters who earn less than the median income spent a lower average of \$189 to file their 2008 tax return, while those earning median income or more spent an average of \$347 to prepare their 2008 taxes ( $t=-1.99$ ;  $p=.05$ ).



**Figure 4 Average \$ spent on tax preparation compared by earned income status**

Figure 5 shows that self-employed respondents were significantly more likely to pay more money for their tax preparation services (average of \$396) compared to those who earned income from sources other than self-employment (average of \$241) ( $t=-2.59$ ,  $p=.01$ ). This finding is consistent with significant results comparing these two groups from the 2008 Vermonter Poll ( $p=.01$ ).



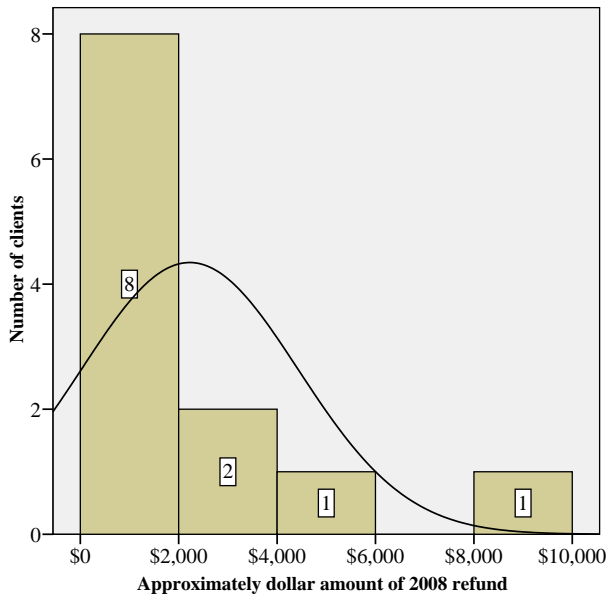
**Figure 5 Average \$ spent on tax preparation by median income status**

**Awareness and receipt of the Earned Income Tax Credit**

When asked about their awareness of the Earned Income Tax Credit (EITC), 95% (139) of 2009 self-employed respondents reported having had heard of the EITC (90%, 119 in 2008). Similar to results in 2008, self-employed persons surveyed in 2009 were significantly more likely to have heard of the EITC compared to 86% (362) of those who earned other types of income ( $x^2=7.98, p\leq.00$ ). Almost two thirds of 2009 respondents or 63% (96) (71%, 95 in 2008) reported that they were not eligible to receive the EITC, 16% (25) were eligible (12%, 16 in 2008), and 21% (32) did not know if they were eligible for this tax credit (17%, 23 in 2008). Of those eligible for the EITC, 68% (17) had or expected to receive this credit, 12% (3) said they did not receive this credit, 8% (2) did not know, and the remaining 12% (3) had not yet filed their taxes to answer this question. Of the three who did not receive the EITC, two people were not sure why they did not receive it and one person said they did not apply for it.

**Status and use of tax refunds**

As of February 2009, 13% (18) of respondents had already filed their taxes and received a refund, 6% (9) had filed and were not getting a refund, 39% (55) had not yet filed but were expecting to receive a



**Figure 6 Reported refund amounts for 2008 taxes**

refund and 41% (58) had not yet filed but were not expecting to receive a refund. Two thirds (67%, 12) of those receiving a refund had received it through a direct deposit into their bank account, while 33% (6) received a check in the mail. The dollar amount of refunds received ranged from \$600 to \$8,600 with an average of \$2,225 and median of \$1,750 (n=12; three clients refused to give this information and three did not know the amount). Figure 6 displays a histogram of refund data, demonstrating that the majority (75% of respondents) received \$2,000 or less while a few clients received larger refunds of up to \$8,600.

Because the sample of Vermonters who reported their refund amount is small (12), bi-variate testing would not yield accurate results. However a means

comparison was run to determine average refunds received by each source of tax preparation and cost of service. Respondents who self-prepared their taxes received an average refund of \$2,500, those who used a paid accountant received an average of \$2,900, and those who worked with family members or friends received an average refund of \$1,133 (data was not available on the average refund received from a national tax preparation service). In addition, respondents who paid any amount for their taxes to be prepared received a higher average refund of \$3,180 compared to the average refund of \$1,542 of those who used a free service or paid \$0.

### ***Spending and saving patterns with tax refund***

Respondents who had received or were expecting to receive a tax refund were asked to indicate either the dollar amount or percentage of their refund that they planned to or had already saved in some fashion. Using these figures, the dollar amount and percentage of the refund spent were calculated. The average amount spent from respondents' tax refund was \$1,058, with a median and mode of \$0, and a range of \$0 to \$5,300 (n=12). The amount saved from tax refunds ranged from \$0 to \$3,300 with an average savings of \$1,166, median of \$950 and mode of \$0 (n=12). Regarding the percentage saved, respondents reported saving between 0% to 100% of their tax refund with an average of 52%, median of 50% and mode of 100% (40% indicated saving all of their refund while 27% indicated saving none of their refund). Overall, results show that self-employed respondents are saving more money from their tax returns than spending it at 55% (34) reported saving half or more of their refund compared to 45% (28) who were saving less than half of their refund.

Table 4 displays the various ways that respondents reported saving their tax refunds from their 2007 and 2008 returns. The majority of respondents over both years saved their refund in some form of bank account, such as a savings, checking, money market, Individual Development Account (IDA), or Certificate of Deposit (CD); however, it is interesting to note that the proportion of bank savers decreased to about two thirds in 2008, with a resulting increase in the proportion who saved money in other ways that are more long-term including investing in stocks or bonds (14%) and in a retirement account (9%). Also noteworthy is that 9% specified saving their refund to prepay taxes for the next year.

**Table 4 How respondents saved their 2007 and 2008 tax refund**

	<b>% (n) 2007</b>	<b>% (n) 2008</b>
Savings/checking/money market/IDA/CD	86% (47)	64% (36)
Stocks or bonds investment	7% (4)	14% (8)
Prepay 2008 taxes	2% (1)	9% (5)
Retirement account	0	9% (5)

Table 5 shows that the top two expenditures using tax refund money, reported on both Polls, were paying household bills (41%) and paying down debt such as a credit card, loan mortgage or car payment (33%). However, purchasing "luxury" items, such as large appliances or furniture, a vacation or other items (e.g. ski passes), increased from 9% in 2007 to 22% in 2008. A slight percentage increase was also observed for the remaining categories of buying necessary items such as food, clothing and medical bills, purchasing a home or house repair, and purchasing or repairing an automobile.

**Table 5 How respondents spent their 2007 and 2008 tax refund**

	<b>% (n) 2007</b>	<b>% (n) 2008</b>
Pay household bills	46% (25)	41% (23)
Pay off debt	47% (26)	33% (18)
Luxury, non-essential items	9% (5)	22% (12)
Necessary items	13% (7)	20% (11)
Home purchase/down payment/repair	9% (5)	16% (9)
Purchase/repair an automobile	2% (1)	7% (4)
Education	7% (4)	5% (3)

## VITA Client Survey

Self-employed persons who used free tax preparation services through the VITA sites were surveyed on their tax preparation practices. Similar to Vermonter Poll respondents, being “self-employed” was defined as clients who filed a Schedule C, a 1099 form as a subcontractor, or both. From the 356 surveys completed in 2009, 23% (83) were self-employed based on this definition. Looking at self-employment over time, five VITA clients in 2007 and 119 in 2008 were self-employed. The increase in self-employed clients in 2008 is most likely due to the continuation of the SETI grant and enhanced services for clients filing a Schedule C in the second year. For the purposes of longitudinal analysis, the sample of self-employed respondents from 2007 and 2008 were combined because the low number received in 2007 would not yield informative results if that year was examined separately. Thus, in 07-08 a total of 124 or 16% of respondents reported earning self-employment income when filing their tax returns. Examining earned income by VITA clients over time, Table 6 (sorted by total) shows that the majority of clients in 2009 (85%) earned income from a 1099 or both a 1099 and a W2 statement for wage employment.

**Table 6 Income types reported by self-employed clients over time and total**

Income reported	2007-08	2009	Total
1099	44% (55)	42% (35)	44% (90)
W2 and 1099	33% (41)	43% (36)	37% (77)
Self employment only	11% (13)	7% (6)	9% (19)
All income types earned	4% (5)	7% (6)	9% (19)
W2 and Self Employment	8% (10)	5% (4)	7% (14)

### ***Previous and current tax preparation services used***

Table 7 shows the percentage of self-employed respondents who used various resources for their tax preparation in the year prior to the survey year, compared over time. In 2009, slightly more than half were a service-user of the VITA site the year prior, which is an increase from 39% in 2007-08. This finding suggests that VITA sites are drawing more self-employed clients to their services. In addition, 16% used free or low cost services in the previous year, including self-preparing their taxes or having a family member or friend assist them. While 4% each paid for their tax preparation services, with and without receiving an instant refund.

**Table 7 Resource for tax preparation in previous tax year over time**

Resource	2007-08	2009
VITA site	39% (48)	52% (43)
Self-prepared	7% (8)	12% (10)
Family or friend	11% (14)	11% (9)
Another free place	2% (3)	5% (4)
Other, not specified	8% (10)	5% (4)
Paid someone without receiving an instant refund	8% (10)	4% (3)
Paid someone like H&R Block and received an instant refund	3% (4)	4% (3)
Did not file taxes last year	22% (27)	4% (3)

Table 8 shows that the majority of self-employed clients or 55% are repeat visitors to the site, which is an increase from the 36% from the past two years. Advertisements through flyers or the newspaper (18%) and word of mouth referrals from a family member or friend (16%) continue to be other main ways in which clients are referred to VITA for their tax preparation.

**Table 8 Referral source to SETI site over time**

	2007-08	2009
Repeat visit	36% (42)	55% (42)
Flyer, newspaper or other advertisement	14% (16)	18% (14)
Family or friend referred	33% (39)	16% (12)
Other referral, not specified	13% (15)	10% (8)
Drop-in	2% (2)	1% (1)
The IRS	3% (4)	0
Total N	118	77

Looking at the percentage of repeat clients by CAA (including data from all years), Table 9 shows that NEKCA and CVCAC each had more than half of SETI clients (52%) come back an additional year for services and 45% of BROC’s clients were repeat clients. Eighteen percent of SEVCA’s clients were repeat visitors and CVOEO did not have any repeat self-employed clients.

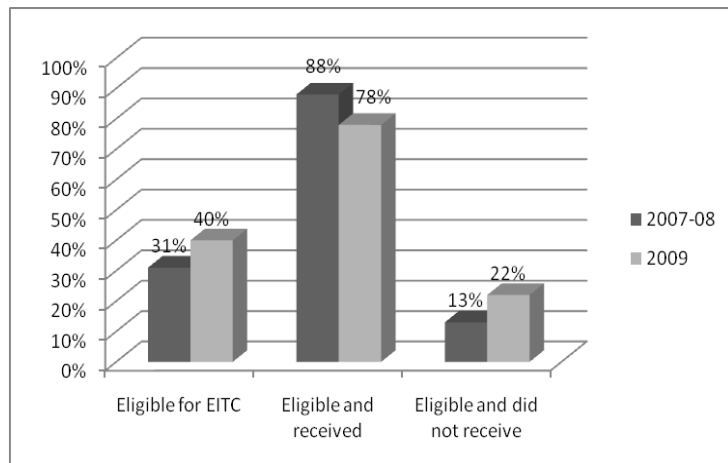
**Table 9 Percentage of repeat clients compared by SETI location**

	NEKCA	CVCAC	BROC	SEVCA	CVOEO
% Repeat client	52% (12)	52% (32)	45% (32)	18% (9)	0

**Receipt and use of tax credits and refunds**

Figure 7 shows that 31% (34) of self-employed clients in 07-08 and 40% in 09 reported being eligible to receive the EITC. A slightly higher proportion (88%) of those eligible in 2007-08 actually received the credit; 78% received this credit in 2009. Thus, 13% in 2007-08 and 22% in 2009 of eligible persons did not receive or report receiving the EITC. Over the past three years of VITA services, 84% (46) of all eligible clients surveyed reported receiving this credit while 16% (9) did not receive this credit. Further information was not provided as to why they did not receive this credit.

Regarding receipt of the EITC in the year prior to the survey, 25% (27) in 2007-08 and 39% (27) in 2009 reported receiving the EITC in the previous tax year. The other tax credit inquired about was receipt of the child tax credit. In 2007-08, 14% (14) of clients reported receiving the child tax credit during that current tax season and 12% (7) received this credit in 2009.



**Figure 7 Eligibility and receipt of the EITC over time**

Table 10 shows that the most common uses of tax refunds, which are consistent over time, are to pay bills or purchase necessary items and to pay off debt. However, a higher proportion of 2009 self-employed clients reported paying bills (64%) and debt (31%) in 2008 compared to the percentages received from 2007-08 clients. In addition, a slightly higher percentage of 2009 clients used their refund to pay property taxes (8%) or put it in an IDA or savings account (7%) compared to the previous years. Also consistent through all years was that very few clients reported spending their tax return on nonessential items, prepaying bills, investing in their business, or donating it to charity.

**Table 10 Use of tax refund received in previous tax year, 2006 through 2008**

	How used in 2006-07 (2007-08 clients)	How used in 2008 (2009 clients)
Paying bills or necessary items	45% (56)	64% (53)
Paid off debt	19% (23)	31% (26)
Paid property taxes	6% (7)	8% (7)
IDA/savings	4% (5)	7% (6)
Spent on nonessential item	4% (5)	4% (3)
Prepaid items, rent or taxes	4% (5)	2% (2)
Invested in business	1% (1)	1% (1)
Donated to charity	2% (3)	0
<i>Did not receive refund</i>	22% (27)	10% (8)

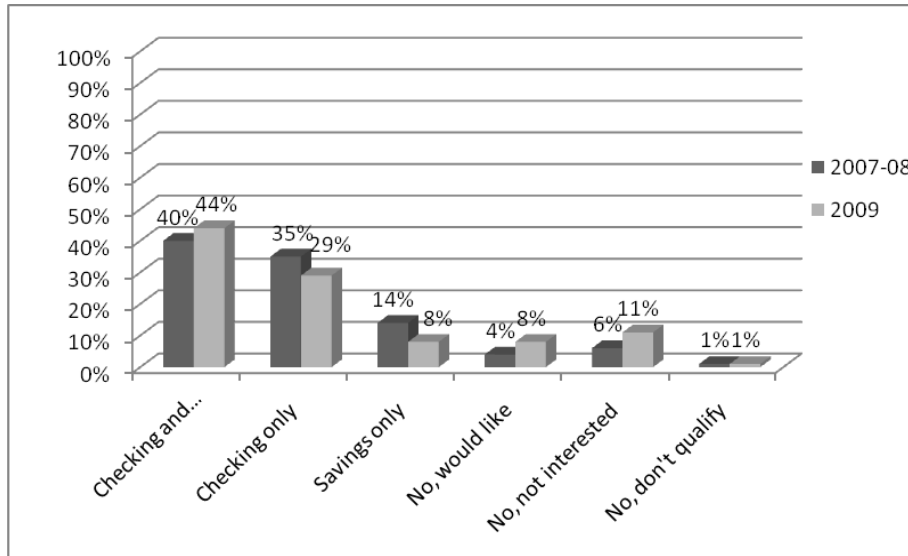
Table 11 displays clients' planned uses of their tax refund received from the current year given. Consistent with findings shown in Table 10, 65% in 2009 planned to use their refund to pay bills or purchase necessary items, which is slightly higher than the 55% of clients from previous years. In addition, almost 40% from 2009 planned to use their refund to pay off debt, compared to only 27% in previous years. On the contrary, very few clients (2%) from 2009 planned to spend their refund on nonessential items, which is much lower than the 10% reporting in the past years. Overall, current self-employed clients are using their tax refunds on essential items rather than making nonessential purchases. In fact, 2009 clients are significantly more likely to have spent their refund to pay off debt compared to 2007 and 2008 clients ( $\chi^2=3.29$ ;  $p=.07$ ).

**Table 11 Planned use of tax refund from current tax year, 2007 through 2009**

	Planned use in 2007-08 (2007-08 clients)	Planned use in 2009 (2009 clients)
Paying bills or necessary items	55% (68)	65% (54)
Paid off debt	27% (33)	39% (32)
IDA/savings	10% (12)	11% (9)
Paid property taxes	9% (11)	11% (9)
Prepaid items, rent or taxes	10% (12)	6% (5)
Spent on nonessential item	10% (12)	2% (2)
Invested in business	2% (3)	1% (1)
Donated to charity	2% (3)	0
<i>Did not receive refund</i>	8% (10)	2% (2)

**Bank Accounts, Savings, IDA, and Retirement**

Figure 8 portrays the specific responses provided by clients when queried about their banking habits. Overall, 81% (64) of self-employed clients in 2009 and 89% (106) in 2007-08 reported having a savings account, a checking account, or both. Only a few clients from all survey years did not have some form of a bank account regardless of interest or perception of whether or not they qualified for one.



**Figure 8 Status of bank accounts**

In total, 51% (41) of self-employed clients in 2009 and 56% (67) of those in 2007-08 have a savings account (See box indicating common savings strategies). Of those who save money, the main reasons

**Savings Strategies**

- Automatic deposit into account from paycheck
- Save a set amount on a regular basis
- Save what is available or left over after bills are paid, regular or random basis
- Save using a program such as Tangible Assets or an IDA'
- Not actively saving but not spending beyond means
- Use of savings, checking, retirement accounts, or certificate of deposit

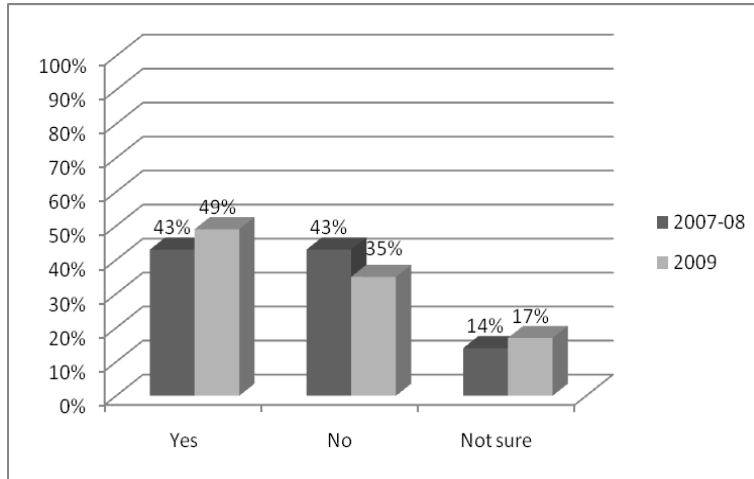
cited by clients for saving were to purchase a house or vehicle, pay bills or property taxes, for education, family members' security, a vacation, or an emergency. Of those clients who are not saving money, the main reasons for not saving were that people are not employed and looking for a job, not making enough money or are living paycheck to paycheck, do not have money left over to save after paying bills and necessity items, or paying off debt.

Four people each in 2007-08 and 2009 indicated that they were currently save money with an IDA

account. The reported reasons for saving with an IDA were to purchase a home or to save money for a college education. However, roughly a third of clients (33%, 13 in 2009 and 30%, 22 in 2007-08) over all years reported being interested in learning more about an IDA account. Regarding saving money for retirement in an IRA or another form, people surveyed in 2009 were slightly more likely to be saving money for retirement (33%, 17) compared to 21% (19) of clients surveyed in 2007-08.

**Debt**

Regarding indebtedness, Figure 9 shows that a slightly higher proportion of respondents in 2009 feel that debt is a problem for their household (49%, 38) compared to respondents in 2007-08 (43%, 51). Likewise, slightly more 2007-08 respondents or 43% (51) reported that debt was not a problem for their household compared to 35% (27) of 2009 respondents. Several respondents in both years were not sure if debt was a problem for their household.



**Figure 9 Whether or not debt is a problem for household**

Table 12 shows the varying levels of self-reported indebtedness. Roughly a quarter of respondents from both survey time frames reported that they do not have any debt. Of those who reported being in debt in 2009, the two most commonly given categories are at the high and low ends of the spectrum, with 30% being in debt for \$10,000 or more and 17% having a debt between \$1 and \$1,000.

**Table 12 Self-reported level of indebtedness**

	% (n), 2007-08	% (n), 2009
No debt	24% (27)	26% (20)
\$1-\$1,000	10% (11)	17% (13)
\$1,001-\$3,000	21% (23)	9% (7)
\$3,001-\$6,000	13% (14)	8% (6)
\$6,001-\$10,000	10% (11)	10% (8)
\$10,000+	23% (26)	30% (23)

**Assets and business outcomes**

As shown in Table 13, a few SETI clients reported having achieved assets and various business outcomes in the past six months. Of 2009 survey respondents, the most common asset reported was operating a business by 11% of respondents. Fewer than 5% of self-employed clients from 2007-08 reported acquiring assets related to their business, education or homeownership.

**Table 13 Assets and business outcomes achieved in the past six months**

Asset/outcome	% (n) Yes, 2007-08	% (n) Yes, 2009
Purchased a home	4% (5)	0
Completed any higher education	3% (4)	1% (1)
Started a business	2% (2)	4% (5)
Operated a business	5% (4)	11% (14)
Expanded a business	0	2% (3)

## CONCLUSIONS

This evaluation report examines the tax preparation practices and use of refunds and credits through a statewide survey and a survey of self-employed clients served by the VITA program offered by the five Vermont Community Action Agencies. This information is important to collect and analyze because tax refund dollars and credits, such as the EITC, provide an injection of cash flow to the average American family and are effective anti-poverty measures for low income families and individuals. In addition, 26% of Vermonters are self-employed, as confirmed by Vermonter Poll findings and national statistics (Kelly & Kawakami, 2007), which is an important sector of Vermont's economy to support and help flourish. The majority of self-employed clients (53%) over all survey years also reported earning income from other sources like wage employment in addition to being self-employed. These findings can also inform CVCAC's participation in the Self-Employment Tax Initiative funded by the National Fund for Enterprise Development about the characteristics about the self-employed in Vermont and how they have their taxes prepared and what they do with their refunds and credits.

### **Growth of SETI and Strategies to Overcome Misconceptions**

VITA has operated statewide since the 1990s and has added the component of examining the tax preparation practices of self-employed Vermonters since 2007. Results from these survey results show that the proportion of self-employed clients receiving free tax preparation services has increased over time from 5 people in 2007, to 16% of the clients in 2008 to 23% in 2009. In addition, VITA sites are receiving more repeat service users since then, with an increase of repeat clients from 36% in 2007-08 to 55% in 2009. This finding suggests that VITA sites are drawing more self-employed clients to their services. In addition to repeat users, advertisements through flyers or the newspaper (18%) and word of mouth referrals from a family member or friend (16%) continue to be other main ways in which clients are referred to VITA for their tax preparation. VITA sites should continue to utilize the internal referral system of micro business owners who participate in Micro Business Development Program and other CAA services to target this captive audience.

Though results show increased utilization of VITA services by the self-employed in Vermont, there is room for expanding the capacity of VITA services to a larger proportion of the self-employed population through increased marketing and education. Vermonter Poll results from 2008 and 2009 show that only a small proportion of Vermonters (5%) use free tax preparation services. Poll data collected over time show consistent barriers or reasons why few respondents take advantage of free tax preparation services. Respondents seem unaware of locations or put off by free tax preparation services, with some questioning their trustworthiness, legitimacy, or ability to file complicated returns such as those filed by the self-employed or business owners. Marketing and advertising efforts of VITA program should be made to target self-employed clients that disclose location and time frame when free sites operate and stress the legitimacy of services provided, competency and credentials of tax filers, as well as program eligibility.

Self-employed persons and business owners could greatly benefit from increased awareness and use of free tax preparation sites because of the large amount of money being spent to file their taxes through paid services. Consistent over the past two years of collected data, self-employed Vermonter Poll respondents, as a sub-group compared to respondents who earn other types of income, were significantly more likely to use a paid accountant to complete their taxes because they felt their tax filing is too complicated for a free service to handle. They were also significantly more likely to have paid more money to have their taxes completed by a paid accountant, with an average expenditure of \$396 (\$378 to a paid accountant) and a range of up to \$3,000. However, results showed that self-employed respondents who earn less than the median household income in Vermont were significantly more likely to pay less for their tax filing (\$123 average spent) compared to those with a household income that is at or above the median (\$244 average spent). Thus, the decision and action to spend more money on one's tax preparation seems to be positively correlated to earning more household income. Self-employed respondents who paid any money for tax preparation did report receiving a higher average refund of \$3,180 compared to an average of \$1,542 reported by those who paid no money for this service. However, the low sample size of those who reported their refund amount (12) does not warrant the drawing of conclusions. Additionally, this finding may be related to the aforementioned notion that respondents who earned more income, and thus would be likely to receive a higher return in general, paid more money for their tax return completion. Regardless of amount spent, business owners have the opportunity to divert money for other purposes by using VITA's free tax preparation services.

### **Awareness and Receipt of EITC**

Self-employed VITA respondents and self-employed Vermonter Poll participants from 2008 and 2009 alike reported high levels of awareness of the EITC. Poll respondents were significantly more likely to have heard of the EITC compared to people who earned income other than self-employment income. Additionally, a strong majority of respondents eligible to receive the EITC reported receiving this credit. Of the three eligible respondents who did not receive the EITC, two people were not sure why they did not receive it and one person said they did not apply for it. Almost half (40%) of self-employed clients from the most recent survey are eligible to receive the EITC and 78% of eligible persons said they received this credit. Thus, 22% of eligible clients did not receive the EITC or did not report receiving this, with no reason provided. Over the past three years of SETI services, 84% (46) of all eligible clients surveyed reported receiving this credit while 16% (9) did not receive this credit. Further information was not provided as to why they did not receive this credit. The VITA programs should continue to work with clients to understand the EITC, their eligibility for this credit, and how to include this in their tax return to maximize their refund and take advantage of credits due to them.

### **Savings and Asset Building**

Thinking of tax refunds as a supplemental income, this money can be used to build assets through direct depositing of refunds, designating refunds in saving or investment accounts, refund splitting and referrals from tax program staff to asset building programs. Substantial savings, and thus asset building, could occur if more people took advantage of these programs. The dollar amount of refunds received

by self-employed Vermonter Poll respondents ranged from \$35 to \$7,000 with an average of \$1,637 and a median of \$1,000. Given the receipt of appropriate refunds and credits, a positive finding is that Vermonter Poll respondents are, in general, saving a greater amount and proportion of their refund compared to spending it. Poll results show that 55% saved half or more of their refund compared to 45% who saved less than half of their refund. The majority of respondents over both years saved their refund in some form of bank account, such as a savings, checking, money market, IDA, or CD; however, it is interesting to note that the proportion of bank savers decreased to about two thirds in 2009, with a resulting increase in the proportion who saved money in other ways that were more long-term including investing in stocks or bonds (14%) and in a retirement account (9%).

Over 80% of SETI clients have either a savings or checking account or they have both and over 50% specifically have a savings account and a specific plan for growing the balance in this account.

Saving strategies include:

- Automatic deposit into account from paycheck
- Save a set amount on a regular basis
- Save what is available or left over after bills are paid, regular or random basis
- Save using a program such as an IDA
- Not actively saving but not spending beyond means
- Use of savings, checking, retirement accounts or certificate of deposit

Of self-employed clients who save money, the main purposes for saving were to purchase a house or vehicle, pay bills, property taxes, and education costs, ensure family members' security, and have money in case of an emergency or to pay for a vacation. Regarding saving money for retirement in an IRA or another form, people surveyed in 2009 were slightly more likely to be saving money for retirement (33%) compared to 21% in 2007-08.

### **Spending Patterns**

Regarding spending their tax refunds, the most common uses of tax refunds by both Vermonter Poll and SETI respondents, which is consistent over time, are to pay bills or purchase necessary items and to pay off debt. However, differences in other spending patterns exist between Vermonter Poll and VITA respondents, most likely due to different socio-economic standings.

VITA clients are using their tax refunds on essential items rather than making nonessential purchases. In fact, 2009 clients are significantly more likely to have spent their refund to pay off debt compared to 2007 and 2008 clients. The researchers speculate that this shift in spending patterns may reflect the current economic conditions with people having less disposable income to spend on discretionary purchases. A higher proportion of 2009 clients reported paying bills (64%) and debt (31%) compared to those surveyed in previous years. Also consistent through all years was that very few clients reported spending their tax return money on nonessential items, prepaying bills, investing in their business or donating it to charity. These types of expenditures suggest that many VITA clients have limited economic mobility. Consequently, VITA survey results show that the main reasons clients are not saving money are that they are not employed and looking for a job, not making enough money or are living

paycheck to paycheck, do not have money left over to save after paying bills and necessity items or paying off debt. Almost half of self-employed VITA respondents, 49% in 2009 and 43% in 2007-08, felt that debt was a problem for their household, with almost two-thirds (30%) facing a high debt range of \$10,000 or more. VITA services are essential to assist the self-employed population in minimizing the cost of their tax returns and maximizing their refunds received to increase supplemental income and possibly encourage savings over time.

However, Vermonter Poll results showed an increase in the percentage of self-employed respondents, from 9% in 2008 to 22% in 2009, who used their refund to purchase non-essential or luxury items, such as large appliances or furniture, a vacation or other fun family activity (e.g. ski passes) increased. A slight percentage increase was also observed for the remaining categories of necessary items such as food, clothing and medical bills, purchasing a home or house repair, and purchasing or repairing an automobile.

## **RECOMMENDATIONS**

Through free tax preparation services and taking advantage of tax refunds and credits and savings opportunities, given the high prices being paid for tax filing and the benefits of VITA services demonstrated in this report, self-employed Vermonters have an opportunity to reduce or eliminate the cost of their tax returns, maximize their refunds and credits, and minimize the risk of errors. Outreach to this target population should increase, educating people about the strong credentials of VITA staff as well as the location, timing, purpose and eligibility requirements of the program. These strategies may help potential clients overcome negative misconceptions about free tax preparation services. In addition to enhanced marketing and outreach, tax preparation staff should standardize their method of educating clients about the IDA program and use of direct deposits to capture those interested in these programs, to encourage more clients to save money and build assets.

- For several years CVCAC has operated a highly successful drop-off tax preparation program which is more efficient for busy business owners and those living in more rural areas. CVCAC has for several years encouraged the IRS to relax its prohibitions related to the preparation of Schedule C tax returns at VITA sites. The IRS is currently taking these suggestions under advisement. CVCAC is pleased that the IRS has recently adopted a modified drop-off program based on CVCAC's successful model. CVCAC's Tax Program Director will continue to work with IRS personnel to encourage them to adopt new rules which would relax their prohibitions related to Schedule C tax returns. Both of these efforts are designed to provide fast, accurate tax preparation service for all low-income Vermonters.
- Given that at the present time VITA sites in Vermont are not encouraged to complete full-scale Schedule C tax returns, CVCAC should replicate its successful parallel drop-off method to the four other CAAs to enable them to complete the more complicated Schedule C tax returns that they are unable to complete through their VITA sites. This will enable the Self-Employment Tax Initiative program initiated at CVCAC to be expanded statewide.

- Already CVCAC has encouraged the IRS to relax its prohibitions related to the preparations of Schedule Cs at VITA sites and adopted a modified drop-off program based on CVCAC's successful model. CVCAC's Tax Program Director will continue to work with IRS' Rural Strategy Team to encourage them to relax their prohibitions as the drop-off program is more efficient for busy business owners and rural tax programs.
- Emphasize in marketing the VITA program statewide that all tax preparers are trained and certified by the IRS to increase the credibility of the VITA tax preparation program. Recent news stories have mentioned that the IRS is considering cracking down on unlicensed tax preparers due to the preponderance of errors in returns completed by these preparers. The VITA program can distinguish itself by emphasizing that its staff is trained and certified by the IRS.
- Thirty-three percent of clients surveyed expressed interest in learning more about the IDA program, demonstrating that there is a target audience that has yet to be reached and could benefit from this program.
- VITA staff should continue to encourage clients' to use the direct deposit and/or the refund splitting feature to increase their savings and asset-building activities; staff and IDA specialists should also continue to educate clients about asset building with their refunds through programs such as the IDA.