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Delaying Tax Refunds for Earned Income Tax Credit and Additional Child Tax Credit Claimants

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December 7, 2016

The Protecting Americans from Tax Hikes Act of 2015 requires the IRS to delay tax refunds for taxpayers who claim an earned income tax credit or additional child tax credit on their returns until at least February 15. The delay could help the IRS better check claims for these credits. But this new requirement will delay refunds only for certain low-income tax filers, in particular low-income families with children. Many of these families file their returns early and use refunds quickly to pay down debt or for spending on necessities. Delaying refunds will likely lead to additional financial hardships for some of these families, who in previous years had received and used their refunds before February 15.

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EXECUTIVE SUMMARY

The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) mandates that the Internal Revenue Service (IRS) must wait until February 15[1] to issue a refund to any taxpayer who claims an earned income tax credit (EITC) or additional child tax credit (ACTC)[2]. Under prior law and practice, the IRS released most refunds about a week after tax filing. The new refund delay legislation takes effect in 2017, when taxpayers file their 2016 individual income tax returns. Tax refunds can contain two components: refundable credits such as the EITC and ACTC and taxes that have been withheld from paychecks throughout the year that the taxpayer ends up not owing in full (often called overwithholding). All of a refund owed a taxpayer will be delayed if the taxpayer claims an EITC or ACTC, not just the portion of the refund attributable to the credits.

Filing-season statistics from the IRS show that the IRS typically begins sending out refunds at the end of January. The delay in paying refunds to EITC and ACTC claimants starting in 2017 provides the IRS additional time to verify the amount of wages reported on each return with the amount of wages reported by the worker's employer or employers. In past years while processing most returns and paying refunds, the IRS received wage reports from employers too late for verification because many employers had until March 31 to report employee wages. The PATH Act accelerated reporting of wages by employers to January 31 (the same date employers are required to report wages to employees).[3] Verification of wages on returns claiming an EITC or ACTC could help reduce erroneous refunds of these credits, which are based (in part) on wages (and earnings from self-employment). It remains to be seen whether these PATH Act provisions will reduce erroneous refunds to EITC and ACTC claimants. What is clear, however, is that any delay in receiving tax refunds could be costly for those taxpayers who have come to rely on their refund as an important source of income in January and early February. This report focuses on the effect the legislation could have on vulnerable families.

Using tax data from Intuit Inc., a survey of low-income tax filers, publicly available IRS data, and interviews with tax preparers who help low-income families file tax returns, we assess the extent to which taxpayers may be affected by the refund delay and how a delay could affect these filers. Analysis of the Intuit data shows that although the refund delay will particularly affect low- and moderate-income families with children—the primary beneficiaries of the EITC and ACTC—very low income taxpayers without children will likely also be affected. Workers without children receive just 3 percent of EITC benefits but account for 25 percent of all EITC recipients (Koskinen et al. 2014). These filers claim a small EITC but can receive large refunds when other credits such as the American Opportunity Tax Credit, which offsets college costs and overwithholding, are included.

We focus our analysis primarily on workers with children whose refunds can contain significant EITC and ACTC amounts. While some workers without children at home may be able to reduce the size of their refunds by decreasing their withholding throughout the year (limiting the amount of their money tied up with the delayed refund), this option is not available to workers with children. Adjusting withholding cannot help families with children avoid getting a large refund, because withholding cannot account for the refundable portion of credits. An unintended consequence of the law may be that childless workers opt to forgo receiving (relatively small) EITC benefits (i.e., by not claiming the credit) in order to avoid the refund delay. The extent of this will not be known until after the 2017 filing season.

Further, we focus on those people who in the past have filed their returns before February 15, who likely represent the type of filers who will be affected by the legislation. The PATH Act requires no changes to when the IRS delivers refunds to taxpayers who claim the EITC or ACTC and file after February 15. The refund delay only matters for taxpayers who file returns early in the year and anticipate getting (and using) their refunds before February 15. Our analysis assumes that refunds for taxpayers who do not claim the EITC or ACTC, or who file after February 15, will not be delayed at all by new and changed processes the IRS puts in place because of the PATH Act.

In recent years, about one-third of tax returns have been processed by the IRS before February 15. The share of low- and moderate-income returns filed in this period was likely higher than the share for the whole population (Rubin 2016).[4] In the Intuit data we analyze, about one-third of returns were filed early. The share of all

EITC and CTC refunds filed early was higher. Returns filed early with children contained relatively large refunds: they were more than twice the size of refunds for all early filers.

Among families with children, there appears to be some need for a timely refund, particularly among early tax filers. Nearly four in five claimants of the EITC or CTC with children report facing a hardship related to their finances.[5] About 4 in 10 of these families had used an alternative (often high-cost) financial service in the six months before filing their return. Given their familiarity with these potentially high-cost loan products, these taxpayers might turn to them again in times of need. Our analysis also demonstrates the financial vulnerability of the households potentially affected by the PATH Act. The median EITC or CTC family with children reported only $400 in liquid assets and $2,000 in credit card debt, and fewer than half of these families reported they could access $2,000 in an emergency.

Finally, this paper also examines how affected households perceive the potential effect of a refund delay. A relatively small share of early filers reported that a delay of three to four weeks would have an extreme effect on their finances, but over 30 percent of these households thought even a one-week delay in receiving their refund would affect their finances somewhat. The most common way filers reported that a refund delay would affect them was by making them delay when they paid down debts or from missed bills or housing payments.

The new law will be a surprise to many affected households. Ninety-nine percent of households reported they had not heard anything about the potential delay in their refund.

INTRODUCTION

The EITC provides substantial assistance to low- and moderate-income families—particularly those with children. For the 2016 tax year, the Urban-Brookings Tax Policy Center estimates that on average EITC beneficiaries with children will receive a $3,314 tax credit. The EITC is fully refundable, meaning that the credit amount can exceed taxes owed. For most families, the credit exceeds their tax obligation. Families without custodial children, often called "childless" in tax terms, can qualify for a small EITC as well. The Tax Policy Center estimates the average EITC in 2016 for workers without children will be $295.

Most families with children who qualify for the EITC will also qualify for the ACTC, often called the refundable child tax credit (CTC). The CTC provides families with children a credit of up to $1,000 per child under the age of 17. For low-income filers, most or even all of this $1,000 can be refunded as the ACTC.

Receiving a tax refund has become the norm for taxpayers at all income levels. For 2015 income tax returns filed in 2016, three-quarters of all taxpayers whose returns were received and processed by IRS by April 22 were owed a refund. The PATH Act includes a new requirement that the IRS not pay tax refunds to filers who claim either an EITC or ACTC before February 15. Tax filers not claiming either of these credits may be paid a refund before February 15. The refund delay becomes effective in 2017, when taxpayers will file their 2016 tax returns. This is a change from previous years, when the tax law allowed (and the IRS sought to pay) refunds to taxpayers soon after returns were processed. Although officially the IRS intended to pay refunds within 21 days, anecdotes from return preparers suggest refunds were paid much faster, often in as little as seven days. An analysis of IRS data in 2005 suggests that nearly three-quarters of all EITC refund payments were made in January or February (Goodman-Bacon and McGranahan 2008). Refunds are paid faster when returns are filed electronically, and tax preparers must file electronically.

For many households that receive the EITC or ACTC, their tax refund constitutes a substantial portion of their yearly income, so any delay in receiving the refund may pose a substantial financial challenge. Many of these households likely plan to spend their refund on necessary expenses or to pay down debts. A delay in receiving their refunds may strain these households and draw them toward alternative financial products. In the past, taxpayers have been willing to pay relatively large fees to receive their refund quickly, as illustrated by the use of refund anticipation loans (RALs) and refund anticipation checks (RACs). An analysis of 2008 tax returns showed that nearly 1 in 6 taxpayers expecting a refund turned to one of these products, and 45 percent of all users of RALs and RACs did so before February 15 (Theodos et. al 2011). In fact, one argument in favor of speeding up refund processing was to help reduce the use of these products, which cost consumers about $833 million in RAL fees in 2006 and $740 million in 2007 (Wu and Fox 2010).

The delay is intended to help reduce errors in the EITC and ACTC, which have long been a source of concern. Whether that goal will be met will likely hinge on whether the IRS is able to take advantage of wage data that is supposed to be delivered to the IRS at the end of January rather than after the filing season is over (PwC 2016).

The IRS has not indicated how long refunds will be delayed, only that they intend to comply with the law, though they expect most refunds to be issued in less than 21 days.[6] Any delay may lead to increased financial hardship and strain for an already vulnerable population. We explore both the potential scope and impact of this delay on the population most likely to be affected by it. To examine these issues, we draw on several data sources; including a survey of low-income tax filers gathered in 2015 and 2016, tax data from Intuit, publicly available data from the IRS, and interviews with tax preparation volunteers.

We find that

- even though the benefits of the EITC and CTC are concentrated on families with children, many households without children will likely be affected by the delay; these households qualify for a relatively large refund, even though they receive only a small EITC;
- in our sample of Intuit data, households that file early in the tax season tend to receive larger refunds than those filing later, and households that claim the EITC or CTC file earlier than those not receiving these credits;
- the effect of the delay will likely be felt most acutely by those with the largest refunds, specifically families with children;
- four out of five of these families face some sort of financial hardship, and these families also report high rates of alternative financial service use and low levels of liquid assets; and
- most families receiving refunds intend to use the refund to pay down existing debt.

Both the low-income taxpayer survey and tax preparer interview data suggest that a refund delay will lead to moderate to extreme hardship for some people, even as very few people are actually aware of the delay. Besides concerns over financial hardships that could be created for some families, we note that delaying refunds for a subset of returns amounts to unequal treatment of some taxpayers. In addition, filers qualifying for only a small EITC may opt to not claim the EITC in an effort to receive a faster refund, forgoing benefits for which they are eligible.

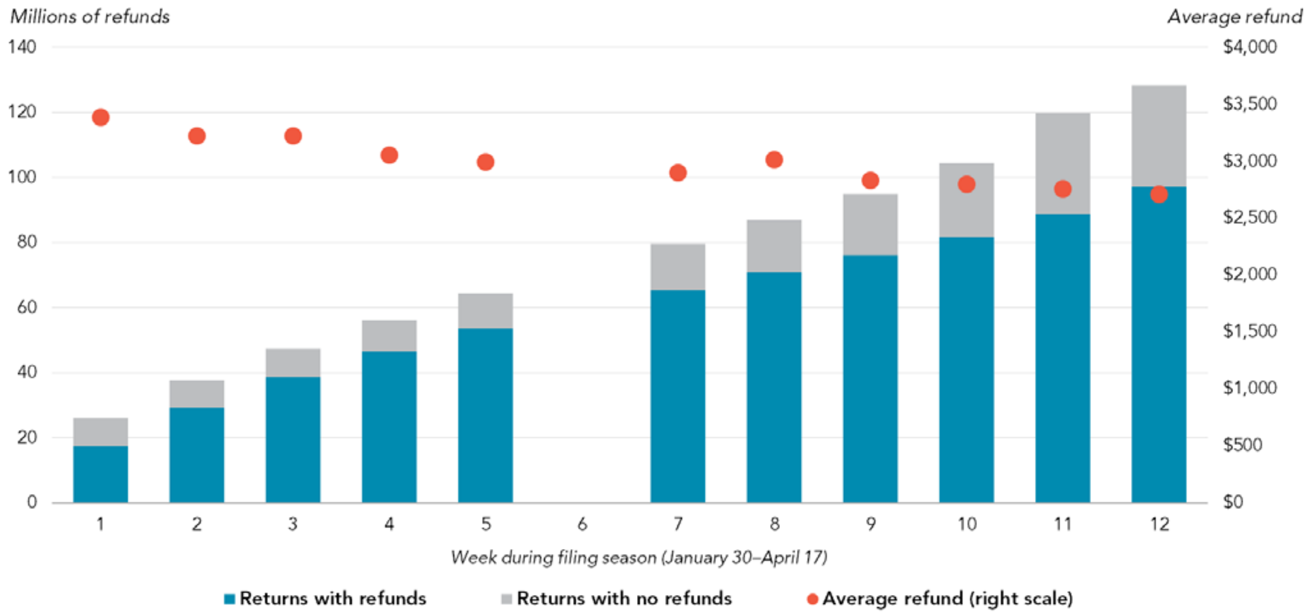
EARLY TAX FILING

Data from the IRS show that in 2016, almost one in five tax filers had filed his or her return by February 5. That share increased to almost 30 percent by February 12 (week 2). Of those returns that were filed early, 77 percent received a refund, averaging $3,224 (figure 1).

FIGURE 1

Cumulative Federal Income Tax Returns Processed, Returns Claiming Refunds, and Average Refund for the 2016 Tax Filing Season

February 5 through April 17



Source: "2016 and Prior Year Filing Season Statistics," Internal Revenue Service, last updated November 4, 2016, accessed November 8, 2016, https://www.irs.gov/uac/2016-and-prior-year-filing-season-statistics?_ga=1.86365851.2030263192.1477511733.

The IRS filing data do not include the number of returns that claimed an EITC or ACTC. However, taxpayers who file early tend to have larger refunds than those who file later in the tax season, and one reason for these large refunds is refundable tax credits. A family with two children could qualify for an EITC as large as $5,572 and a CTC as large as $2,000 in tax year 2016. Based on this, it is reasonable to conclude that returns including an EITC or ACTC are prominently represented in the group of early filers.

Taxpayers who claim an EITC may file early because they need their tax refund as soon as possible. When EITC recipients were asked how they plan to spend their refunds, the most common answer given was to pay bills (Linnenbrink et al. 2006; Mammen and Lawrence 2006). Other common responses included repairing cars and buying durable goods. Goodman-Bacon and McGranahan (2008) analyzed data from the Consumer Expenditure Survey and found that spending was concentrated on vehicles and other transportation. To better understand the of refund receipt timing, our analysis delves further into the question of how money is spent.

DESCRIPTION OF DATA

Some of the data we use were collected as part of the Refund to Savings Initiative[7] from users of TurboTax Freedom Edition (TTFE) in 2015 and 2016 (tax years 2014 and 2015). TTFE is a free self-prepared tax preparation software program accessed online and developed by Intuit Inc. as a part of the IRS Free File program.[8] To qualify for TTFE, households had to either fall below an income threshold or qualify for the EITC. In 2015 and 2016, the income threshold was set at $31,000, though military families could use TTFE if their incomes fell below $60,000 in 2015 or $62,000 in 2016. Data on tax filing date, adjusted gross income, receipt of tax credits, filer age, and refund amount come from the administrative data collected by Intuit on TTFE filers.[9]

Consenting TTFE filers responded to the Household Financial Survey (HFS) immediately after they filed their returns and could respond to a follow-up survey administered six months later. We match data from these surveys to the return data collected by Intuit on TTFE filers. These data allow us to outline the financial and life circumstances of the group of tax filers most likely to be affected by refund delays in the coming year.

Most of this analysis relies on the 2015 HFS data, including the follow-up survey, linked to 2015 (2014 tax year) return data.[10] A survey module was added to the 2016 follow-up survey to directly assess filers' perceptions of the refund delay.[11]

To isolate the tax filers most likely to be affected by the refund delay, this section of the analysis restricts the sample to EITC or CTC claimants with children in their household who filed their returns before February 15 in either 2015 or 2016. We focus on EITC and CTC households with children because, unlike childless EITC recipients who may be able to adjust their withholding to reduce their refunds (limiting the effect of any refund delay), families with children cannot do this because the bulk of their refund consists of the refundable portion of these credits. No mechanism exists to receive refundable credits before filing: they can only be received at tax time. Our data include 846 families with children that received an EITC or CTC and filed their 2014 return before February 15, 2015, and 1,032 similar families who filed their 2015 returns before February 15, 2016.

We conducted interviews with three leaders of Volunteer Income Tax Assistance sites to better understand why people claiming the EITC and ACTC file early. The sites were chosen because they represent relatively large Volunteer Income Tax Assistance operations and the administrators had several years of experience helping low-income families prepare returns.

RESULTS FOR ALL TAX FILERS

Just as shown in the IRS filing data, the filers included in the Intuit data we use also tended to file early. In 2015, about 40 percent of all returns in the TTFE tax data had been filed by February 15. We refer to the taxpayers who filed these returns as "early tax filers." A larger share of returns claiming an EITC or CTC were filed before February 15 than returns not claiming these credits. CTC claimants include both filers who claimed the refundable portion of the CTC (i.e., the ACTC) and filers who claimed only the nonrefundable portion of the CTC. Only the refunds of filers who claim either an EITC or an ACTC are subject to the delay. We are unable to distinguish in this set of data which filers claiming the CTC claimed only the CTC and no ACTC.

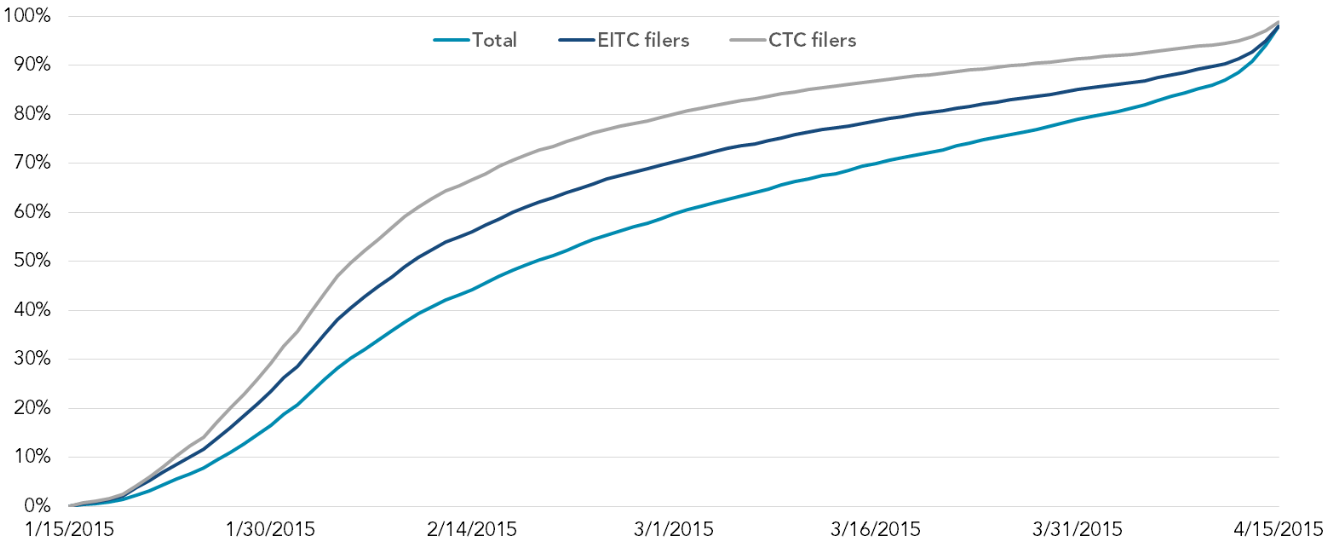
Because of the income requirements to use the TTFE, however, most filers claiming the CTC likely claim some amount of ACTC. Additionally, almost all CTC filers in our data (95 percent) also claim the EITC. Those EITC filers who do not claim the CTC often claim the EITC for workers without qualifying children.

Most EITC claimants (56 percent) and CTC claimants (67 percent) were early tax filers (figure 2). Only 44 percent of all returns in our data were filed early; only 35 percent of all returns not claiming an EITC or CTC were filed early (not shown).

FIGURE 2

Cumulative Tax Filing over the 2016 Tax Season; Turbo Tax Freedom Edition Filers

Cumulative percentage filing-by date



Source: Intuit's 2015 TurboTax Freedom Edition filings.
Note: Figure is based on the 852,238 Turbo Tax Freedom Edition returns filed.

In total, 42.5 percent of tax filers in the TTFE data claimed the EITC, 8.5 percent claimed the CTC, and 42.9 percent claimed either the CTC or the EITC. Because 56 percent of EITC claimants file early, we estimate that, had the delay been in place during the 2015 and 2016 filing seasons, roughly one in four low-income tax filers in the sample would potentially have been affected by a delayed refund.

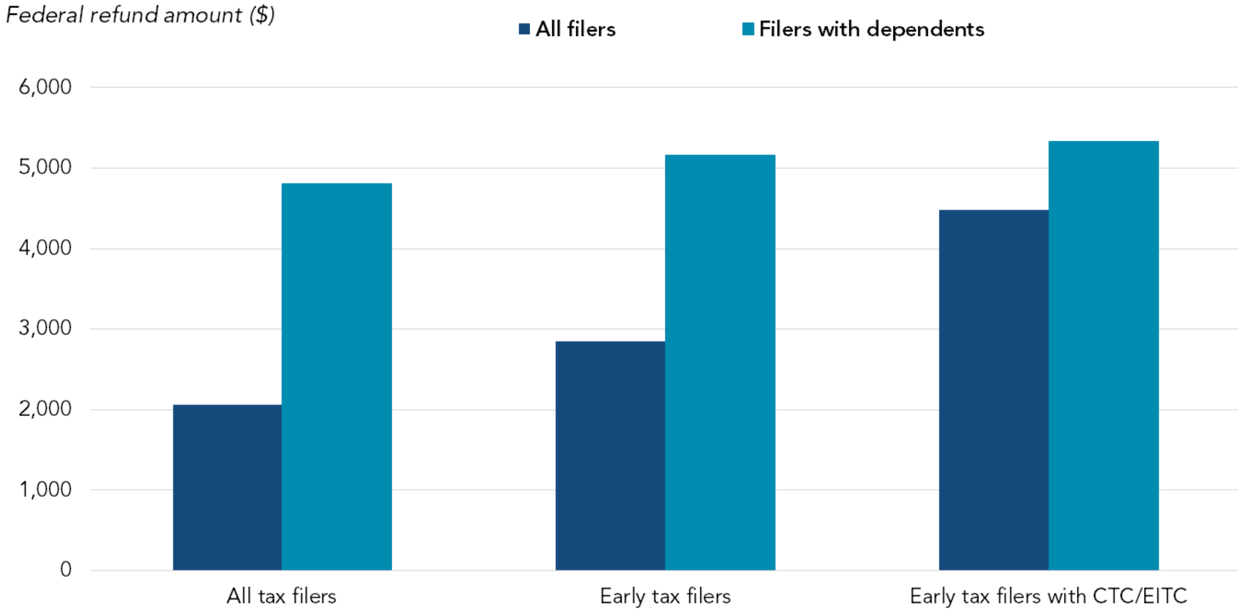
Households receiving refundable tax credits are more likely to file early in the tax season, implying a relationship between the size of the expected tax refund and the date of filing (figure 3). The average tax refund among TTFE users in 2015 was $2,055. Early filers received an average refund of $2,846, and early filers claiming the EITC or CTC had average refunds of $4,479. Families with dependents could expect larger refunds.[12] For early filers with dependents claiming the EITC or CTC, on average, about $850 of their refund came from other refundable credits or overwithholding.

Although most of the benefits of the EITC accrue to households with children, many households without children also receive the EITC and thus might be affected by the delay. In the 2015 TTFE data, 31 percent of low-income filers without children received the EITC (higher than the 25 percent reported by the IRS). The average refund for these filers was $870, which included an average EITC of $321. The amount in excess of the EITC came from other refundable tax credits and overwithholding.

FIGURE 3

Federal Tax Refund Amounts

Turbo Tax Freedom Edition filers



Source: Intuit's 2015 TurboTax Freedom Edition filings.
Note: CTC = child tax credit; EITC = earned income tax credit. Figure is based on the 852,238 TurboTax Freedom Edition returns filed.

RESULTS FOR FAMILIES WITH CHILDREN

As noted, families with children have little ability to reduce their refunds by altering their withholding. These families tend to have little or no taxable income because their income is less than the sum of the standard deduction and personal exemptions they qualify for. Consequently, they tend to have very little or no withholding. This makes a refund delay a substantially larger issue for early-filing families with children. We focus the remainder of our analysis on these families, using survey data from the HFS, supplemented with remarks from return preparers who work with low-income clients.[13]

Refund Usage

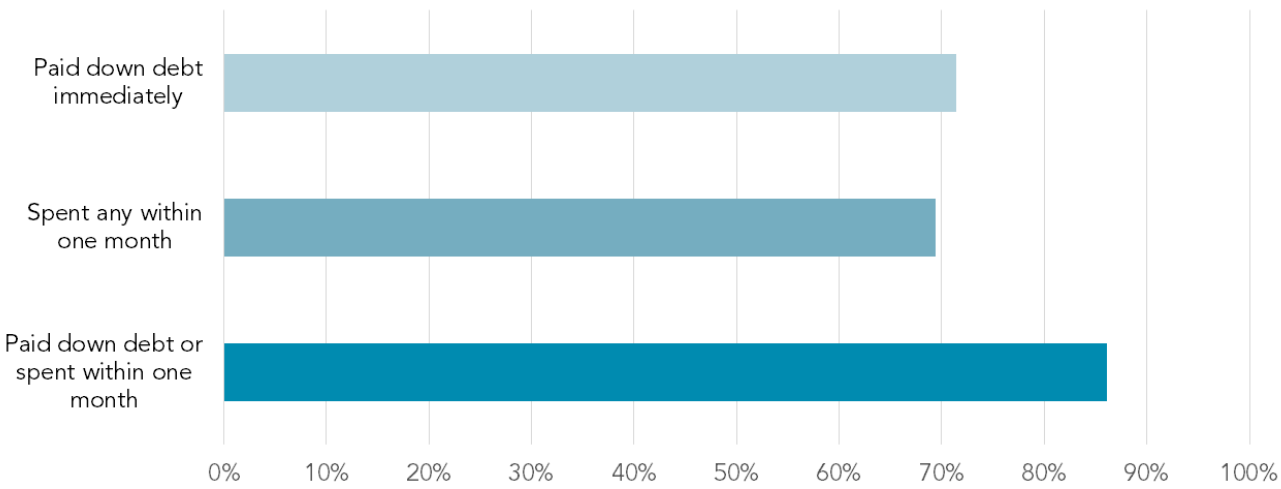
Tax preparers we interviewed who work with low-income families indicated that their clients needed the money from refunds as soon as possible. They described situations where a refund allowed a client to avoid dire circumstances, such as keeping a house out of foreclosure. Quantifying how many people needed refunds very early in the filing season nationally was not possible; our survey data are from families that opted to answer the HFS questions, and they are not nationally representative. We are able to see how early filers with children who claimed the EITC or CTC and answered the HFS used their refund, which provides some insight into the importance of early refunds to these filers.

Our data show that a substantial share (just over 70 percent) of early filers with children who answered the HFS used their refunds to pay down debt immediately, and around 70 percent reported spending at least part of their refund within one month. This amounted to 85 percent of families that either paid down debt or spent at least part of their refund within one month (figure 4).

FIGURE 4

Share of Tax Filers who Paid Down Debt or Spent Refund within One Month

2015

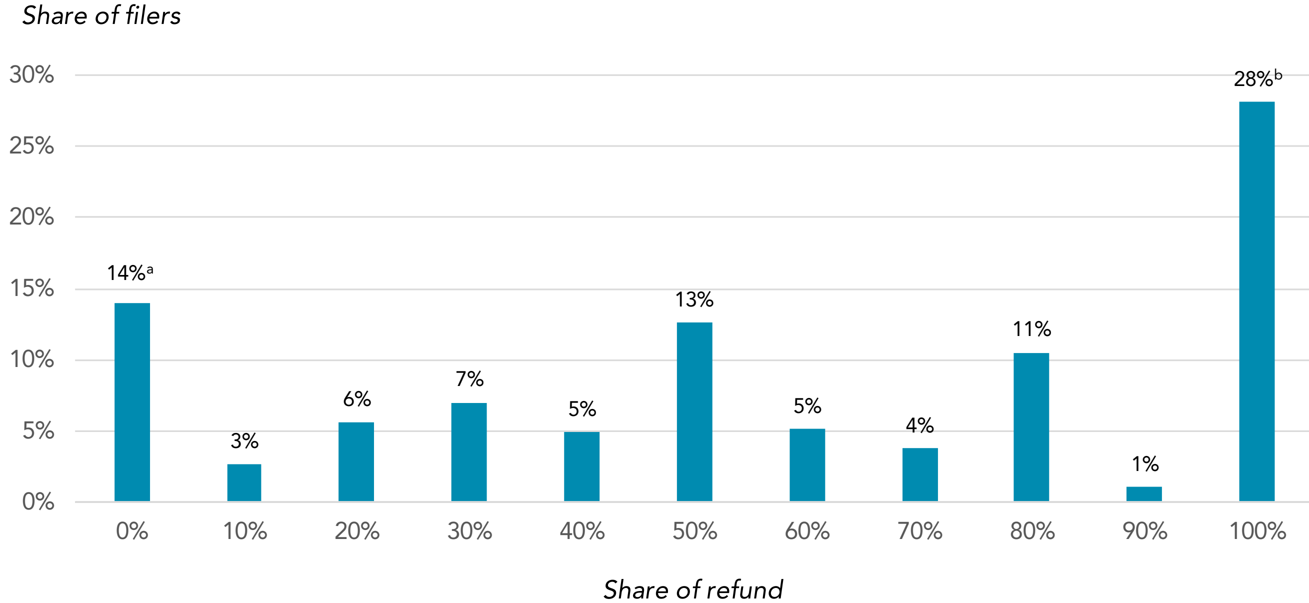


Source: 2015 Household Financial Survey.
Note: Figure is based on 846 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.

Many early EITC or CTC filers with children reported using large shares of their refunds within a month. Approximately 30 percent of these households used at least 90 percent of their tax refund within a month and 27 percent of families in this group reported using all of their refund to pay down debt or for spending immediately (figure 5). Only 14 percent of these households reported not using any of their refund within a month.

FIGURE 5

Share of Refund Used to Pay Debt or Spent within One Month



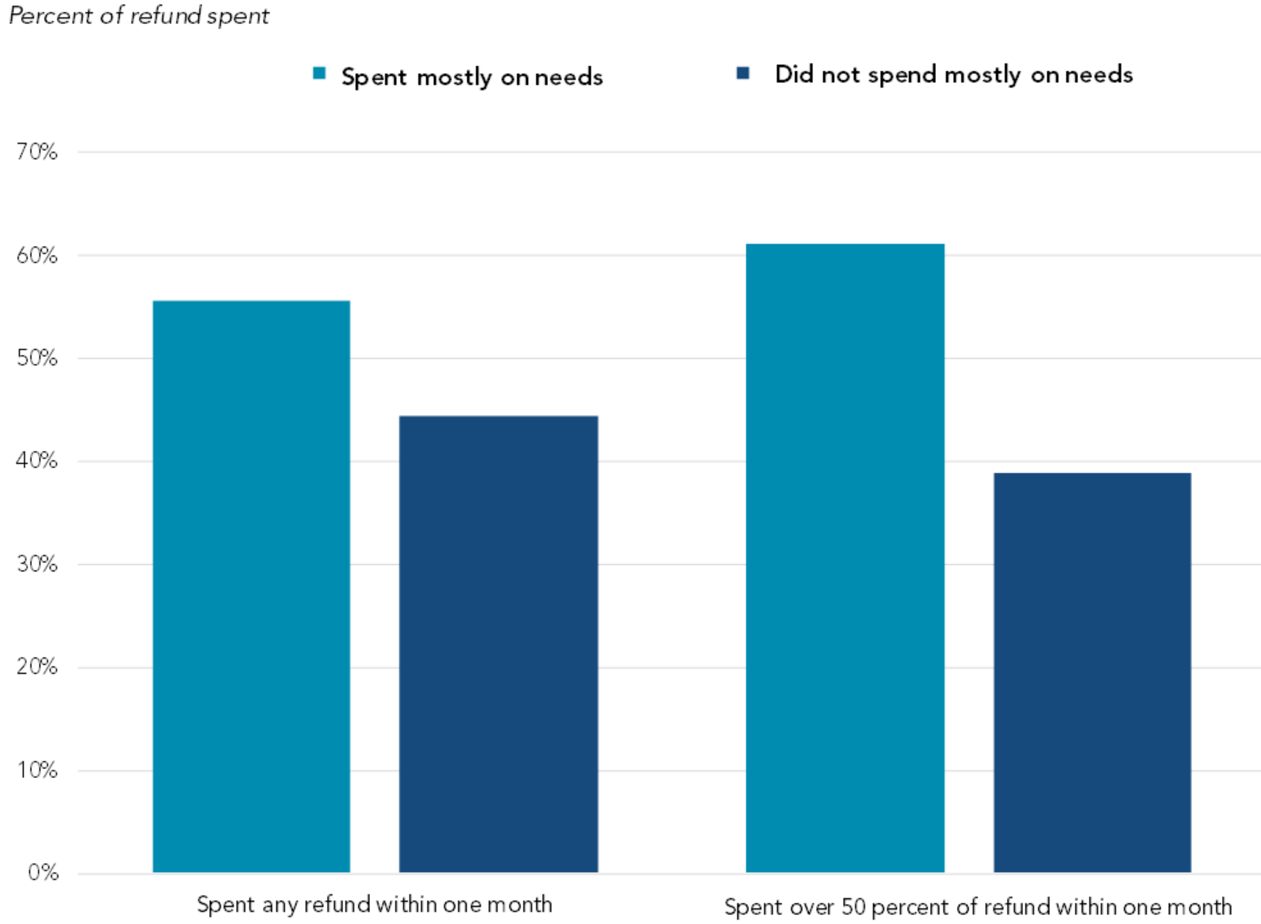
Source: 2015 Household Financial Survey.
Note: Figure is based on 846 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.
[a] 14 percent of filers spent none of their refund on consumption or to pay down debt within one month.
[b] 28 percent of filers spent all of their refund on consumption or to pay down debt within one month.

To get a sense of how filers were using their tax refunds, the 2015 HFS also asked respondents who spent at least part of their refund whether the spending was mostly on "needs" or mostly on "wants" (with the definition of needs and wants left to the respondent's own understanding of these terms). Of those who spent any of their tax refund within a month, over half reported that they spent the refund mostly on needs (figure 6). When isolating the analysis to those who spent over half of their refund within one month, the proportion reporting that they spent it mostly on needs increased to 61 percent.

FIGURE 6

Needs versus Wants

How early refund spenders used their refunds



Source: 2015 Household Financial Survey.
Note: Figure is based on 846 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.

Although the 2015 HFS did not ask respondents who spent at least part of their refund specifically what the spending was for, a version of the HFS used in 2013 explored this issue. Among families with children who spent at least a part of their refunds in the first month, the most common use was for household expenses, with smaller shares of families reporting spending for other purposes (table 1). Note that families could use the refund for more than one purpose.

TABLE 1

How the Tax Refund was Spent

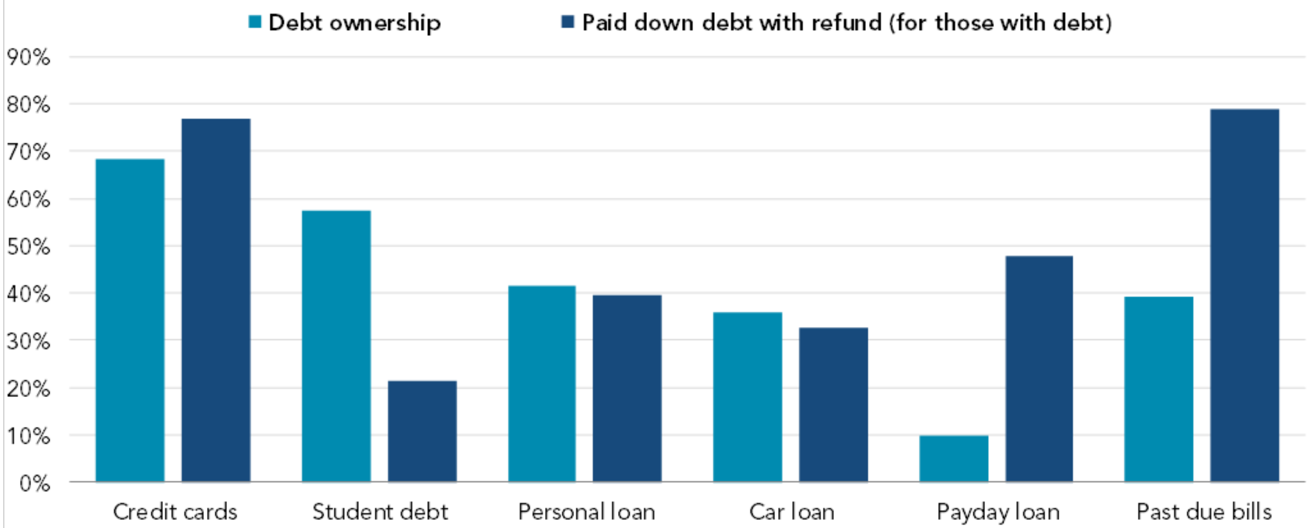
Was any of your tax return spent on…	Percentage
Household expenses such as rent, mortgage, bills, or groceries	83%
A big ticket item such as furniture, home repair, electronics, or a car	42%
School or training for a family member or yourself	10%
Necessities such as clothes, shoes, or school supplies	75%
Special things such as gifts, toys, or a vacation	37%
Emergencies or things that unexpectedly came up	40%
Other	7%

Source: 2013 Household Financial Survey Data.
Note: Table is based on 1,428 Household Financial Survey respondents.

For filers using their refunds to pay off debt, the effect of a refund delay may depend on the type of debt to be paid off. In some cases, the practice of holding debt for an additional month may have little bearing on the total cost of the loan. In other cases, delaying payment could put a person at risk of losing a car or home or lead to high fees or interest payments if he or she resorts to financial products such as payday loans. Although tax preparers we interviewed described these extreme situations, we found filers in our data had varying sources of debt. Filers most frequently used their refunds to pay down higher-cost debts and past-due bills (figure 7). Of those who paid down debt with their refund (71 percent), relatively few used the refund to pay down lower-interest installment loans, such as student or car loans, but almost 80 percent of those with credit card debt used the refund to pay it off, about the same proportion with past-due bills paid them off with the refund, and almost half of those with payday loans used the refund to pay them off.

FIGURE 7

Types of Debt Held by Early Refund Users and Share of Debt Holders Paying Down that Debt



Source: 2015 Household Financial Survey.
Note: Figure is based on 846 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.

Financial Characteristics of Early Filing EITC/CTC Families with Children

In some cases, the receipt of a tax refund has an important financial role because low-income taxpayers might have few other sources of support to turn to. We presume that filers who used any of their refund soon after receiving it, which we refer to as "early refund users," are likely to be more affected by any delay.

TABLE 2

Financial Characteristics of the Analytical Sample

By use of the refund

Financial characteristics	Full Sample	Early Refund User?	
		Yes	No
Adjusted Gross Income (mean $)	23,032	22,921	23,720
Employment			
Full time employment	64%	65%	63%
Part time employment	18%	18%	18%
Unemployed	18%	17%	19%
Total assets (median $)	13,430	12,188**	21,250
Liquid assets (median $)	400	350***	1,365
Total debt (median $)	33,760	33,510	40,650
Credit card debt (median $)	2,000	2,500**	1,000
Can access $2,000 in an emergency	45%	42%***	64%
Have credit card debt	69%	69%	64%
Own home	32%	31%**	41%
Observations	**846**	**728**	**118**

Source: 2015 Household Financial Survey.
Note: *p < .10; **p < .05; ***p < .01.

In general, EITC and CTC households with children who file their returns early are in relatively vulnerable financial circumstances. Their median holdings of liquid assets (i.e., checking and savings accounts, cash, prepaid cards, certificates of deposit, or money market accounts) are extremely low at only $400 (table 2). Additionally, 69 percent of this group has credit card debt, with a median debt of $2,000. Eighteen percent are unemployed, fewer than half can access $2,000 in an emergency, and only 32 percent are homeowners.

Overall, those households who used the refund within the first month (for spending or to pay down debt) were in a weaker financial position than those who did not. Though income and employment measures did not differ substantially between these two groups, early refund users held fewer liquid assets than later refund users ($350 versus $1,365) and had substantially more credit card debt ($2,500 versus $1,000). They were also less likely to be able to access $2,000 in an emergency (42 percent versus 64 percent) and had lower rates of homeownership. These results provide more evidence that those most likely to be affected by the delay in tax refunds are more economically marginalized: they have less of an existing buffer to weather shocks and stand to incur more expenses from unpaid debt than those who did not use their refund immediately.

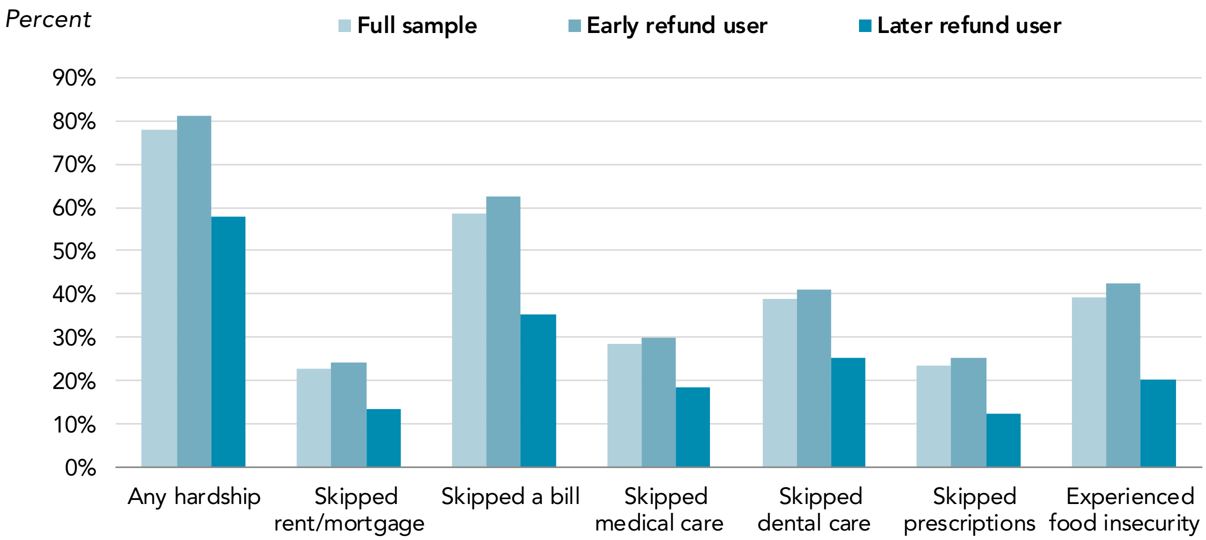
Material Hardships

Even a modest delay in receiving a tax refund can increase the hardship experienced by a population already fairly prone to hardship. To explore the incidence of several material hardships in this population, the 2015 HFS survey asked respondents to report their experience with any material hardship in the six months since they received their tax refund. Almost 80 percent of EITC and CTC filers with children who filed their returns early in the season reported high levels of material hardship in a least one of several areas (figure 8). Almost 60 percent skipped a bill in the past six months, almost 40 percent skipped necessary dental care, almost 40 percent could not afford the type or amount of food they needed (i.e., experiencing "food insecurity"), almost 30 percent skipped necessary medical care, and more than 20 percent skipped necessary prescriptions or skipped their housing payments.

FIGURE 8

Material Hardships in the Six Months after Filing Taxes

By use of the refund for early tax filers



Source: 2015 Household Financial Survey.
Note: Figure is based on 846 Household Financial Survey respondents with children who filed early and claimed the earned

Those filers who reported using their refund within one month of receiving it appeared to be much more prone to hardship in the months after filing their taxes. Compared with filers using their refunds later, they reported significantly higher levels of every type of hardship. Most strikingly, early refund users were over twice as likely to experience food insecurity as later filers and almost twice as likely to skip a bill, a housing payment, or a necessary prescription. Early refund users also reported significantly higher numbers of total hardships: on average, these filers reported 2.8 hardships in the six months after filing their taxes compared with 1.6 among later refund users.

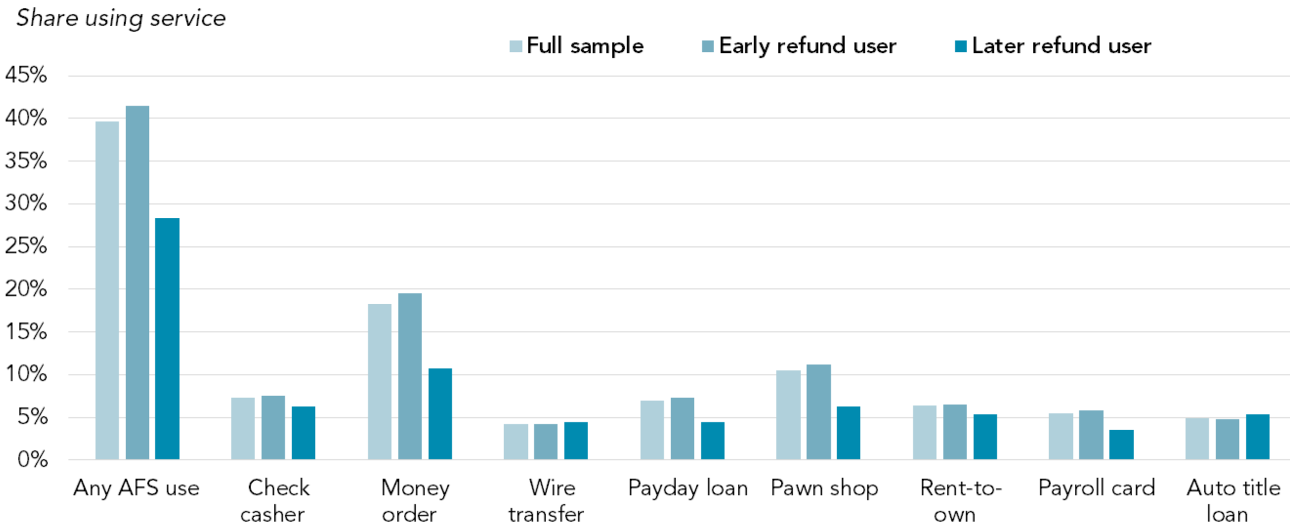
Alternative Financial Services Use

If a delay in receiving tax refunds makes taxpayers unable to cover necessary expenses or offset an unexpected emergency over the span of the delay, they may turn to high-cost alternative financial services such as payday loans, title loans, or pawn shops. HFS respondents were asked about their use of alternative financial services in the six months following receipt of their refund.

FIGURE 9

Use of Alternative Financial Services in the Six Months After Filing Taxes

By early and later refund users



Source: 2015 Household Financial Survey.
Note: AFS = alternative financial service. Figure is based on 846 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.

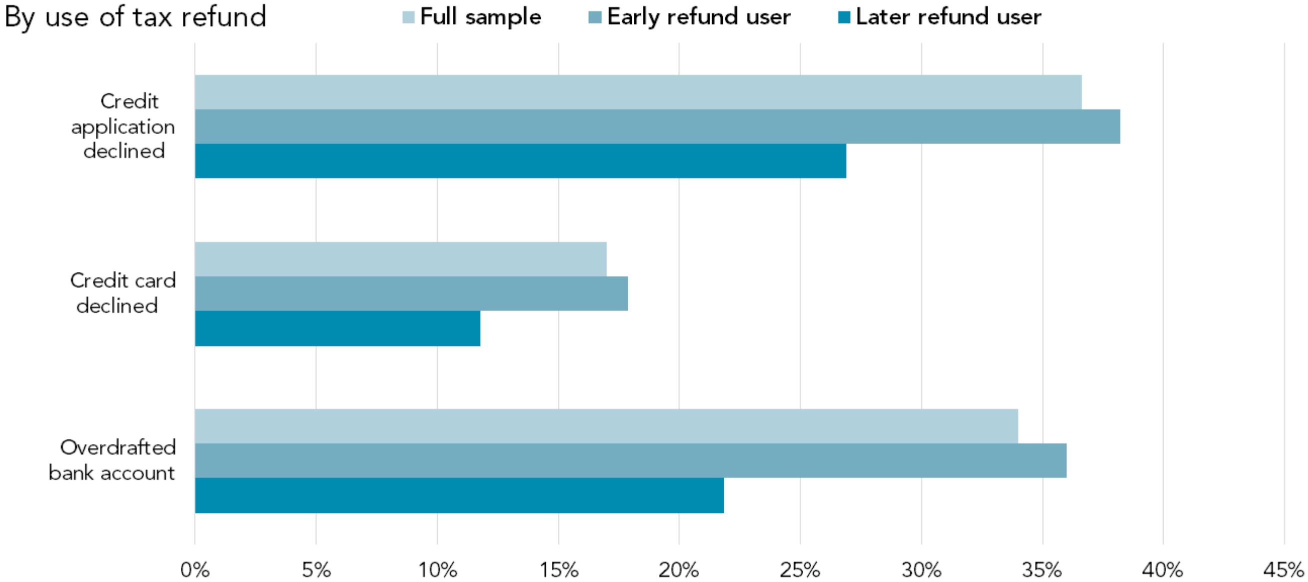
Generally, alternative financial service use was reasonably high in this sample; around 40 percent of these HFS respondents reported using at least one type of alternative financial service in the six months after they received their refund (figure 9). The most prominent types of services used were money orders (18 percent) and pawn shops (11 percent), with the use of other services ranging from 4 to 7 percent. Across many of these services, early refund users were more likely to patronize them than later refund users, and the incidence of payday loan and pawn shop usage is almost twice as high for early refund users as for later refund users.[14] Early refund users are also substantially more likely to use any alternative financial service than later refund users (41 percent versus 28 percent).

EITC and CTC filers with children may turn to alternative financial services because their options for traditional financial services may be limited. For example, filers may be much less likely to turn to alternative financial services if they can access lower-interest credit cards or if they have large enough balances in their bank accounts to help offset an unexpected expense. To understand filers' experience with mainstream financial services, the 2015 HFS asked respondents if they had a credit application declined, had a credit card declined because it was over the limit, or overdrafted their bank account in the six months since receiving their tax refund. In total, around 35 percent of these respondents had a credit application declined or overdrafted a bank account in the past six months; 17 percent had a credit card declined because it was over the limit (figure 10). Respondents who reported using the refund within the first month were significantly more likely to have had a credit card application declined (38 percent versus 27 percent) and have overdrafted a bank account (36 percent versus 22 percent).

FIGURE 10

Access to Mainstream Financial Services in the Six Months after Filing Taxes

By use of tax refund



Source: 2015 Household Financial Survey.
Note: Figure is based on 846 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.

Vulnerability to Shocks

Given the relative lack of access to traditional financial services and the lack of adequate balances in their bank accounts, EITC and CTC filers with children are likely vulnerable to even minor financial shocks. The 2015 HFS asked respondents about their experience with a variety of shocks in the six months since receiving their tax refund. Sixty-eight percent of these respondents reported experiencing any type of shock (table 3). Note that respondents could report more than one type of financial shock. The most prominent shocks were a major vehicle repair (41 percent), an unexpected reduction in income (26 percent; 14 percent of respondents reported that unexpected reduction came from an unexpected job loss), and an unexpected house or appliance repair (20 percent). Early refund use appears to be caused, at least in part, by unexpected financial shocks; 70 percent of early refund users reported an unexpected shock compared with 55 percent of later refund users.

TABLE 3

Unexpected Financial Shocks in the Six Months After Filing Taxes

By usage of the refund

Financial characteristics	Full Sample	Early Refund User?	
		Yes	No
Any unexpected shock	68%	70%***	55%
Lost job	14%	14%	15%
House/appliance repair	20%	21%	15%
Major vehicle repair	41%	43%**	32%
Legal fees/expenses	9%	9%	9%
Medical expenses	13%	14%	11%
Reduced income	26%	27%	20%
Natural disaster	3%	2%	4%
Crime affecting finances	7%	7%	6%
Major life change	7%	7%	6%
Observations	**811**	**701**	**110**

Source: 2015 Household Financial Survey.
Note: *p < .10; **p < .05; ***p < .01.

Case Studies on Filers Most At-Risk from a Refund Delay

Although many filers will be unaffected by the refund delay, the most financially vulnerable likely will be. Using the HFS data, we can highlight the stories of some of the respondents who likely face the highest costs of a delayed refund: low-income households that file their returns early, receive the EITC, have children, and who used their refund to pay down a payday loan. These households are likely handling many competing needs and using payday loans to make ends meet in the short term. Given the fee structure and high interest rates of payday loans, receiving refunds to pay down this debt as quickly as possible is critical for low-income households. The cases that follow provide detail about the financial lives and experiences of filers who use refunds to pay down debt (names have been changed to protect the identity of the respondents).

Case #1

Sandra is a 28-year-old single mother living in the Southwest and working full time for minimum wage. In the months preceding tax time, she reported struggling to pay her bills, put off a necessary trip to the dentist, and had trouble buying food for herself and her child. In the previous year, she reported facing a substantial amount of volatility in her expenses. Sandra appeared to struggle substantially with her debt. At tax time, she was in default on $10,000 in education debt and had overdue bills; she was also paying down a car loan and had a $2,000 payday loan. Sandra used her entire refund, nearly $6,000, to pay down her car loan, her overdue bills, and her payday loan.

Case #2

David is a married 45-year-old homeowner from the Midwest with a household income of just over $25,000. David's household owed $8,000 in credit card debt at tax time as well as a $400 payday loan, which he reported taking out to help cover the cost of his mortgage and everyday expenses. David's debts severely outstripped his assets: his household had just over $100 in checking and savings accounts combined. The tax refund appears to have been instrumental in managing the household's debts: David reported allocating three-quarters of the $6,500 refund toward paying down credit card debt, the payday loan, and overdue bills.

Case #3

Charlie reported that his household had substantial debt issues. A medical emergency in the six months preceding tax time left the household with a $10,000 medical loan, and Charlie reported being in default on both the medical debt and on $5,000 he owed in student loans. These debts left his household little flexibility with their $35,000 income. Before tax time, Charlie reported taking out 12 payday loans to cover expenses and yet still skipped bills, medical treatment, and food to make ends meet. At filing time, he reported having a $500 payday loan. Like the other cases, Charlie reported that the tax refund was instrumental in handling household debts: he reported putting 90 percent of the $4,000 refund toward paying down credit card debt, bills, and the payday loan.

Tax Filer Perception on the Impact of a Refund Delay

To assess the potential effect of a delayed tax refund, the 2016 HFS asked respondents questions directly pertaining to the refund delay. Though the questions were asked of all filers, the results in this section are, as in the previous section, limited to EITC and CTC households with children who filed their returns before February 15.

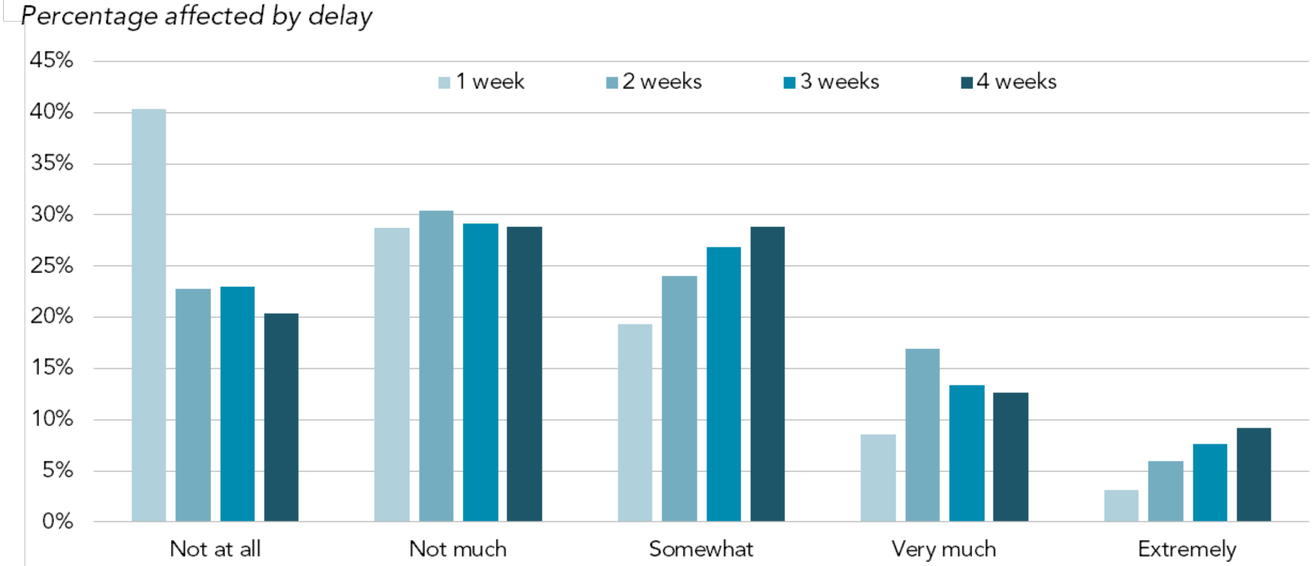
The survey first asked respondents "Thinking about the federal refund you received this year: If your refund had arrived X weeks later, how much would it have negatively affected your household's finances?" For this question, respondents were randomly shown a number of weeks ranging from 1 to 4, effectively allowing us to measure the perceived effect of different lengths of delay. This is important because the length of the delay for a return is not set in advance; it is a function of both when the return is filed and the length of time between filing and the IRS delivering the refund.

Even a one-week delay in receiving the refund was perceived as negatively affecting household finances; 31 percent of respondents reported it would affect them at least somewhat, though only 3 percent thought it would have affected their finances "extremely." As the length of the delay increases, the perceived effect on respondents' finances also increases; about 50 percent of respondents perceived a three- or four-week delay as negatively affecting their finances at least "somewhat," and this same length of delay would affect over 20 percent of respondents either "very much" or "extremely." Although only 8 to 9 percent of respondents reported that a three- to four-week delay would affect their finances "extremely," it is worth noting that this number likely translates to tens of thousands (and perhaps hundreds of thousands) of households in the United States.[15]

FIGURE 11

Perceived Effect of Refund Delay

By length of delay

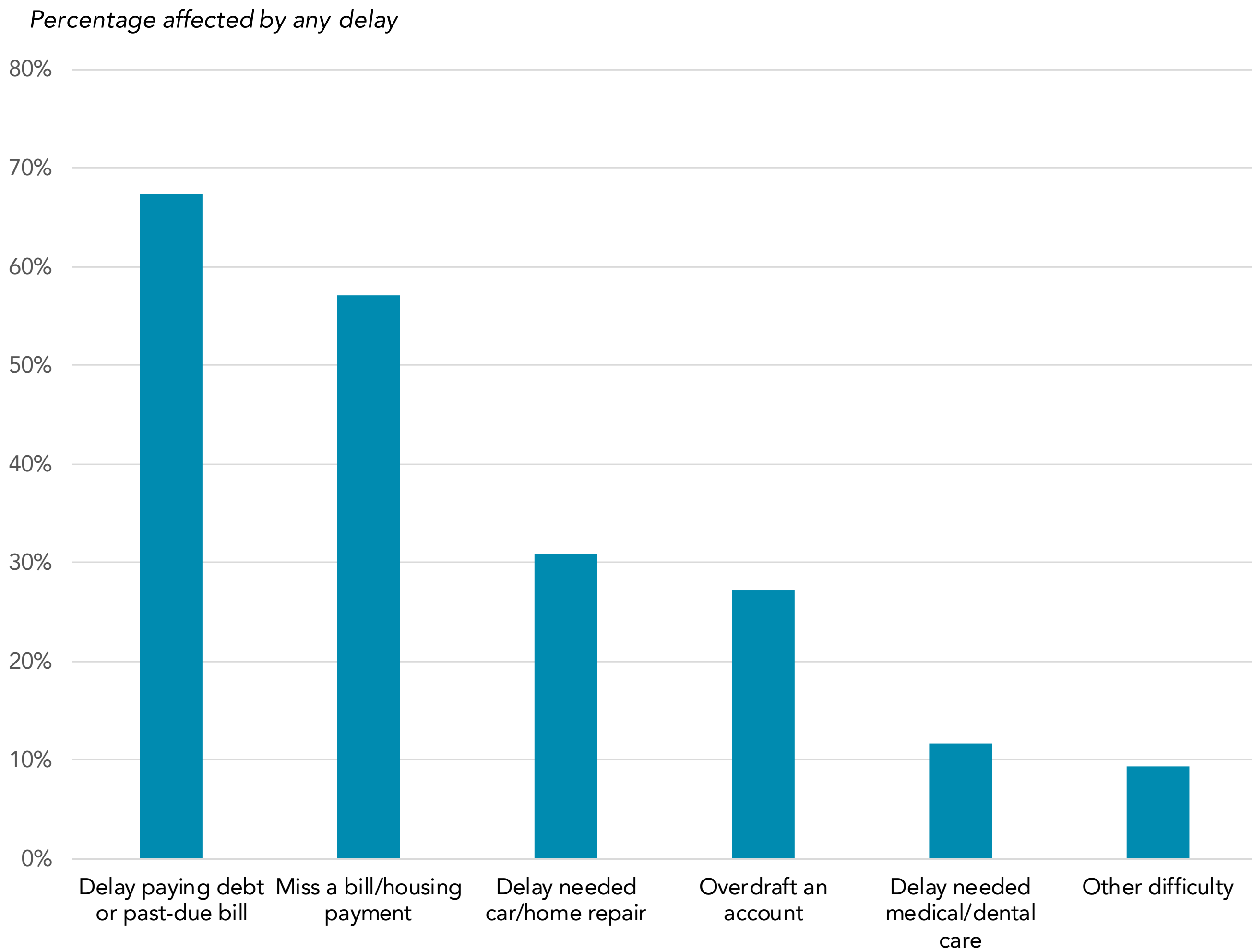


Source: 2016 Household Financial Survey.
Note: Figure is based on 981 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.

For those respondents who answered that any length of delay would affect them at least somewhat, the 2016 HFS also asked about the effect of a delay on specific measures of hardship. Over two-thirds of these respondents reported that any delay in the tax refund would increase the likelihood that they would delay paying debts or a past-due bill, and 57 percent reported that a delay would make them more likely to miss paying a bill or making a housing payment (figure 12). Additonally, 27 percent of these respondents reported that any delay would make them more likely to overdraft a bank account.

FIGURE 12

Likelihood of Increased Financial Strain Because of Delay



Source: 2016 Household Financial Survey.
Note: Figure is based on 981 Household Financial Survey respondents with children who filed early and claimed the earned income tax credit or child tax credit.

Finally, respondents were asked if they were aware that their refunds would be held until February 15. The results for EITC and CTC respondents with children strongly suggest such filers are unaware that they may face a delay in receiving their refund; 91 percent of respondents reported that they had not heard anything about the delay.

DISCUSSION

The PATH Act mandates that, starting with the 2017 filing season (when 2016 income tax returns are filed), no refunds can be paid before February 15 to a filer who claims an EITC or ACTC on his or her return. The legislation delays the IRS's issuance of the refund, potentially allowing the IRS time to use employer wage data to verify the amount of wages filers report (wages are an important determinate of the amount of these credits a filer is entitled to). How well the IRS can make such verifications remains to be seen, particularly because the PATH Act did not provide additional funding for potentially necessary technology upgrades.

Although the legislation has the greatest effect on low-income families with children, our analysis of IRS data and filing data from Intuit's TTFE shows that a large share of workers without qualifying children could be affected by the delay in refunds. Although childless workers receive just 3 percent of EITC benefits, they file 25 percent of returns claiming an EITC. A taxpayer's entire refund, not just the portion of the refund that comes from the EITC or ACTC, will be held up. Possibly, some childless workers will be able to reduce the size of their refunds by adjusting their withholding, mitigating the effect of a delay. These workers might also decide to not claim the small EITC for which they are eligible to avoid delaying their entire refund.

Families with children who are owed large refunds as a result of the EITC and ACTC will not be able to reduce their refund substantially. Withholding cannot be adjusted to reflect the refunded portion of the EITC and ACTC, and no other mechanism exists to deliver the EITC or ACTC throughout the year; the refundable portion must be paid as a tax refund following the end of the tax year. These families are particularly vulnerable to delays because they have sizeable refunds composed primarily of the EITC and ACTC.

Likely the largest effects of the refund delay will be felt by workers who file early. Data from the IRS and from Intuit show that about one-third of taxpayers file before February 15. The vast majority of early filers with children are owed a refund. The average size of this refund (in the Intuit data) was $5,328.

Delays could be quite costly for some, including for those who may seek costly alternative financial services to bridge the gap between filing and refund receipt and for others who face critical financial circumstances. Among our sample of early filers with children who claimed either the EITC or CTC, we found that a large share used at least some of their refund to pay off bills, and respondents reported that the majority of spending in the first month following receipt of a refund was on necessary purchases. These findings were supported anecdotally by tax preparers who have experience helping low-income families with their tax returns.

We found some evidence that tax refunds provide a buffer to vulnerable households. When compared with later refund users, early refund users were more likely to be faced with financial hardship, such as skipping a mortgage or rent payment, skipping medical and dental care, or facing food insecurity.

As refunds are delayed, some filers may seek alternative financial services, which can often be quite costly. In our sample of filers with children who filed early, we found that 40 percent had already resorted to using an alternative financial service. These filers may be prone to returning to these sources for additional financial help while waiting for their delayed refund.

Financial hardships such as job loss, other decreases in income, and major vehicle repair following tax return filing were relatively common. Early refund users were more likely to experience them than later refund users, showing that early refunds from the EITC and ACTC may be buffering the financial hardships of the most vulnerable.

To date, the HFS data indicate that most taxpayers are unaware that refunds will be delayed starting next year. When filers with children who filed early were asked about hypothetical delays, some indicated that a delay as short as a week could be costly. Longer delays would negatively affect a larger share of these filers. About half of the respondents, however, indicated that a delay would not affect them much or at all.

Delaying refunds for a specific group of tax return filers has not been used as an enforcement action in the past. Rather, our tax system fundamentally relies on taxpayers to file accurate returns.

Whether the delay will ultimately lead to a cascade of negative financial actions for some low-income working families remains unclear. Our data and analysis show that low-income families with children receive relatively large refunds, mostly because of the EITC and CTC. These families reported needing a tax refund to pay down past debts and pay for other necessities, and they reported lacking a very large safety net, which increases their refund's importance. So it seems clear that for at least some vulnerable EITC and ACTC recipients, delaying refunds could be quite costly. It is not clear, however, how much the delay will improve the IRS's ability to identify potentially erroneous EITC and ACTC claims before refunds are sent out.

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[1] The specific requirement in the legislation is that the IRS delay refunds until the 15th day of the second month following the end of a taxpayer's tax year. Nearly all individuals file on a calendar-year basis, so for most filers the delay is until February 15.

[2] The ACTC is the refundable portion of the child tax credit.

[3] The PATH Act did not change the January 31 date for reporting wages to employees.

[4] Richard Rubin, "Tax-Refund Delays Seen Hitting Low-Income Households," *Wall Street Journal*, May 11, 2016, http://www.wsj.com/articles/tax-refund-delays-seen-hitting-low-income-households-1462998418

[5] Our data do not allow us to separate refunds containing an ACTC from those containing only a CTC. However, most families in our data that receive the CTC also receive an EITC, so they are likely to receive an ACTC because the data includes mostly low-income filers.

[6] "New Federal Tax Law May Affect Some Refunds Filed in Early 2017." Internal Revenue Service, last updated June 9, 2016, accessed October 8, 2016, https://www.irs.gov/for-tax-pros/new-federal-tax-law-may-affect-some-refunds-filed-in-early-2017.

[7] The Refund to Savings Initiative is run by the Center for Social Development at Washington University in St. Louis in partnership with Intuit.

[8] For more information on the Free File program, see "About the Free File Program," Internal Revenue Service, last updated November 1, 2016, accessed November 8, 2016, https://www.irs.gov/uac/about-the-free-file-program.

[9] These data were collected on 852,238 filers in 2015 and 749,207 filers in 2016.

[10] In total, 23,925 households completed the first wave of the HFS (administered after tax filing), and 8,836 households participated in the follow-up survey (administered six months later).

[11] Although data collection is ongoing for 2016, at the time of this report, 24,786 tax filers had completed the first wave of the HFS, and 4,231 respondents had participated in the follow-up.

[12] The TTFE data used for this analysis includes the number of dependents in each tax return but not the number of dependent children specifically. Including returns with nonchild dependents in figure 3 produces a somewhat conservative estimate of the overall refund size for EITC and ACTC households with children. As a robustness check, the same analysis was run for filers who completed the HFS after filing their returns, allowing us to measure the refund size for those who reported having children. These results were not substantially different than those in figure 3.

[13] As the survey asks about children in the household, we are able to specify the analytical sample based on the presence of children in the tax household rather than the presence of dependents generally (as in the previous analysis of tax data).

[14] Note that this difference is only statistically significant for money orders.

[15] We are not able to make a precise estimate, in part because the HFS is not a statistically random sample and in part because we do not know how long refunds might be delayed beyond February 15.

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