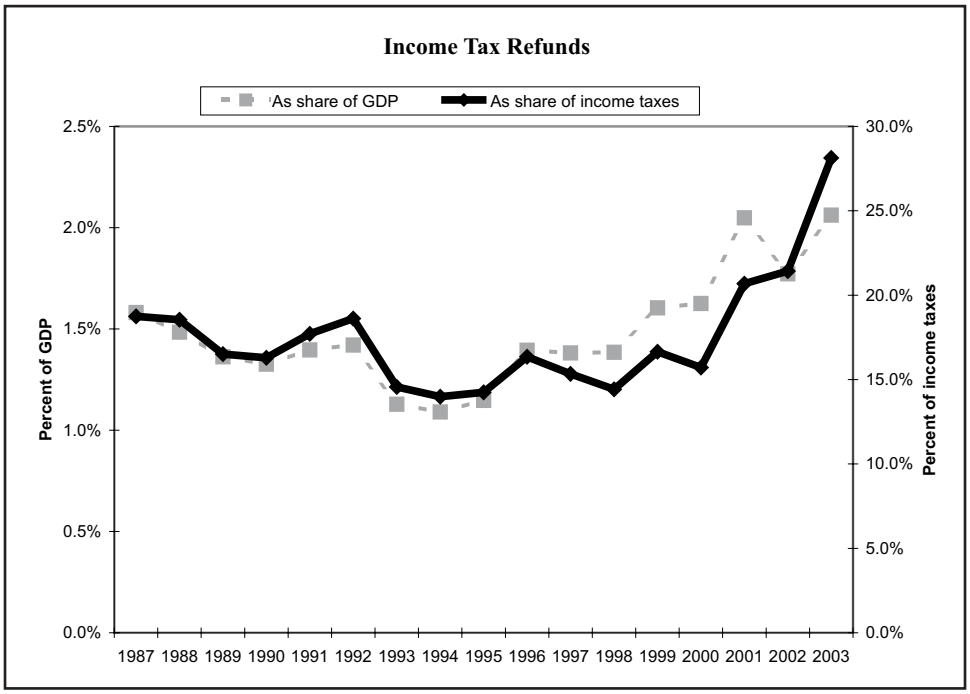
Individual Income Tax Refunds

By Peter R. Orszag

In recent years, income tax refunds have grown markedly. In fiscal 2003, individual income tax refunds amounted to $223 billion. The chart shows that tax refunds declined modestly in the late 1980s and early 1990s, rose a bit during the late 1990s, and then rose sharply following enactment of the 2001 tax legislation. As a share of gross domestic product, income tax refunds were almost twice as high in 2003 (2.1 percent) as in 1993 (1.1 percent). Similarly, as a share of income tax receipts, refunds are now substantially higher (28 percent) than in the mid-1990s (roughly 15 percent). Refunds are not only substantial in the aggregate, but also very common. Data from the Internal Revenue Service suggest that more than three-quarters of filers receive an income tax refund.

The vast bulk of these income tax refunds are not linked to the earned income tax credit. In 2003, for example, the EITC amounted to $32 billion, or less than 15 percent of total income tax refunds. Instead, income tax refunds primarily reflect overpayment of withholding taxes. Economists have long wondered why so many families receive income tax refunds, since the refunds reflect an interest-free loan to the government. (A family could reduce withholding taxes, and thus gain access to the money earlier in the year, rather than waiting for the refund.)

Whatever the explanation, the substantial magnitude and prevalence of refunds raise potential policy opportunities. The administration and other policy analysts, for example, have proposed encouraging households to deposit part of their income tax refunds into savings accounts and part into checking accounts. Refunds are not only substantial in the aggregate, but also very common. Data from the IRS suggest that more than three-quarters of filers receive an income tax refund.



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