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Refunds grow fat on tax changes

By Dennis Cauchon, USA TODAY

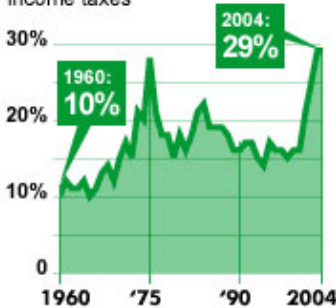
Americans are enjoying their biggest tax refunds ever — and it's costing them billions of dollars.

Taxpayers overpaid their federal income taxes by a record 29% in both 2003 and 2004, according to a USA TODAY analysis of Internal Revenue Service data.

That has pushed refunds above \$200 billion a year. Final figures aren't in for the 2005 tax year, but the average refund so far is \$2,423, up 4% from last year.

Hefty withholding

Taxpayers are having a larger percentage of their wages withheld from their paychecks, usually more than they need to for their federal income taxes



Source: IRS
By Ron Coddington, USA TODAY

The fatter refunds are the result of taxpayers withholding nearly twice the traditional safety margin from their paychecks to avoid a year-end tax bill. (**Related story:** [It pays to be on the mark on W-4s](#))

The extra withholding gives the government an interest-free loan worth more than \$10 billion a year, equal to about \$100 per tax return.

"The deficit is a little smaller because of this voluntary tax," says Leonard Burman, co-director of the Tax Policy Center in Washington.

The increasing use of tax credits and deductions caused the jump in overwithholding.

Changes in tax rates automatically revise withholding levels, but changes in tax credits and deductions do not. Workers getting expanded credits or deductions must fill out new W-4 forms to change the amount of money deducted from their paychecks.

The child tax credit, which rose from \$500 to \$1,000 per child in 2001, is the biggest reason for a jump in excessive withholding. More than 25 million tax returns claim this credit, worth \$55 billion in 2005.

Tax credits are available for a dozen purposes, including college education, adoption assistance and child care expenses. The portion of returns claiming at least one credit rose from 13% in 1995 to 31% in 2003. Credits reduce the tax owed dollar for dollar.

Expanded deductions for health costs, college expenses and retirement accounts also played a role. Deductions reduce income that is subject to tax, rather than the tax itself.

Overwithholding has grown fastest among families earning \$50,000 or less a year because they benefit most from tax credits. Many low-income families obtain refund anticipation loans, which typically cost \$100 or more, to get their money about 10 days earlier than from Internal Revenue Service.

"It's crazy to lend your money to the government interest-free and then pay triple-digit interest for a refund anticipation loan," says Chi Chi Wu, a lawyer with the National Consumer Law Center.

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But many people love the forced savings and its reward — the fat refund — no matter how much it costs. "Taxes are so complicated people are just happy to come out ahead on April 15 rather than behind," says Ellen Katz, editor of the *Tax Savings Report* newsletter.

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