

Understanding Your Tax Refund: A Primer

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Teresa Meek, October 2017

Do you have your fingers crossed for a big tax refund? It always feels great to get a check in the mail, especially when the average tax refund is \$3,120, according to the IRS. A tax refund might feel like found money, but it really means you've paid the government more than you owe, and now they're giving it back.

Some people prefer to have less taxes taken out of their paycheck each month. In that case, they likely won't get a large refund. People who owe back taxes or have a lot of investment income also won't get a large refund or any refund at all.

How to Get a Refund: Tax Deductions

Did your friend get a bigger refund than you when you both make around the same salary? The size of your refund depends not only on your income, but on the deductions and tax credits you take. If you claim more, less money will be withheld - hence, if you have a lot of deductions and your friend doesn't, your refund will be less.

You can claim deductions for yourself, your spouse and qualifying dependents. You may also be able to deduct fees for professional societies, job search expenses and charitable donations.

How to Get a Refund: Tax Credits

A tax credit is a reduction in the amount of taxes you're required to pay. Tax credits can lower your tax payments even more than deductions. If you meet the IRS income limits, the earned income tax credit can cut \$500 to more than \$6,000 from your tax bill, according to the [IRS](#). There's also a child and dependent care credit, a child tax credit, a child and dependent care credit and education credits.

Choose Your Deductions and Credits Every Year

You can adjust the amount that gets withheld by filing a new W-4 form with your employer. Use the [IRS Withholding Calculator](#) to input your information to determine the deductions or credits you're eligible for. Then mark your choices on your W-4 form.

The Advantages of a Tax Refund

Whether it's large or small, your refund is an opportunity to put your money to work - if you don't spend it right away and all at once. Here are ways to consider using your refund money:

- Pay off debt - in 2016, 27 percent of tax refund recipients used the money to pay down debt, reports [Money](#).
- Start an emergency fund - [The Motley Fool](#) reports that nearly half of Americans don't have enough savings to cover an unplanned \$400 expense. You should have six months of living expenses available in an easy-access [savings or money market account](#).
- Refinance your mortgage - though mortgage rates have inched up slightly, they're still way below historic averages, according to [Mortgage News Daily](#). Use your refund to cover closing costs and fees and you could save thousands a year for the term of the loan.

The Disadvantages of a Tax Refund

- A refund means you've essentially given the IRS an interest-free loan by letting it take money from your paychecks. If you're a disciplined saver, you could have earned interest on the money instead.
- A big refund may tempt you to blow it all at once. Though most people use the money to improve their finances, [CBS](#) reports that 11 percent of people spent it on a vacation and 5 percent splurged on a luxury purchase in 2016.

No matter what the size of your refund, if you spend it wisely it can boost your finances for years to come.

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