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## Your Tax Refund is On Its Way - Now What?

Imagine you were just handed a check – a check in addition to and larger than most of your paychecks. Do you know what you would do with this money? And what would it take to change your mind?

Last week marked the end of tax season, with millions of families now awaiting the arrival of their tax refunds and, in many cases, of additional tax credits which represent the lion's share of America's income redistribution efforts. According to the advocacy group Prosperity Now, refunds received at tax time can make up as much as 30% of a low-income family's annual income. Consumer advocates and financial empowerment organizations, including Volunteer Income Tax Assistance (VITA) program providers, have long seized upon tax time as an opportunity to promote savings as a path to financial empowerment. VITA providers frequently target tax filers with savings bonds, financial coaches, prepaid debit cards, and no-frills checking accounts as part of the tax filing process, and encourage families to direct all or part of their refund to savings. And it's true - tax time presents an opportunity to engage with some of the most vulnerable families about their finances and provides a teachable moment to leverage an impending tax refund for some kind of "financially healthy" use.

In 2016, the research group MDRC released [a randomized evaluation of the program SaveUSA](#), which provided a match incentive to low- and moderate-income tax filers who saved a part of their tax refund for a full year. Program participants saved an average of \$522 - 30 percent more - than regular tax filers, and were eight percentage points more likely to have any kind of savings 42 months later. While these results are important, they do beg the question- could these families be getting more bang for their buck?

One of the recognitions in last year's Nobel Prize in economics to Richard Thaler, who is said to have brought the humanity back to economics, was the idea of mental accounting. That is, even though a dollar spent or saved in one domain of our lives is equal to dollar in another domain, we tend to simplify our math by separating it into smaller mental buckets – our grocery money, our vacation savings, etc. By the time we get a tidy windfall already saved up for us by Uncle Sam, we may have already mentally allocated it towards a goal, which might be hard to undo.

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While every individual and family's situation differs, it is quickly gaining traction that the advisable option for the most financially insecure is to encourage them to prioritize paying down high-interest debt rather than increasing savings. According to [NerdWallet](#), the average U.S. household had nearly \$16,000 in credit card debt in 2017. With typical credit card APRs hovering between 13-16%, it's time to start looking at debt reduction as a first best approach to strengthen the financial stability of American families.

We discovered ... that mental accounting starts early.

A study from the [Center for Social Development at Washington University in St. Louis](#) shows evidence that small behavioral interventions, including anchoring (suggesting a number as a mental reference point) and prompts (changes in the concreteness of the goal messaging) can induce changes to tax-filer savings contribution while filing their tax returns online. These low-touch interventions were effective for savings, but can they create similar effects on debt repayment? [Innovations for Poverty Action](#) is conducting an evaluation to test whether [a small nudge of information](#) is enough to encourage tax prep customers to use their tax refunds to reduce costly outstanding debt. In partnership with the [CASH Campaign of Maryland](#), we included an encouragement to pay down high-interest debt as part of a typical VITA appointment reminder postcard. We discovered in the process, that mental accounting starts early. Some programs find when they introduce the idea of planning for a refund at the end of the tax process it's too late - people have already mentally allocated their refunds. So we tried to leapfrog this by sending the postcards early in the season.

If successful, this idea may shed light on a more promising, potentially more impactful approach to helping Americans best leverage their tax refunds to improve financial health. Research that takes into account a household's full balance sheet - not just savings - could provide give policymakers and practitioners new insight into the best way to help VITA clients and all Americans make the most of their tax refund dollars. How will you use your refund?

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