

## ECONOMIC FINDING

# Tax Refund Uncertainty: Evidence and Welfare Implications

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*Low-income tax-filers have substantial subjective uncertainty about tax refunds; this research suggests that refund uncertainty reduces the welfare benefits of the EITC by about 10 percent.*

Much of income redistribution generated by the US tax system occurs through large tax credits paid out in annual tax refunds, such as the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC). These credits are a substantial portion of income for many recipients, but complexity may lead to uncertainty about tax liability or refund status, even after other income-related uncertainty is resolved.

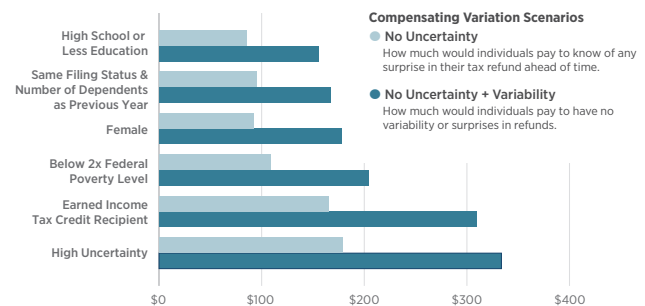
The authors employ novel survey data about tax filer beliefs to find the following:

- There is substantial tax-refund uncertainty among low-income filers, and among EITC recipients in particular.
- Despite considerable uncertainty, filers' expectations are often correct, and they seem to update their beliefs from year to year in response to new information.
- Uncertainty may stem from more complex features of the tax code, such as the phase-in and phase-out regions for tax-based transfer programs or rules for married tax filers.
- Finally, refund uncertainty distorts individuals' consumption-savings choices and is large enough to cause welfare losses among EITC filers on the order of 10 percent of the value of the EITC.

These are important insights for policymakers, but the authors acknowledge that more work is needed to better understand the underlying mechanisms

**Figure 1 • How Much Would An Average Tax Filer Pay to Eliminate Tax Refund Uncertainty and Variability in Refunds?**

*Compensating variation by demographic groups*



Note: This figure shows the mean compensating variation (CV) for different demographic groups under two scenarios. Under the "no uncertainty" scenario, individuals are made aware ahead of time about any surprise in their future tax refund, relative to what they expect the refund to be. Under the "no uncertainty + variability" scenario, individuals face no variability or surprises in refunds. The figure shows how much an average individual in each group is estimated to be willing to pay to face either scenario. The average filer would give up \$93 per year to eliminate tax refund uncertainty, more than 5 percent of the average tax refund. Please see working paper for more description.

that influence low-income tax filers. For example, a better understanding of why households fail to resolve uncertainty could inform the design of tax simplification policies, and could help predict behavioral responses to, and welfare consequences of, other tax reforms. Tax-related uncertainty may also affect other economic decisions, such as whether and how much to work.