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TAXES

Use your tax refund or save it? Tax refunds are delayed but plan now to invest or splurge.

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Key Points

- Where's your tax refund? It's slow, but coming.
- The average refund is $3, 263 but advisors warn against impulsive spending.
- Rising interest rates make paying off credit cards a smart money move.

Tax refunds are coming at an opportune time this year for many Americans – despite an IRS processing lag delaying the money.

Inflation increased nearly 8% compared to last year and household savings are drying up as cash-strapped consumers take on more credit card debt to finance purchases.

The IRS has issued more than 57.9 million refunds totaling nearly $189 billion, as of March 25. The average refund was $3,263, up 12.4% from a year ago, according to the IRS.

Since the start of tax season, the IRS processed more than 78.8 million tax returns. That's up 3.8% compared to the same time last year.

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The processing delay – prompted in part by stimulus check mistakes – can be a blessing in disguise if you make a plan before the money arrives to avoid impulsive spending once it does, said Sharon Powell, an educator with the Family Resiliency team at the University of Minnesota Extension Center.

“It’s just like going to the grocery store with a list – you're more likely to stick to it.”

Talk about your plan with immediate family members or a trusted adviser said Mary Jo Katras, program leader of the Family Resiliency team, which helps Minnesota residents manage their finances. “Figure out how can we use this money moment to benefit as a family?”

Don't beat yourself up if you deviate from the plan, Powell added. "I really support people taking some of their refund money to do whatever feels good to them so they don't have as hard of a time focusing on the more discipline choices."

So, what could you do with the remainder?

Use tax refund to pay off debt

Interest rates on credit cards, auto loans, and mortgages have risen since the Federal Reserve raised interest rates last month for the first time during the pandemic. Borrowing money will become even more expensive as the Fed prepares to raise interest rates six times this year in a bid to lower inflation.

So, if you’re sitting on a lot of debt, consider using a portion of your refund to pay it down or off, said Ted Rossman, senior industry analyst at Bankrate.com

Start with the debt that has the highest interest rate. That’s likely credit card debt since the average credit card charges a 16.36% interest rate, according to data from Bankrate.

“That’s three to five times higher than what most people are paying on other financial products like mortgages, car loans, and student loans,” said Rossman. “So I’d make a strong case for paying off credit card debt given what fed is doing with interest rates.”

But he cautioned “if put you put your refund towards paying off credit debt and don’t have savings what are you going to do if your AC breaks? That’ll just restart the credit debt cycle.”

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“You don’t want to find yourself in a position where you’re robbing Peter to pay Paul.”

That’s why it’s important to have emergency savings to cover unexpected expenses, said Ryan Decker, founding director of North Central College's Center for Financial Literacy and an economics professor there.

An upside to the Fed raising interest rates is that you’ll earn a bit more money from saving compared to recent interest rates earning near zero.

IRA contribution

If you’re fortunate enough to have adequate emergency savings and minimal debt, consider putting some of your refund into a retirement account, Decker said. You can contribute to your 2021 traditional or Roth IRA through April 15, even if you've already filed taxes and received a refund.

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Either kind of IRA will help you earn money tax-free that you can withdraw without penalties once you’re 59 ½ years old.

Decker recommends buying a target-date retirement fund, which increases investments over a specific period toward a targeted goal, or a low-cost index fund.

"Set it, and quite simply forget it," he said.

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W-4 tax form: How to review

Most people get yearly tax refunds because too much money was withheld from each paycheck to cover, for instance, Social Security and Medicare.

“If your refund ends up being a few thousand dollars you're probably getting too much taken out of your paycheck,” Decker told USA TODAY.

You can adjust your withholding rates "anytime you want," he said. Just review the W-4 form submitted when joining your current employer, Decker said.

Significant life changes like getting married, buying a home, or having a child are good times for such a review because you could qualify for more deductions to reduce the withholding burden.

IRS tax withholding estimator

The IRS has a tax withholding estimator that can help you get a more accurate sense of how you should fill out your W-4 form. Keep in mind that this means you'll likely be getting a smaller refund when you file your taxes for 2022.

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IRS TAX UPDATE: Massive backlog of unprocessed returns to be eliminated by end of year

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