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Why Are Millions of Dollars in Tax Refunds Going Unclaimed?

by Nathan Anderson, Kartik Athreya, Jason Keller, and Roisin McCord

Each spring, millions of Americans file federal income tax returns and receive tax refunds. For many, these refunds are attributable, in large part, to two refundable tax credits—the earned income tax credit (EITC) and the child tax credit (CTC). By reducing taxes and providing tax refunds, these credits help families pay for essentials like food, clothing, and housing. The EITC and CTC also allow them to keep more of their take-home pay. There is broad consensus that among major federal assistance programs, the EITC and CTC are among the most successful at alleviating child poverty, and they have also been shown to improve infant health, maternal health, children's cognitive outcomes, educational attainment, and employment for single mothers.

Yet each spring, millions of Americans with low incomes who are eligible to claim these tax credits and receive large tax refunds do not claim them. This article reviews what we know about why some eligible families do not claim the EITC and CTC and how schools, social service agencies, nonprofit organizations, and community groups can help more eligible families do so.

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In sum, the evidence suggests that many families are aware that they are eligible for potentially large tax refunds, but they do not claim them mainly because of nonfinancial barriers to filing tax returns. This implies that efforts to increase take-up of the EITC and CTC among low-income communities will be most effective when they focus more on overcoming these barriers and less on merely increasing awareness of the tax credits. Consistent with this, evidence suggests that schools, social service agencies, nonprofits, and community groups can and do play a large role in helping families overcome these barriers.

After presenting some background on the EITC and CTC, we discuss the take-up problems with the EITC and CTC, provide some details on what causes families to not claim these tax credits, and share some insights from tax preparation services on successfully connecting people with low incomes to services that help them claim the EITC and CTC.

EITC and CTC background

The EITC and the CTC are "refundable" tax credits, which means that when the amount of the tax credit exceeds the amount a family owes in income tax, the Internal Revenue Service (IRS) pays some or all of the excess to the family as a tax refund. Thus, even when an eligible low-income family owes little to no income tax, they can receive a federal income tax refund once a year when they claim the EITC and CTC on their tax return.

In 2019, over 20 million households filed for and received one or both credits—which together generated over $90 billion in federal income tax refunds (for tax year 2018). In 2019, the average EITC refund was approximately $2,400 and the average CTC refund was approximately $1,700.[1]

The EITC works, as its name suggests, by providing a credit that depends on a person's earned income and on the number of qualifying children the person can claim. The amount of the CTC does not strongly depend on income, and the CTC provides a credit based simply on the presence of children in a household.

The perceived success of the EITC and CTC led Congress to expand them over time and, most recently, to expand each temporarily in 2021. The EITC was expanded temporarily for adults without qualifying children. The temporary changes to the CTC were broader, including expanding eligibility to the lowest-income families, increasing the amount, and making it fully refundable.

More specifically, temporary changes to the CTC included monthly advance payments of 50% of the expected CTC, so eligible families could receive part of their CTC (up to $300 per child each month) in 2021, rather than having to wait until after they file their tax returns in 2022. Each month from July through December, the IRS sent the advance CTC payments automatically to eligible families that filed tax returns for 2020 or 2019 or registered using the IRS's new online nonfiler tool (which is now closed).

Estimates indicate that in 2021, the first two batches of advance monthly payments, each worth roughly $15 billion, reached at least 35 million families with about 60 million eligible children and lifted 3 million children out of poverty. According to the U.S. Census Bureau's *Household Pulse Survey*, in the weeks following the first advance payment on July 15, 2021, the share of families that sometimes or often did not have enough to eat in the past week fell to the lowest percentage since the pandemic started. The *Household Pulse Survey* showed that in the weeks following the third advance monthly payment on September 15, 2021, over two-thirds of those who reported mostly spending the credit used it to pay for food and about a third spent some of their CTC on utility and phone bills. Made on December 15, 2021, the final advance payments were worth about $16 billion and reached over 36 million families.

In her annual report to Congress, the National Taxpayer Advocate Erin M. Collins warned that processing delays at the IRS in 2022 could lead to substantial delays in refund payments, which have "a disproportionate impact on low-income taxpayers." During the 2022 tax-filing season, families that file income tax returns will be eligible to receive a refund attributable to the portion of their CTC that they did not receive as an advance payment during 2021. For most families, this will be about 50% of their total CTC. In contrast, because no portion of the EITC was paid in advance, any tax refund received by eligible families will reflect the full EITC.

Millions of eligible families do not claim the EITC and CTC

Increasing take-up of the credits is an enduring policy concern. In this section, we discuss evidence on the large number of eligible families that do not claim the EITC or CTC and what we know about why they don't take up these tax credits.

The IRS estimates an EITC take-up rate of 78%, which means that about 22% of eligible families do not claim the EITC. While this take-up rate is much higher than it is for other anti-poverty programs, such as Temporary Assistance for Needy Families (TANF) and the Supplemental Nutrition Assistance Program (SNAP), the 22% non-take-up rate means that roughly 7.5 million eligible families do not receive the EITC.

More importantly, estimates indicate that perhaps half of all the poorest eligible families do not claim the EITC. The IRS does not publish similar take-up estimates for the CTC, but the IRS has estimated that as many as 2.3 million children live with eligible families that did not receive the temporary advance CTC payments.

The most common reason that eligible families do not claim the EITC or CTC is that they don't file a federal income tax return. An estimated two-thirds of the eligible families that do not receive the EITC do not file an income tax return and thus do not receive it. Similarly, the eligible families that did not file income tax returns for 2020 or 2019 generally did not receive the 2021 advance CTC payments.

Even if a person is not required to file a return, they must file a return to receive a refund of taxes withheld by an employer or to claim refundable tax credits like the EITC and CTC.

One reason eligible families, especially families with low incomes, don't file an income return is that they are not legally required to. In general, people with income under a certain amount aren't required to file a federal income tax return. However, even if a person is not required to file a return, they must file a return to receive a refund of taxes withheld by an employer or to claim refundable tax credits like the EITC and CTC.

Another reason why some eligible families might not file is that they are eligible for only a small credit, and such a small amount is not worth the time and costs of filing a tax return when they are not legally required to do so. Although this is true for some families, the evidence suggests that for many families the expected tax refund is relatively large.

This is concerning because it means that many of the eligible families that do not claim these credits are missing out on substantial amounts of money. A recent survey of nonfilers in California indicates that 75% of nonfilers are eligible for more than $300 in tax refunds and that a nontrivial portion are eligible for over $1,000 in tax refunds. Although nonclaimants are often eligible for a lower EITC amount than many claimants, if eligible nonclaimants were eligible for even one-quarter of the average EITC claimed, unclaimed EITC would have exceeded $4 billion in 2019. The amount of unclaimed EITC may be higher than this. One study estimates that the average unclaimed EITC is about $1,500, which represents an unclaimed EITC amount of over $11 billion in 2019.

For the expanded CTC, amounts forgone for each family can be much larger for the lowest-income families. For example, an eligible family with two children under six and, say, $10,000 in income that does not file a tax return would effectively lose a total of $7,200 in CTC—$3,600 delivered in 2021 via advance payments and $3,600 received in 2022 as an income tax refund.[2] If each of the estimated 2.3 million children living with eligible families that the IRS estimated did not claim the advanced CTC were at least six years old and no older than 17, the families would be eligible to receive the $3,000 per child; this would translate to a total of about $6.9 billion in CTC—with half distributed as advance payments in 2021 and the rest paid as a refund in 2022.[3]

Despite the large financial benefits, there are many nonfinancial barriers that might explain why an eligible family not legally required to file a tax return might not claim a large tax credit. Research suggests these barriers include a lack of awareness of the credit or the amount they are eligible for, a desire to avoid a complex and burdensome tax-filing process, a distrust of government, or a desire to avoid any stigma associated with receiving tax credits. Other possible barriers include a fear that any tax refund will be applied to offset debt such as child support, student loans, or back taxes. In the next section, we review some efforts to overcome these barriers and discuss why a lack of awareness is likely not the most important barrier to overcome.

Evidence on the effectiveness of efforts to increase take-up

Most efforts to increase take-up have focused on increasing awareness of the credits. Governments and nonprofits have traditionally devoted substantial resources to raise awareness of the EITC and, more recently, the CTC. The outreach efforts are done in person and via letters, emails, social media campaigns, or text messages. Generally, these communications focus on the existence of the credit, the likely amount of the credit, or where to get free or software-assisted tax-filing help.

Evidence on EITC take-up suggests that for nonfilers, these information-only efforts have little to no effect on tax filing and, in turn, claiming the EITC. In contrast, prior research has shown that simple information-only outreach is effective at increasing EITC take-up among eligible families that already filed income taxes (but didn't claim the EITC). For nonfilers, a recent study evaluated how eligible nonfiling families responded to information-only EITC outreach by the State of California and local nonprofits. The research found that the information did not increase tax filing or EITC claims among nonfilers. Similarly, another recent study finds that when the IRS sent letters to nonfilers about both free tax-filing assistance nearby and free tax-filing software, nearly all such families receiving the letter continued to not file taxes.

The limited impact of information-only outreach suggests that eligible nonfiling families likely face significant barriers to filing taxes, such as scarcity of the time and resources required to navigate the filing process. These barriers are unlikely to be purely financial because for many eligible families that do not file a tax return, the amount of the tax refund is likely to substantially exceed the cost of getting help filing taxes.

Examples of outreach that connects people with tax-filing assistance

Here we provide examples of how taxpayers can be connected to tax-filing assistance and how those connections can help families. The research previously described points to the importance of helping eligible families with a tax-filing process that can be complex and burdensome. These examples show the value of using trusted information-sharing networks and hands-on assistance to increase EITC and CTC take-up among eligible families.

To better understand what connects eligible nonfilers to tax-filing assistance, community and economic development staff at the Chicago Fed connected with two organizations that provide volunteer tax assistance and counseling to qualified families in Iowa and Wisconsin: the United Way of Central Iowa (UWCI) and the Social Development Commission (SDC) in Milwaukee, Wisconsin.

The Chicago Fed staff asked these organizations to describe the methods and challenges associated with connecting eligible families with their services and to share stories of how their assistance helped some individual families claim EITC and CTC. UWCI's and SDC's stories suggest that sharing information with families through sources they trust or already have contact with can be an effective way to connect families to tax-filing assistance.

Both UWCI and SDC include volunteer income tax assistance (VITA) programs—which provide free tax-filing assistance to qualifying families with low incomes and can also sometimes help other taxpayers better navigate the filing process.

Both organizations discussed the importance of local partnerships and referral networks in connecting low-income families with VITA programs. They both reported that they share information with community and government partners and advertise through social media, digital displays, and public radio campaigns. Both also reported that referral networks are useful; referrals from those that provide a direct service to the targeted population and from satisfied clients are particularly effective. For example, SDC stated it planned to partner with organizations that provide direct employment-related services to families.

Both noted that sharing only general information does not help convince families that are in fact eligible for tax credits. However, both emphasized that talking face to face is especially helpful. SDC reported success with its open houses, where its staff shared not only information but also tax preparation intake documents that help determine eligibility. SDC added that in most cases, traditional advertising fails to connect people to its services because the targeted group hears about them, but don't feel that these services apply to them. In contrast, the open house allows staff to explain the credits and the process for securing them. UWCI reported that many of its new clients have either never filed or are still relatively new to filing and that some are not even aware of the EITC and CTC, and so both explaining these credits and determining eligibility are important parts of the organization's process.

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UWCI described two connections that depended on the family hearing about VITA from a trusted source. First, UWCI shared how a family that immigrated to the United States was connected to its VITA program through a son who learned about it while attending classes at the Des Moines Area Community College. That family came to the United States from Iraq in 2016 and has nine children. They had previously filed income taxes but had not claimed the EITC or CTC. The VITA program helped them understand more about the EITC—something they had no idea they would qualify for—and other tax credits. Second, UWCI described how it connected with a single mother of four children, who was living paycheck to paycheck, through one of the marketing flyers distributed by Iowa's Department of Human Services, which makes VITA information available to its clients. The program allowed her to save on her filing fees and get a refund because she qualified for the EITC and CTC. She reported using the refund to catch up on her back payments on utilities, enroll her son in driver's education, and, for the first time, open a savings account.

SDC also described connections made through trusted sources. First, SDC shared how it connected with a single mother of a three year old through a direct referral from the Social Security Administration (SSA). SSA told her that she might be eligible for the CTC, and she then found SDC by searching online for local free tax preparation sites. SDC determined that she was eligible for the temporary CTC and its advance payments, but not the EITC because she did not have enough earned income. In addition to the temporary CTC, filing the return allowed her to receive over $2,000 in pandemic stimulus payments she had missed. The missing stimulus payments were enough to pay for three months of rent. SDC also described connecting with families via its open houses. SDC reported that many families at these open houses said they had tried to use the IRS website to get their stimulus payments and set up their advance CTC but had given up. SDC described two families—both of which were led by single mothers without enough earned income to qualify for the EITC—that the VITA program helped by confirming their eligibility for the temporary CTC and its advance payments, as well as other tax benefits, including thousands of dollars in missing federal stimulus payments.

Conclusion

Each year, the EITC and CTC allow millions of Americans to pay less in taxes and receive large tax refunds. Research shows that these refundable tax credits help many Americans, including by better allowing single mothers to work and by helping alleviate child poverty.

Each year, most families eligible for these tax credits claim them, but many families, especially families with low incomes, eligible to receive these tax credits do not claim them and, as a result, do not receive potentially large cash benefits to which they are entitled. Research suggests that organizations with existing relationships with eligible families can play a large role in increasing take-up of these benefits by connecting families with low-cost or free tax-filing and tax assistance programs.

Notes

1. Authors' calculations based on data from the Internal Revenue Service, 2019, *Statistics of Income—2018 Individual Income Tax Returns*, complete report, Publication 1304 (Rev. 09-2020), Washington, DC, table 3.3, pp. 215–224, available online.
2. Authors' calculations based on section 24(i)(3) of the Internal Revenue Code of 1986 (as amended)—which sets the child tax credit amount for tax year 2021 at $3,600 for each qualifying child who is not yet six years old during 2021. Section 7527A(b)(1) of the Internal Revenue Code of 1986 (as amended) states that the annual advance amount of the CTC is the amount estimated to be 50% of the allowed CTC for 2021.
3. Authors' calculation of the product of 2.3 million and the $3,000 annual credit amount for each qualifying child aged six to 17 pursuant to section 24(i)(3) of the Internal Revenue Code of 1986 (as amended).

Biographies

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