Rethink Your Refund

You worked hard for that tax refund; it should work just as hard for you

Key takeaways

- **Explore the emotions behind refunds.** Whether you view tax refunds as hard-earned income or free gifts can go a long way toward determining what you will do with the money.
- **Get your financial house in order.** Building up emergency funds and paying down debt are good first steps to take with tax refunds.
- **Think long term.** Think about using some of the money to invest in tax-advantaged retirement accounts or college savings plans—or both.
- **Prepare now for next tax season.** Consider adjusting your 2020 withholding so you can put more of each paycheck to work sooner instead of waiting for next year's refund.

A tax refund isn't "free money" or a gift from generous old Uncle Sam. It's part of the income you worked hard to earn. When you think of it that way, you may be less tempted to spend it frivolously—and more likely to manage it as carefully as the rest of your paycheck.

Take a pause before spending

"Don't ask what you can do with the money, ask what the money can do for you," says Michael Liersch, PhD, Global Wealth Planning and Advice at J.P. Morgan Chase. "As you focus on your feelings, you might find you'd rather experience the lasting peace of mind of doing something sensible instead of the temporary rush of an impulse purchase."

Pad your emergency fund

"Keep three to six months of living expenses in an interest-earning account that's both physically and mentally separate from your everyday assets," suggests Katherine Roy, CFP®, Chief Retirement Strategist for J.P. Morgan. You may need closer to three months if you have a stable job and steady paycheck, or closer to six months if your income is less certain.

Pay down debt

Tax refunds can help you pay off loans and credit cards faster, which frees up money for other purposes. Start with your highest-interest debt and work your way down from there.

Invest in tax-advantaged retirement accounts

Investing tax refunds is a good way to boost retirement savings without disrupting your normal budget. One possibility is to increase 401(k) contributions and then use tax refunds to offset the difference in your take-home pay. Another option is to fund an IRA, especially if you've already maxed out your company plan.

"Get in the habit each year of seeing how diversified your retirement assets are from an income tax perspective," says Roy. "A healthy mix of taxable, tax-deferred and tax-free accounts can help guard against future tax hikes, and also give you more control over taxes during retirement."

Start or add to a college fund

A 529 plan lets you save on taxes while saving for children, grandchildren, nieces, nephews or any other college-bound kids or adults. Many families combine automatic monthly contributions with annual tax refunds to steadily build their accounts and keep pace with rising tuition costs.

Spread it around

According to Liersch, using a tax refund isn't an either-or decision between spending or sacrifice. "Decide how much to save, invest or maybe even share with others," he says. "After making smart moves for the future, consider how you can live in the moment and indulge in yourself."

Fill out a new W-4

A big tax refund basically means you've given the government an interest-free loan. Consider having your employer withhold less tax from each paycheck so you have more money throughout the year. But be careful not to reduce your withholding so much that you trigger a hefty tax bill next April.

Next steps

Whether you invest on your own or with a J.P. Morgan Advisor, annual tax refunds should be factored into your financial plans. The key is to strike a balance that allows you to enjoy your hard-earned refund now without sacrificing your long-term goals later.