Insight

This Year's Higher Tax Refunds: What's Driving Them

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Executive Summary

- Federal individual income tax refunds have been larger for many taxpayers this filing season; Internal Revenue Service (IRS) data shows an average refund of $3,462, which is $346 (11 percent) larger than last year's average amount.
- The larger refunds are driven by the tax changes enacted in last year's One Big Beautiful Bill; the legislation created or expanded existing tax deductions and credits that reduced taxpayers' year-end tax liabilities more quickly than withholding systems could adjust.
- This lag resulted in a systematic overpayment of federal income tax by most taxpayers during tax year 2025; the overpayments are being returned to taxpayers in the form of higher tax refunds this filing season.

Introduction

Federal individual income tax refunds have been larger for many taxpayers this filing season. According to the latest data from the Internal Revenue Service (IRS), over 70 percent of the tax returns processe*d thus far received a refund. The average refund amount is $3,462, which is $346 (11 perce*nt) larger than last year's average refund of $3,116.

The larger refunds are driven in large part by the tax changes enacted in last year's One Big Beautiful Bill. The legislation created or expanded existing tax deductions and credits that reduced taxpayers' year-end tax liabilities more quickly than withholding systems could adjust. This lag resulted in a systematic overpayment of federal income tax by most taxpayers during tax year 2025. The overpayments are being returned to taxpayers in the form of higher tax refunds this filing season.

The higher-than-usual tax refunds are almost certainly a one-year anomaly. Refunds for tax year 2026 are likely to normalize as the withholding system is adjusted – and employees again have the appropriate amounts withheld from their paychecks – to reflect tax changes in the One Big Beautiful Bill. This year's higher tax refunds are likely to provide a temporary boost to the economy, as the one-time increase in disposable income is likely to translate into a boost in consumer spending.

Taxpayers Are Receiving Larger Refunds

Refunds for tax year 2025 – filed during the 2026 tax season, which opened on January 26 and closes on April 15 (Tax Day) – have been larger than in recent years. The latest data from the IRS shows that over 70 percent of the tax returns processed thus far received a refund. The average refund amount is $3,462, which is $346 (11 percent) higher than the $3,116 average refund taxpayers received last year. The IRS has issued $241.7 billion in refunds, a $30.7 billion (15 percent increase) from the $211.1 billion in refunds issued last year. The increased refunds are driven in large part by the mid-year tax changes enacted in the One Big Beautiful Bill.

The One Big Beautiful Bill created or expanded existing tax deductions and credits, many of which were retroactive to the entirety of tax year 2025. The IRS did not update its withholding tables for tax year 2025 to reflect the legislation's income tax changes, however. Employers use the IRS' withholding tables to determine how much income tax to withhold from an employee's paycheck. As a result, employers were still using the original withholding tables, which triggered a systematic overpayment of taxes in 2025. As workers filed their tax year 2025 returns, many found that they over-withheld taxes and were going to receive a sizeable refund.

Put simply, the larger tax refunds being issued this filing season are the result of the lag between the One Big Beautiful Bill's mid-year tax cuts and the adjustment of the withholding system to reflect those changes, which caused many taxpayers to withhold too much from their payments during tax year 2025.

The One Big Beautiful Bill's Tax Year 2025 Changes

The One Big Beautiful Bill made a series of changes to individual income taxation. While the legislation cut taxes halfway through tax year 2025, some changes were retroactive to the full tax year. This includes the law's creation or expansion of existing tax deductions and credits. Though some of the law's tax changes affected 2025 taxes, most of its tax changes will be in effect for tax year 2026 and beyond.

The following tax changes were in effect for tax year 2025.

Standard Deduction

In recent years, most taxpayers have chosen to claim the standard deduction rather than itemizing their deductions. The Tax Cuts and Jobs Act (TCJA) of 2017 nearly doubled the standard deduction. The One Big Beautiful Bill not only made the TCJA's larger standard deduction permanent but increased it further. For tax year 2025, the standard deduction was increased to $15,750 for singles, $23,625 for heads of households, and $31,500 for couples. Seniors aged 65 and older at all income levels qualified for an additional standard deduction of $2,000 ($3,200 for couples).

State and Local Tax Deduction

The state and local tax (SALT) deduction provides a federal tax deduction for income and property taxes paid at the state and local levels. The TCJA temporarily capped the SALT deduction at $10,000. The One Big Beautiful Bill temporarily increased the SALT deduction cap to $40,000 for taxpayers earning less than $500,000 for tax year 2025. For each subsequent tax year through 2029 (when the policy expires), the cap and income threshold will be increased by 1 percent. For taxpayers with incomes above $500,000 in tax year 2025, the $40,000 cap was reduced by 30 percent until it reached $10,000.

Senior Deduction

The One Big Beautiful Bill created a new, temporary tax deduction for seniors. The new deduction allows those aged 65 and older to deduct up to $6,000 ($12,000 for couples) from their taxable income. The deduction phases out for taxpayers with income over $75,000 ($150,000 for couples) and is in effect for tax years 2025–2028. Seniors may claim this new deduction on top of the main standard deduction and the additional standard deduction. As a result, seniors could reduce their taxable income by up to $23,750 ($46,700 for couples) in tax year 2025.

Child Tax Credit

The TCJA temporarily increased the maximum Child Tax Credit (CTC) amount from $1,000 to $2,000 per child and created a $500 nonrefundable credit for dependents who do not qualify for the main CTC. The One Big Beautiful Bill not only made the TCJA's maximum CTC amount permanent but increased it to $2,200 for tax year 2025 and beyond. For many taxpayers, the increased CTC showed up as a $200 boost per child on their federal tax returns. Notably, taxpayers that did not pay any federal income taxes or had a modified adjusted gross income above $200,000 ($400,000 for couples) were not eligible for the credit.

Adoption Tax Credit

The One Big Beautiful bill made the Adoption Tax Credit partially refundable. Under prior law, the credit was nonrefundable, meaning eligible families could only use it to reduce their tax liability and did not receive any benefit beyond that. Under the One Big Beautiful Bill, up to $5,000 of the tax credit could be refunded in tax year 2025. The law also increased the maximum credit amount to $17,280 for 2025.

No Tax on Tips

The One Big Beautiful Bill created a new, temporary deduction for tip income. The new deduction allows workers in tipped industries – such as waiters, bartenders, and valet parkers – to deduct up to $25,000 in qualified tips from their taxable income. The deduction is limited to workers in certain qualified jobs and phases out for taxpayers with income over $150,000 ($300,000 for couples) and is in effect for tax years 2025–2028.

No Tax on Overtime Pay

The One Big Beautiful Bill created a new, temporary deduction for Fair Labor Standards Act overtime. The new deduction allows workers to deduct the "half" in time-and-a-half pay up to $12,500 ($25,000 for couples) from their taxable income. The deduction phases out for taxpayers with income over $150,000 ($300,000 for couples) and is in effect for tax years 2025–2028.

No Tax on Car Loan Interest

The One Big Beautiful Bill created a new, temporary deduction for car loan interest. The new deduction allows taxpayers to deduct up to $10,000 of interest paid on loans to purchase new, U.S.-assembled vehicles from their taxable income. The deduction phases out for taxpayers with income over $100,000 ($200,000 for couples) and is in effect for tax years 2025–2028.