

Make sure bigger is better
Tax refund may be larger than you think; use the windfall well

By PAMELA YIP Personal Finance Writer
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This tax year, taxpayers entitled to a refund will have something extra to smile about: Their check will be fatter.

You can thank the midyear tax cuts for that.

"Unless people decreased their withholding, it's likely they overpaid the first part of the year," says Mark Luscombe, principal federal tax analyst at CCH Inc., which publishes information for tax professionals.

How much the average tax refund will increase is unknown.

"It depends on your particular situation, like your marginal tax bracket and how much dividends and capital gains you have," Mr. Luscombe says.

But one thing is sure: Since your refund will be bigger, it's more important than ever to put the windfall to the best use.

"Have a plan for the funds before they arrive and implement the plan as soon as you receive the check," says **Michael Busch**, a certified financial planner and president of Vogel Financial Advisors LLC in Dallas. "It's dangerous to let the money sit in your checking account. It might get spent."

Instead, use the refund to get your finances in order - to reduce your debt, increase your savings, invest in your home, and more.

"Most people use their income tax refund every year to splurge and then wonder why their finances are not getting better as the years go by," says Bryan Clintsman, a certified financial planner at Clintsman Financial Planning in Southlake.

The biggest target you can hit with your refund is debt.

"If you have high-interest debt like credit cards, you need to get that

paid off before the interest buries you," Mr. Clintsman says.

The national average interest rate on a standard variable-rate credit card is 13.8 percent, according to Bankrate.com, which tracks consumer interest rates.

"Paying down debt at this rate is the equivalent of earning a risk-free return of 13.8 percent," says Greg McBride, senior financial analyst at Bankrate.com.

Once you attack credit card debt, make sure you don't land in that place again.

"You should ask yourself how the debt got there in the first place because even if you pay it off, it may recur if you have not dealt with the underlying issue of how it got there," Mr. Clintsman says.

Save, save, save

If your credit card debt is under control, you're lucky. You have more options.

First, consider beefing up that emergency fund. Financial planners recommend keeping three to six months worth of living expenses in a rainy-day fund.

"Use your refund to start an emergency fund if you don't have one or get it back up to a healthy level if it has been depleted," Mr. Busch says. "Make sure this money is easily accessible by keeping it in a liquid investment like a money market fund."

Not having an emergency fund is one of the biggest mistakes you can make with your financial planning.

"This is what keeps you from getting out the credit cards and going into debt when bad financial things happen in your life," Mr. Clintsman says.

If you can save the money that way, you have more flexibility when it comes to other money-saving opportunities. For example, you could increase the deductible on your homeowners or auto insurance by the amount of your refund. This will cut your premiums.

"If you do have a claim, you have the funds to cover the increased deductible," Mr. Busch says.

Feed that 401(k)

Think about your retirement. Right off the bat, if you're not participating

in your employer's 401(k) plan, sign up now. If your employer matches your contribution, you're turning down free money if you're not participating.

A 401(k) does two things: It enables you to build up your retirement savings tax-free and it saves you money on current taxes because contributions are taken out pretax, which lowers your taxable income.

"While you can't deposit the refund directly to your 401(k) account, what you can do is increase the amount deferred from your paycheck for the remainder of the year by the amount of the refund, and use your refund to offset the reduced take-home pay," Mr. Busch says.

"If your employer doesn't offer a 401(k), or if you have already contributed up to the limit that your employer matches, look next to contribute to a Roth IRA, if you qualify, then to a traditional IRA," Mr. Busch says. "The earnings grow tax-free in the case of a Roth or tax-deferred in the case of a traditional IRA."

The sweetener in the Roth is that you don't pay any taxes when you withdraw the money. However, in order to qualify for a Roth IRA, your modified adjusted gross income must be less than \$110,000 if you're single and less than \$160,000 if you're filing a joint tax return.

Shave your mortgage

You may also consider using your refund to make an extra principal payment on your mortgage.

"A \$1,000 extra principal payment at the beginning of a 30-year \$100,000 mortgage at 6 percent will save you nearly \$5,000" in interest over the life of the loan, Mr. Busch says. "If your interest rate is higher, the savings will be even greater."

Or refinance and use your refund to pay for closing costs.

"With mortgage rates near six-month lows, rates have re-entered the refinancing zone for many borrowers," Mr. McBride says. "Using the refund check to pay for your closing costs and refinancing at current rates can cut monthly payments and interest costs for years to come."

A 30-year fixed-rate mortgage averaged 5.66 percent last week, near a four-decade low.

A good investment

You could use your refund to start or add to a college savings fund. A 529 college-savings plan offers different types of investment portfolios, tax-free growth of investments and tax-free withdrawals on earnings

used for qualified college expenses.

"The return on this kind of investment - a college education for your children - can't be measured. It's priceless," Mr. Busch says.

For more information on Texas' college-savings plan - called Tomorrow's College Investment Plan - go to the plan's Web site, www.enterprise529.com/about/index.shtml.

Note: The Texas Guaranteed Tuition Plan, the state's prepaid tuition plan, is closed to new enrollment.

For more information on saving for college, go to savingforcollege.com.

A nice luxury

If your credit card debt isn't a problem, and your savings are in good shape, then you've got the ability to do something for yourself.

If you've been planning to buy that new TV or appliance, you can use your refund and pay cash instead of putting it on a credit card.

"This will keep you from frittering the refund away, and you will save the interest charges you would have otherwise incurred on the credit card balance," Mr. Busch says.

Or you can use the opportunity to invest in your home, while also improving your quality of life.

"Using the tax refund to make home improvements can boost the value of your largest investment - your home," Mr. McBride says. "Using the tax refund for home improvements also avoids borrowing money that may ultimately be repaid at higher interest rates."

Finally, if you don't really need the money, consider donating your refund to support your favorite charity. Your contribution is tax-deductible, which could give you an even bigger refund next year, if you itemize your deductions.

Adjust withholding

As much as you've enjoyed receiving a fat refund, you've just given the government an interest-free loan that you could have put to better use.

The solution: Change your tax withholding on your W-4 form to boost your take-home pay and avoid giving the government an interest-free loan for the next year.

"My suggestion is to choose at least one financial goal to apply that refund to and then maybe do something fun with a smaller portion of the refund," Mr. Clintsman says.

E-mail pyip@dallasnews.com

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