

# Smart Uses for Your Tax Refund...

A tax refund is always a welcome bonus. Whether it's \$300 or \$3,000, the way you use that money can have a real impact on your personal and financial well-being.

*New computer? New recliner? Nice vacation? Those are all nice ideas, but...*

Before you spend your refund, try to think through *all* the options – even ones that aren't especially glamorous.

## Follow Three General Rules:

1. **DO plan ahead before spending your refund.** Without a plan, you may use the money on the first important thing that comes to mind, and then later realize something else was *more* important. Planning ahead and involving the family increases the chances you will identify all the possibilities, and think about which are most important.
2. **DO devote a portion of your tax refund to build long-term financial security.**
3. **DON'T throw away part of your refund on loan fees.** Did you know that those companies that offer "quick refunds" are just giving you a loan? It's a high-cost, high-risk loan. [For more information on refund anticipation loans, see [www.consumerlaw.org](http://www.consumerlaw.org), and follow the logical links]

## Four Smart Uses for Your Tax Refund

### 1. Pay off bills

- First priority: regular monthly bills if you have gotten behind (utilities, phone)
- Most other debts should be prioritized with highest-interest rates paid off first.

**Suppose** you have a credit card balance of \$2,000 at an interest rate of 18%, and you're making payments of \$50/month. At that rate it will be 62 months before the bill is paid off, and it will cost you \$1,077 interest.

**If you use your tax refund** to pay off \$1,000 of that bill, and then continue to pay \$50/month, the bill will be paid off in 24 months, at an interest cost of only \$198. **You save \$800** interest by paying \$1000 toward the debt now.

### Do you find yourself in a yearly cycle?

- Using your tax refund each spring to catch up
- then gradually getting more and more behind throughout the year, (and more and more stressed out), until...
- you can once again use your tax refund to get caught up

You can prevent this common cycle, *and* save on late fees and finance charges, by putting more money in your regular paycheck, instead of getting such a large tax refund. (See Reverse)

### 2. Save for needs in the coming year

**Emergency Funds.** Having money saved for emergencies can get you through small emergencies like car repair or medical bills without breaking a sweat. In the ultimate emergency (loss of income), an emergency fund can keep you afloat until you find another income source.

Use part of your tax refund to start or build your emergency fund!

**Occasional Expenses.** Those big bills that come once a year or every few months can cause huge problems for families. Avoid those problems by being ready for the bills! Use your tax refund to start a special savings fund, then keep adding to it throughout the year.

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### 3. Long-term savings!

You CAN make progress toward long-term goals, and your tax refund can help make that happen.

**Even small amounts add up.** Adding just \$500 a year into a retirement account such as an IRA can make a difference over a period of decades.

Earning an average annual return of 9%, a contribution of \$500/year would yield \$68,100 after 30 years.

**Take the “small amount” theory one step further.** Build on the momentum created by that once a year contribution, and make a monthly contribution too.

If you contribute \$500/year *and* \$25/month, earning a 9% return, in 30 years you will have \$113,800!

**Contributing to your retirement *may* pay off with a tax credit!**

Moderate-income workers who contribute to their retirement accounts may qualify for a tax credit! For example, a married couple filing jointly with earnings of \$32,000 would qualify for a 20% credit. That means that if they contribute \$2,000 to retirement accounts, they will receive a direct tax credit of \$400! Consult with the IRS for details!



### 4. Special Purchases

What about that new refrigerator?  
Or the sofa? Or ... ?

Those purchases are valuable, too.  
Some may be essential, while others simply add enjoyment to life.

#### Your best bet:

*First* put some of your tax refund toward financial security:

- pay off some debt
- plan for needs in the coming year,
- set some money aside for long-term goals.

*Then* use part of your tax refund to make your day-to-day life better. Among all the items on your “wish list,” choose the most important and shop wisely for it!

*For additional information* on these topics, contact your County Extension Office, or go to

[www.extension.iastate.edu/financial/taxrefund.html](http://www.extension.iastate.edu/financial/taxrefund.html)

#### How can I get part of my refund money throughout the year instead of waiting?

- 1) Change your Withholding Instructions on Form W-4. If you receive a large refund, it may be because you claim too few exemptions. Talk with your payroll office at work about this.
- 2) If you have children and qualify for the Earned Income Credit, you can request to receive part of it throughout the year.

**How?** Ask your payroll office for Form W-5 –Earned Income Credit Advance Payment Certificate.

**How Much?** Using IRS guidelines which estimate what your Earned Income Credit amount for the year might be, your payroll office distributes about half of that amount in your paychecks throughout the year.

*Example:* a worker earning between \$500 and \$1200 per month might receive \$60 extra in each bi-weekly paycheck.

Workers who receive part of their Earned Income Credit in advance benefit in two ways:

- they can still expect a good refund check in the spring,
- they will have more money throughout the year – for paying the bills, paying off debts, or contributing to a retirement account.