

Spend your tax refund wisely

by Jason Alderman

For many of us, the agony of filing taxes each April is partially offset by knowing that a few weeks later we'll get a nice refund from Uncle Sam (assuming you don't have to write him a check). Last year, nearly 70 percent of the nearly 123 million U.S. taxpayers received refunds averaging \$2,237.

But before you go out and blow your refund on a flat-panel TV, take a deep breath and consider a few ways you can put that money to better use:

Pay off debt. The smartest thing you can do with your refund is to pay down debt. If you carry a balance on your credit card from month to month, the interest can really add up over time. For example, by paying only the minimum amount due each month (assuming 4 percent) on a \$1,000 balance, it could take over seven years and cost more than \$500 in additional interest for a card with an 18 percent annual rate — and that's only if you don't make any new purchases.

Save for emergencies. Experts recommend putting aside at least three to six months of living expenses in case you lose your job, incur unexpected medical expenses or experience other unplanned events. Consider stashing your refund in a high-yield money market savings account or a short-term CD. You can find accounts with competitive rates at www.bankrate.com.

Save for retirement. Put your refund in an Individual Retirement Account or your 401(k) plan (especially if it has matching contributions). Retirement may seem far off, but the sooner you start saving, the faster your account will grow. Some experts say for every five years you delay, you may need to double your monthly savings amount to achieve the same retirement income.

Practical Money Skills for Life, a free personal financial management site sponsored by Visa USA, contains detailed retirement financial planning information, including tax ramifications and interactive online calculators for estimating your retirement needs.

Save for Education. Open a 529 Qualified State Tuition Plan, where you contribute to an account to fund a child's or grandchild's education. Account earnings are exempt from federal taxes when withdrawn if used for qualified expenses. Go to the U.S. Securities and Exchange Commission's Web site to learn how 529 Plans work.

Don't overpay taxes. Your primary goal should be to pay your fair share of taxes throughout the year – no more, no less. Ideally, the amount being withdrawn from your paycheck all year falls within a few dollars of your final tax bill. If you get hundreds or thousands of dollars in refunds that means you're basically giving the government an interest-free loan all year. Fill out a new W-4 form and recalculate how much is being deducted each pay period. Someone in your employer's benefits department should be able to help.

Invest in yourself. Consider spending part of your refund on something good for your health (like a gym membership) or your community (charitable contributions).

If you're intent on splurging, consider using at least a portion of your tax refund for one of these investments in your future. You worked hard for that money – make it work hard for you too.

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