

How Should I Use My Tax Refund?

Q: I got a bigger than expected tax refund this year and I don't want to blow it all. How can I use it responsibly?

A: You're already making the better choice by thinking about what to do with your small fortune instead of splurging and then watching it all disappear within a few weeks.

When you receive an unexpected windfall, whether it's from a tax refund, work bonus or a cash gift, it's always a good idea to be proactive about how you'll spend it instead of letting it just blow through your checking account.



Below, we've listed some dos and don'ts for you to consider.

Do: Pay down debt

You probably don't want to see your entire refund go straight to your credit card bill, but you don't have to take the all-or-nothing approach. Consider earmarking 20% of your windfall toward paying down high-interest debt you may be carrying. You can adjust this number as you see fit, but you'll be doing yourself a favor by paying off a large chunk at once. You'll save a ton on interest and you'll be finished with this debt a lot sooner than you'd planned.

Don't: Lend out your refund money

It's sweet of you to want to help a friend or relative out of a tight spot, but lending all of your refund money is not the smartest idea. You might not see that money for a while, and if you do, it'll likely be repaid in small amounts instead of the large chunk of cash you have now. And that is severely limiting to what you can do with it.

If a friend or relative is in desperate need of financial help, consider lending them a small portion of your refund. Also, be sure to create a repayment plan so you can have some assurance you will see that money again.

Do: Start saving or investing

If you've always been waiting until you have a substantial amount of cash in hand to start a savings account or an emergency fund, you've just run out of excuses! Take \$1,000 out of your refund and use it to start a savings account. You can set up an automatic transfer to take money out of your checking account each month to help it grow, even if you can only afford as little as \$10. The head-start you're getting now, along with the small monthly contributions, will add up quickly.

If you're feeling super-responsible and forward-thinking, use this opportunity to start investing. The rewards will greatly outweigh any qualms you might feel about not spending this money. Say you receive an annual refund of \$2,800 and invest this money at 6% interest. If you continue investing this amount each year, you'll find yourself with approximately \$250,727 in 30 years' time.

Now that's making your refund work for you!

Don't: Invest in a low-interest account

If you decide to sock away some or most of your refund money, don't be lazy about it. Keeping all of that cash in a low-interest savings account or an ordinary checking account with little to no interest at all will dramatically decrease its

growing power. If you're not sure where to invest or save your refund, call, click or stop by [credit union] where a member service representative is happy to help.

Do: Invest in yourself

It might sound trite, but you are your own most precious commodity. Advance your career and increase your earning power by using your tax refund to pay for a work-related conference, additional training in your field or for learning an entirely new skill. Money invested in yourself is never wasted!

Don't: Blow it all on impulse buys

Don't spend your entire refund without planning or you'll be setting yourself up for disappointment later. You'll likely end up with nothing substantial and not more than two pennies of your refund money to rub together.

Do: Reward yourself

While you don't want to blow it all, it's OK to celebrate on one or two major purchases you've been eyeing throughout the year. Now's the time to splurge on that pair of designer shoes you've been drooling over all season, or to treat yourself to a night out at that expensive new restaurant in town.

Don't: Receive your refund on a gift card

Gone are the days when Uncle Sam licked a stamp for every refund he sends. Today, you can choose to get your tax refund deposited directly into your checking account, and many tax software programs even offer you the opportunity to get the refund via gift card. While direct deposit is fine, if you're offered your refund on a gift card, opt out. You always stand the chance of losing the card. A gift card will also limit the ways you can spend your refund money.

Do: Donate to charitable causes

For many people living paycheck-to-paycheck, donating to charity can take a back seat on their list of priorities.

This might be a great time to break that habit. The bonus cash in your pocket gives you the opportunity to give back to your community in ways you might not be able to afford throughout the year. Plus, it gives you a head start on potential deductions for next year if you plan to itemize.

However you choose to spend your refund, consider all of your options carefully before making your decision and you won't have any regrets.

Your Turn: Are you expecting a tax refund this year? How are you going to spend it? Share your plans with us in the comments!

SOURCES*:

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