

Thinking About a Tax Refund Loan? Rethink Your Refund and Spending Strategy Instead

The formal name is refund anticipation loans, or RALs. They're marketed primarily to cash-poor taxpayers who use their annual federal and state tax refunds as a piggy bank for discretionary items or increasingly, essentials like food and rent.

Do they make sense? Ask yourself this question – would you borrow money at rates well in excess of 40 percent with additional fees at a minimum of 10 percent or higher just to get your hands on money that you could have in your possession the previous 12 months?

Let's go a step further. The Consumer Federation of America and the National Consumer Law Center reported last year that RALs cost the average borrower from about \$30 to over \$125 in loan fees. Some tax preparers also charge a separate fee, often called an "application" or "document preparation" fee, of about \$40. The agencies added that the effective annual interest rate (APR) for a RAL can range from about 40 percent to over 500 percent, and if application fees are charged and included in the calculation, the effective APRs range from about 57 percent to over 1,100 percent.

Granted, the leaders in the field have been forced to cut their rates and fees under pressure – No. 1 H&R Block says its fees now average two percent of the principal on each loan. But why even bother with that?

In the tax refund loan game, there are really two issues. First, there's what borrowers pay for something they could get interest- and fee-free a few weeks later. Second, there's the issue of tax planning that could eliminate the need for such loans in the first place.

If you're working with a tax advisor or a financial planner such as a CERTIFIED FINANCIAL PLANNER™ professional, they'll tell you that the best way to put cash in your hand is through tax planning, not overpayment of tax so you can get a check later.

It's been said that tax refunds are really interest-free loans to the government, and it's true. The benefit of working with a qualified tax professional or a financial planner is that they might have more incentive to lead you in the direction of sensible tax strategies than a tax preparation firm that offers such loans. Why would any firm offer smart tax advice when it might threaten such a huge revenue stream?

Want to put extra money in your pocket all year round, not just at tax time? Consider the following steps:

Make this the year you do some real tax planning: Qualified tax professionals such as certified public accountants (CPAs), enrolled agents (federally licensed individuals who have passed a comprehensive Internal Revenue Service exam) or a tax attorney can help you devise a strategy so you and Uncle Sam don't owe each other anything at tax time. You'll do this through smart withholding and finding legal deductions that might create tax savings. Many individuals can get by with the help of an enrolled agent or CPA, and while there are many tax attorneys who do individual returns, they are typically used for business returns or more complex individual tax situations

Restructure your spending: Maybe if you knew where your money was going each day you wouldn't have to pay extreme rates and fees to score extra cash at tax time. A financial planner can give you some critical advice in building a budget that fits you and your income and spending picture, or you can make this the year when you buy a financial tracking program for your computer and start typing in your daily spending – that activity alone will be an eye-opener.

Rethink the whole instant gratification thing: Yes, it's fun to think about the big-screen TV or the weekend package in Vegas you might splurge on with your tax refund, but if you're still addicted to getting one every year, why not use it to deposit a little extra in an IRA? Finish your taxes early enough and you'll be able to get an extra bump in your retirement for the 2007 tax year. This is a good year to make a fresh start in your relationship to saving and spending.

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When You Add Up the Numbers on Retirement, It Pays to Save Now

With all the financial responsibilities we face, it's often tough to put yourself first. But retirement savings must be a priority, and sometimes to drive that home, it pays to see some statistics:

- The Employee Benefit Research Institute (EBRI) reported last month that the group of people with the longest timeframe to save for retirement – young workers aged 21-24 – are the least likely to participate in any kind of workplace retirement plan. Only 29 percent sign up for their retirement plans at work, compared to 60 percent of the workforce aged 55-64.
- In a May 2007 MetLife study of mothers and adult daughters and their attitudes about retirement, women who are married are more likely to retire than single women. Mothers who are married are more likely than unmarried mothers to retire before age 55 (26 percent vs. 6 percent), and married daughters are more apt than single daughters to expect to retire before age 60 (13 percent vs. 8 percent) and less likely to retire after age 65 (28 percent vs. 43 percent). Debt is also a problem – daughters are almost twice as likely as mothers to have debt of 25,000 or more (22 percent vs. 12 percent).
- According to Social Security statistics reported last month by *USA Today*, there's a 41 percent chance that a 62-year-old woman today will live to be 90, while a man has a 29 percent chance. The publication also reported that retirees who signed up for retirement benefits at the earliest qualifying age of 62 would lose significant benefits due to the longer lifespan – roughly \$39,000 in lost benefits for those who live until age 90, and up to \$54,000 in lost benefits for those who live until age 95.
- According to the AARP Public Policy Institute, the average cost of a nursing home stay is more than \$67,000 per year and exceeds \$100,000 per year in some urban areas. Assisted-living facilities can cost more than \$35,000 per year, while home care agency rates average \$37 per hour for a licensed practical nurse and \$19 per hour for a home health aide. For those who cannot finance those costs themselves, long-term care insurance might be a worthwhile investment.
- Don't ignore out-of-pocket health care costs in retirement, even for those with insurance. The ERBI reported in July 2006 that a couple both age 65 retiring that month and living to average life expectancy could need as much as \$295,000 to cover premiums for health insurance coverage and out-of-pocket expenses during retirement. A couple that lives to 95 could need as much as \$550,000.
- And to underscore the need for retirement planning, the EBRI reported last year that many Americans have little money put away in savings or investments. Among workers who participated in the 2007 Retirement Confidence Survey and provided this type of information, nearly half reported that the total value of their household's savings and investments—excluding the value of their primary home and any defined benefit (“traditional” pension) retirement plan—was less than \$25,000 (49 percent). Only one in 10 workers each reported total savings and investments of \$25,000–\$49,999. Only 14 percent reported having savings of \$250,000 or more.

What does this all mean? That for the most part Americans are unprepared for retirement, which means we will all be working longer or trying to seek other means of covering the shortfall we face. In the short run, it makes sense to take better care of our health and try as much as we can to reduce debt and other pressures that get in the way of setting aside money. There is no question that the sooner you begin to plan and save for your retirement the better off you will be. But it also pays to get some advice. A CERTIFIED FINANCIAL PLANNER™ professional can be a good guide to making the most of what you have and creating a plan that balances the financial concerns of today with those you will face in retirement.

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Be Smart about Renovations in a Down Home Market

It's unlikely the real estate market will return to the fever pitch of the mid-2000s anytime soon – and maybe that's not such a bad thing. But even though homes are languishing on the market, it's not a bad time to make sensible renovations that will better position your property when times improve.

The idea is to discover the most affordable renovation ideas that produce the greatest returns in your particular market. And if you must borrow, do it sensibly. Evaluate the following:

Start with your credit report: If you're considering borrowing, make sure your credit report and bill payment records are in the best possible shape. As in most economic crises, lenders go from being permissive to squeamish in an instant, so even people with good credit behavior are going to be under the microscope. Start by checking your credit report -- you have the right to get all three of your credit reports – from Experian, TransUnion and Equifax – once a year for free. You can do so by ordering them at www.annualcreditreport.com, but do so at staggered times throughout the year so you can catch potential errors in your report as they happen. Also, if you need to clean up any bad behavior – late bills, heavy credit card debt, clean it up before you wander back into the real estate market. It is very important to understand that a bad credit score can raise the total cost of your mortgage.

See what kind of payoff your chosen renovation will have: During the housing boom, people thought virtually any renovation would offer big returns. That wasn't true then, and it's particularly untrue now. Take the time to figure out what renovations have the best chance for return on investment now – go to *Remodeling* magazine's annual *Cost vs. Value* report online (<http://costvalue.remodelingmagazine.com/index.html>) and check 2007 project cost averages for your region of the country. Whether it's renovating for a family need, an upgrade of the home's features, or for putting the home on the market always do a cost benefit analysis based on returns in your particular market.

Know how long you'll need to stick around: When you sell, remember that married couples, most likely, can exclude from their taxable income up to \$500,000 of gain and individuals filing separately can exclude up to \$250,000. It's required that you must have owned and used your home as your principal residence for two out of five years before the sale. The exclusion is generally applicable once in a two-year period. However, if you are unable to meet the two-year ownership and use requirements because of a change in employment, health reasons or unforeseen circumstances, then your exclusion may be prorated.

Beware the bump in property taxes: The great thing about a more valuable home is the potential higher value when you sell. The bad thing is a visit from the county assessor – more valuable property tends to lead to higher tax assessments. Make sure you cannot only afford the cost of renovation, but what you'll need to pay higher taxes if your home is reassessed.

Don't forget to deduct applicable sales tax: If sales tax was imposed on a major renovation or if your state or locality imposes a general sales tax on the sale of a home or the cost of a substantial addition or major renovation, you might be able to deduct it. Consult IRS Publication

600 for more instructions. If a contractor is acting as your agent, the sales tax he pays on your major renovation may be deductible as well.

Make sure your renovation makes your home salable: A discussion with a real estate agent or someone familiar with the value of improvements in your immediate neighborhood can tell you what will add to value or take it away. For instance, a big addition can take away from the value of a home if it's not aesthetically in tune with the rest of the neighborhood. Obviously, any renovation that keeps your house on the market longer better be worth it for your own comfort while you're living there because it may cost you later. Talk with a CERTIFIED FINANCIAL PLANNER™ professional to see how your improvement plans fit into your financial long-term goals and objectives.

Don't forget taxes, shipping or fine print when shopping online: Online prices might look like a great deal until you realize you may be spending another 20 percent of the gift's price to get it to your house or the recipient. Also, read product descriptions very carefully to make sure what you're buying contains all the features of the item that you could buy at the store. At the same time, if there is a legal opportunity to avoid paying sales tax, watch for that.

Allocate spending for charity: You can either make charity a separate item in your annual budget or part of your holiday budget, but if there are specific charities you want to support by yearend, it's a good idea to decide on those amounts before the holiday shopping season gets underway. This way, you'll support the organizations you wish to without going outside your budget. Also, don't forget to check with your employer to see if they'll match your contribution and consider gifts of appreciated stocks rather than cash if it fits your charitable goals and tax situation.

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