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How Best to Use Your Tax Refund

By Sheryl Nance-Nash

You are anticipating that gift from Uncle Sam this year. Maybe you're thinking of splurging, spending it on something you really, really want. Well, think again.

Here's a better plan for your tax return

Pay down debt

Much as it might pain you to take that "fun money" and put it toward bills, it is surely a good thing to do. Maybe even if you don't put all of your refund toward debt, consider plunking down half or more. You'll be glad you did later. Pick your highest interest rate card as your target.

Strengthen your retirement kitty

It has perhaps been a challenge to save for retirement with the crazy economy. Make up for some of your losses by salting away your tax refund in a Roth or Traditional IRA or your Keogh plan. "If you choose a Roth IRA, unlike other retirement accounts, you can always withdraw your original contribution free of taxes and penalties. And all earnings in a Roth are income-tax free forever, as long as you don't remove them before age 59 1/2," says Paul Jacobs, a certified financial planner with Palisades Hudson Financial Group.

Whatever you can contribute will go a long way. Remember, the power of compounding is working in your favor.

Prepare for an unpleasant surprise

If you don't have an emergency fund, now's a good time to get one going. A bank money market account is a good place to put it, recommends Burk Rosenthal, a certified financial planner. If you already have an emergency fund, pile some more on.

If there's anything learned from the last couple of years, trouble does come and it can stay for a while. Job loss, pay cuts and the like are a reality. An extra \$1,000 or two can make a big difference if you get a tough spot and keep you from having to turn to a credit card.

Start your house fund

Say you've been dreaming about a home sweet home. Use that lump sum to jump start the funds you will need for a down payment, suggests Mitchell Freedman, a personal financial advisor with MFAC Financial Advisors. You'll be surprised that once something is there, it will motivate you to

add to it, little bit by bit. If you already have a home, consider using the money to make an extra payment on your mortgage so the principal will be paid off sooner, he adds.

Protect your family's financial future

"The Great Recession has certainly increased the desire for a stable, dependable way to protect loved ones," says Gerald Rocchi, senior vice president at New York Life. Life insurance is one way to go.

A tax return of about \$2,800 could be used to purchase term life insurance. For example, a healthy 35 year-old male could purchase a 20 year term policy, providing coverage for 20 years, with a death benefit of \$125,000, with an annual premium of \$143 for 20 years, says Rocchi.

Spend wisely

It's okay to spend the money, but purchase something of significance. "Something that will make your life more efficient like a computer," says Freedman. Using it to take a professional or personal develop class is a good investment as well. The point is, spend if it's an investment, not just a frivolous, empty purchase.

Resist temptation

Don't go for the electronic gadget that you've been thinking about buying. Ask yourself do you *really* need it? Most likely, no. Do not use the money for a down payment on a new car if yours will last several years, longer, says Freedman. You also shouldn't view your return as "free money" so you invest it in a stock tip that you got from your best friend. Basically, says Freedman, "Don't make a compulsive purchase of any kind without totally thinking it through."

Make this the year you do the right thing with your refund.

Sheryl Nance-Nash is a freelance writer specializing in personal finance, small business, general business and career issues. She is a former reporter for *Money* magazine and former staff writer for *Your Company* magazine.

To qualify for the tax-free, penalty-free withdrawal of earnings, a Roth IRA must be in place for at least five tax years, and the distribution must take place after age 59 ½ or due to death, disability, or a first time home purchase (up to \$10,000 lifetime maximum). Before taking any specific action, be sure to consult with your tax professional.

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