



A TAXING ISSUE

What If Your State Delays Your Tax Refund?

GREENWOOD VILLAGE, COLORADO—It is no secret that with the economy in a tail spin, everyone is having a hard time making ends meet. So too are states, which face not only declining revenues, but the need to find millions of dollars for income tax refunds.

California and Kansas are the first two to face that dilemma. California's solution is to suspend refunds for a time. In Kansas, the governor and the legislature are trying to fashion a solution. If this could happen in California or Kansas could it happen where you live? It's possible. And if you were counting on that refund now what?

The solution is to plan for the unusual rather than have to scramble to limit the damage.

First, don't count on your tax refund to pay down debt or purchase a truly *necessary* big-ticket item. Try to replace that dying refrigerator or washing machine before its last gasp. Also, instead of banking on that refund for a lump-sum boost to your Individual Retirement Account (IRA) or other retirement accounts, invest in those instruments prior to tax season—perhaps at regular intervals, even if the deposits are small or modest. And beat the state to the punch: adjust your withholding or estimated tax downward and keep more of your paycheck up front.

“The goal of most tax professionals and tax preparers' advised clients is not to have that big a refund,” says Brent Neiser, director of Strategic Programs and Alliances for the National Endowment for Financial Education® (NEFE®).

Doing this lets you avoid playing the waiting game for your refund.

“People don't always make sure they've accurately calculated how much they'll get back,” says Neiser. “I've heard horror stories where people really counted on something, but just didn't do their taxes properly or operated on certain financial assumptions that were mistaken.”

If your withholding is too high, estimate your income for the current year and submit a new Form W-4 reflecting an adjusted number of allowances to your employer, or re-evaluate quarterly estimated payments. States have their own versions of the W-4, so this process also may be applicable. The Internal Revenue Service has a Web site calculator to help you determine the right number of exemptions to claim at

<http://www.irs.gov/individuals/article/0,,id=96196,00.html>

Exercise caution though. Calculating your withholding is anything but an exact science, with potential penalties for errors.

“There is a penalty for under-payment,” warns Neiser. “A lot of people with moderate income sometimes will make adjustments to increase their cash flow every two weeks or monthly, and will ultimately not have an appropriate amount withheld. I don’t encourage people to try to zero that out,” advises Neiser. “If you have to err, then err on the high side.”

And keep in mind there are three life changing events that also will have an impact on your withholding: buying a home, birth of a child and death.

But what if you need that refund to pay your creditors? Don’t panic. Instead, go to your debtors and ask to work out a deferred payment plan.

“Call them in advance and tell them that the tax refund or other piece of revenue you had counted on may not be there,” says Neiser. “Just come clean and tell them your situation. Laying low and hoping your creditors won’t find you, or that they’ll forget about your debt, never works. The late fees will just keep piling up, your debt will be turned over to a collection agency and your credit rating will take a beating.”

Whatever it is, a medical expense not covered by insurance, overdue utility or credit card bills, or anything else—most creditors will accommodate good-faith efforts on your part. Before you call your creditor, plan what you’re going to say. Never make a promise you can’t keep.

Deferred payments generally are better than lowered payments over a longer period of time. In some cases, creditors will allow you to make a lower payment for a few months. The catch is the interest.

“You’re sort of extending the amount of interest,” says Neiser, “so you’re just going to pay back interest for awhile.”

Neiser suggests another option for taxpayers waiting on their refunds is to look to their local commercial or community bank or credit union to see if they are eligible for a short term loan. Rates there are usually reasonable, unlike tax refund anticipation loans or so-called “payday lenders,” which troll the lower-income marketplace for customers. They have created an ultra short-term loan market with sky high interest rates, in many cases as high as 650 percent. The result, borrowers find themselves in an ever deepening debt “death-spiral” with no way out.

The easiest road however, is likely the one not traveled: designing a home budget and living within it. According to the National Foundation for Credit Counseling, only a minority of Americans closely track their typical monthly expenses, and some 40 million adults do little or no tracking at all.

Fortunately, credit counseling agencies and local community- or faith-based Volunteer Income Tax Assistance (VITA) services can take the mystery and fear out of budgeting. They examine all income and debt obligations, review an existing budget and supply a new detailed one with clear goals and objectives.

There are two basic approaches to reducing spending thru budgeting. First, you must decide to do without something, for example, eliminating dinners or going out to the movies. The alternative is to decrease each category a little—maybe \$40 less a month in groceries, \$20 on dinners out and so on. Neiser acknowledges making some of these choices is never easy.

“Everybody is probably going to have a dominant category where the cuts get more meaningful, but they often require more of a lifestyle change than small cuts across the board,” he says. “That can take some time. You can’t do it right away so small incremental cuts may be better.”

The result however, is rewarding. You’ll get a better handle on where your money is going and won’t have to race to the mailbox looking for that refund check.

For helpful resources on building a budget, tracking spending and tips on tax planning, visit www.smartaboutmoney.org. NEFE is a nonprofit foundation dedicated to helping all Americans acquire the knowledge and skills necessary to take control of their financial destiny. To learn more, visit www.nefe.org.

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