

## Don't Blow Your Tax Refund

*Tips, Laws Help Maximize Return Potential*

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UPDATED: 11:36 am EDT April 23, 2007

With that tax return due in your bank account, now is the time to start planning your vacation to the Bahamas or researching flat-screen TVs and new motorboats, right?

Wrong.

While it may seem like a tax refund is an extra bonus, those funds are actually money that taxpayers already earned that has been sitting in limbo since last year.

"The first mistake is getting a tax refund (at all)," said Sandy Shore, a manager of counselor training at the nonprofit financial counseling agency Novadebt, based in New Jersey. "A tax refund means that you paid more in withholding tax than you owed. That money could have been in your bank account earning interest. It would be better to adjust your withholding and start or increase the amount of money you have going automatically into your savings account."

Shore said the second mistake is considering a return a handout.

"Most taxpayers consider the money a windfall and use it to purchase big-ticket items that they may not really need," she said.

To resolve these two mistakes, there are two approaches to take. First, employees are free to file a new W-4 for the current and future years. Upcoming tax returns can be reduced by claiming more dependents or by having the withholding reduced by a specific amount.

"I prefer the second method, since you can pinpoint the amount," Shore said.

She recommended considering future tax-situation changes, and for taxpayers receiving the Earned Income Tax Credit, which reduces or eliminates the taxes that low-income workers pay, she said it's best to file a W-5 to see those funds in regular paychecks.

Even with the withholding status change, a refund may still be in order.

Novadebt said the first place a refund should go is toward paying down high-interest credit card debt.

"Come April, those consumers still suffering from a holiday hangover should consider using their refund to pay their debt down immediately," according to Novadebt.

For those out of debt or paying off low-interest accounts, the best plan may be to put refunds in various savings accounts or toward home improvement investments. As of 2006, two bills were signed into law that allow for refunds to be maximized in these capacities. The Pension Protection Act of 2006 includes a number of provisions to encourage personal savings. One helps taxpayers get more money back, and the other helps them invest their refunds in their future rather than spending it.

If the adjusted gross income is \$50,000 or less for joint filers or \$25,000 or less for single filers, those taxpayers can claim contributions made to retirement funds -- either a 401k or an IRA -- which will give an added tax credit by filling out [Form 8880](#), according to Novadebt.

## More Deposit Options Available

If taxpayers should find themselves with a refund post-tax time, they now have more direct deposit options than in the past.

They can have their refunds directly deposited to their checking or savings accounts -- ideally for applying to debt payments or housing improvements, according to Novadebt -- or have their refund split among up to three accounts including mutual funds, IRAs and other investment and savings accounts by filling out [Form 8888](#). Another bill, passed in 2005, which taxpayers may not be aware of, is the Energy Policy Act. Among its provision is one that encourages homeowners to make energy-efficiency improvements, resulting in a tax credit.

"This includes anything from new windows to insulation, heat-reducing roofing materials, solar panels or fuel cells," according to Novadebt. "There are also an array of energy-efficient products such as dishwashers, washing machines and refrigerators that can give credits as well," but consumers should check if the particular products meet IRS standards for the tax credit.

Not only will these credits save taxpayers in the short term, but Novadebt says, "Increasing a home's energy efficiency can also help save hundreds of dollars a year in utility bill savings."

These credits can be claimed by filling out forms [Form 8909](#) and [5695](#).

If there is money that is still left over, or if the above options don't apply, Shore suggests depositing tax refund dollars in a simple savings account.

"An emergency fund doesn't really change your tax situation as much as it's another smart choice to make when deciding what to do with your tax refund," she said. "Having an emergency fund means that when unexpected expenses -- car repairs, medical bills -- and irregular expenses -- insurance bills, utilities that are seasonal -- come up, you will have the money to pay them without needing to borrow."

While a minimal refund is ideal, receiving a refund is preferred to owing money to the government. But that isn't the case for all taxpayers. For those who find themselves owing in, an emergency fund may help buffer those costs next year, or they may want to increase paycheck withholdings or work to estimate taxes more accurately, Novadebt suggests. For this year, Shore suggests coming up with a plan -- now.

"The IRS is reasonable in trying to collect taxes," she said. "If you can't pay, you can call them. One possibility is an Offer in Compromise. The IRS will look at your expenses and income and determine how much you can pay."

"The worst thing you can do is ignore [the tax bills]," Shore said.

And by resolving this year's debt, taxpayers can be on the road to savings and investments in the years ahead.