

RETIREMENT PLANNING SERVICES, INC.



Advice You Can Use!

Tax Season Follow-Up: Overwithheld? Underwithheld?



Did you owe tax on your 2008 federal income tax return? If so, you might want to consider increasing the amount of federal income tax that's withheld from your paycheck by completing and filing a new Form W-4 with your employer. (If you're self-employed, you'll have to bump up your quarterly estimated tax payments.) Not having enough withheld can result in more than just a cash crunch at tax time—it can mean penalties and interest.

On the other hand, receiving a large federal income tax refund can be an indication that you should adjust your withholding as well. Why? A large refund essentially means that you're providing Uncle Sam with an interest-free loan during the year. Think of it this way: if you received a \$4,000 refund, in 2008 you paid approximately \$333 more each month to the federal government than you had to. Sure, you get that money back in the form of a refund when you file your federal income tax return, but the government doesn't pay you interest on those funds. —

If you had taken that \$333 every month and instead invested it in an account that earned exactly 3% annually, you would have an extra \$80 by the time your return was due. And, depending upon how you invested the funds, you would be able to access those dollars during the year if you had the need.

If overpaying the government during the year is the only way that you can force yourself to save, go right ahead. Just recognize that there's an opportunity cost when you overwithhold. Consider investing those dollars instead; if your employer provides a 401(k) plan, think about increasing your contribution to the plan. Alternatively, you might be able to use payroll deductions to make IRA contributions. Like withholding, these contributions would come directly out of your pay; unlike withholding, though, the funds would be working for you instead of for Uncle Sam.

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