Money and Budgeting

It's Yours to Spend or Keep

Your money is yours. Your decisions about how to spend or save it will make huge differences in your life, both now and in the future. These are *your* decisions and *you* are the one who stands to gain or lose the most. The purpose of this section is *not* to tell you what to do with your money, but to help you organize your financial life and make decisions about spending and saving. Money has three main uses:

- To provide for basic needs, such as food, housing, and clothing
- To save for emergencies and retirement
- To give pleasure to you and others

Income

Most of us work for someone who pays us on a regular basis, whether as employees or independent contractors.

- *Employees* may be paid weekly, every two weeks, or, in some cases, once or twice a month. Pay may be based on hours worked, or

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on a monthly or annual salary.

- *Contractors*—independent workers hired for a specific job—may be paid by the hour, or they may charge a fixed fee for the job, payable either on completion of the work, or in installments at agreed-upon stages of completion.

Other sources of income include child support payments, businesses, investments, government help such as disability payments, pensions, and income from savings.

Withholding and Other Payroll Deductions

If you receive a paycheck as an employee, the amount you receive in each paycheck will be less than what you actually earned.

- Your employer is required to send some of your earnings, called *withholding*, directly to the government for taxes and retirement benefits.
- With every paycheck, you should get an explanation—usually attached to the check—that states how much your employer withheld and what it was withheld for.
- Keep these "stubs." They are proof of employment, proof of income, and they are useful if there is a question about your pay.

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- If your employer pays you in cash, you still need a written statement showing how much, if anything, was withheld on your behalf.

Withholding is required for

- Federal and state (and possibly, local) income tax. The employer uses a formula to estimate how much you will owe the state and federal government in taxes, based on the amount you earned during each pay period.
- Social Security, which usually appears under the puzzling heading, "FICA." This is a fixed percent of your wages that the United States collects (matched by an equal amount from your employer) to help cover the costs of retirement payments when you reach retirement age.
- Medicare, another fixed percent of your wages set aside to help cover your medical costs when you reach retirement age.
- **Withholding for employees** describes how this process works.

Your employer may also deduct payments for

- Health insurance. Your employer may offer a health insurance plan that calls for you to pay some of the costs. If you buy into this plan, your share is usually

deducted proportionately from each pay check.

- Retirement plan. Your employer may help fund a general retirement plan in addition to Social Security if you agree to a regular contribution, as well.
- Charitable contributions. Employers may offer to deduct a set amount from your paycheck for a charitable contribution, which they will forward to a charity you choose from a list of approved organizations.

Independent contractors must negotiate a payment plan with each company or person that retains them. Payment might be based on bills submitted at regular intervals, a lump sum for the whole job, or anything in between.

- It is important for an independent contractor to have a clear, written agreement or contract, including provisions for payment, before starting work.
- Companies that hire independent contractors do not deduct any taxes or other benefits from their payments. The contractor must keep track of income and pay the necessary taxes to the government when they are due.
- The company will report its

payments to the government and will send the contractor a copy of its report.

- If you work as an independent contractor, it is essential to learn what taxes you are responsible for and set aside money to cover those costs. You may have to make quarterly payments of estimated taxes.
- You can find more details at **Withholding for Independent Contractors**

Cashing a Paycheck

Employers may offer to deposit your pay directly into your bank. If you don't have a bank account, most employers will pay by check, a document that instructs the employer's bank to pay you a certain amount. To turn a check into usable money, you will need either to cash it or deposit it in a financial institution—a bank, credit union, or savings and loan institution—that safeguards and keeps track of money.

- *To cash a check immediately,* you have two options:
    - You can go to the bank that issued the check. The bank name, but not necessarily the address of the branch that issued the check, is on the face of the check. Banks may or may not cash checks

from a different branch of the same bank.

  - The bank will require your photo ID (or perhaps two forms of ID) to cash the check.
  - The bank will pay you the full amount of the check.

- You can go to a check-cashing company. This is a business that charges you for the service. The company will verify the check and subtract a fee—which can be quite large—from the cash it gives you. One check-cashing service advertises online that it charges "only" $9.31 to cash a $100 check! It may cost you as much as 3% to 5% of the face value of the check—or $75, to cash a $1,500 check.

  - Be extra careful when you are leaving the business if you use a check-cashing service. It will be an easy guess for anyone on the lookout that you are carrying a lot of cash—whether or not you are.

Banking Your Money

Far more convenient than these options is to open an account at a bank, savings and loan institution (S&L), or credit union. You can get pretty much the same services from any of these institutions. A credit union requires you

to have some connection with a sponsoring group, such as teachers, or members of the military. Credit unions are nonprofit businesses, so they tend to offer loans at lower prices and pay higher interest on your savings. If you are eligible, it's usually a good idea to bank at a credit union.

Opening a Bank Account

Most banks, S&Ls, and credit unions participate in federal programs that insure deposits up to $250,000. The insuring agency reimburses you if the company fails. If you cannot find a written statement naming the federal agency that insures a bank's deposits, it is not a safe place to deposit your money.

- Most people select banks that are conveniently located.
    - Usually, you can find a suitable kind of account at any bank you walk into.
    - Sometimes a better deal for a particular service makes a difference in the bank you choose.
- To open an account, you will need an ID and some money to deposit, either in cash or check form.
- The bank will require you to provide a street address. If you are in temporary housing or need

to move often, you can use a **mailing service**.

- If your opening deposit is a check, there may be a delay before the bank lets you take anything from the account, while it "clears the check" and gets the money from the bank that is paying it out. It's a good idea to ask about this up front, so that you know when you will be able to withdraw money.

Checking, Savings, and Certificates of Deposit

Checking, savings, and certificates of deposit are different kinds of accounts. *Checking accounts* are for managing money that you plan to use soon.

- Money in a checking account is available for your needs as soon as the deposit clears. There is no limit on the amount you can withdraw from a checking account so long as you have enough money in the account. Some kinds of accounts will charge you an additional fee if your balance goes below a set limit.
- Most banks offer a variety of checking accounts. Each will have different terms and conditions, such as
    - the number of checks you can write each month;
    - the amount of money—or

"minimum balance"—you must keep in the account;
  - whether or not you get an ATM card, which allows you to deposit and withdraw money by machine, without going into the bank;
  - charges for bank services such as checks and statements, and fees for "bounced" checks (checks you write for more money than you have in your account) and other mishaps.

Although tedious to study, these details may include some differences that are important to you, so it's a good idea to learn about them before you decide which checking account is best for you.

Savings accounts are designed to build funds for long-term goals and emergencies.

- Withdrawals from savings accounts may be limited to as few as two or three a month.
- The bank pays interest—a fee for the use of the money in your account—that helps increase your savings.

Certificates of deposit, or CDs, are commitments to leave a given amount of money in the bank for a specific time,

usually at least six months.

- CDs usually pay a higher rate of interest than savings accounts.
- But they also charge a penalty—usually the loss of interest—if you withdraw money from them before the agreed-on time.
- A CD is a good place to put money you are saving for a long-term goal, such as education expenses, vacation travel, a car, and so on.

Often the salesperson opening an account for you will help you choose the kind that best meets your needs. This person should also explain terms you don't understand and answer other questions. If you do not receive courteous, helpful service, feel free to take your business elsewhere. There are plenty of banks to choose from.

Deposits: Putting Money in the Bank

Once you have an account, you can put money into it in several different ways:

- You can make cash deposits in person.
- You can deposit checks in person, by mail, or, if your account allows, into an ATM.
    - For each deposit,
        - You will fill out a deposit slip that lists your name and account number, the

date, and the amount you are depositing.

- If you deposit more than one check at the same time, the bank will have you list each check separately, and then total all the checks.
- The bank will provide you with a copy of the deposit slip.
- If you deposit into an ATM (automated teller machine), you will get a receipt that includes all this information.

By keeping these records you will not only be able to track your deposits without going to the bank, but you also will be able to correct any errors the bank might make.

- *Electronic deposit* of your pay, if available, is a convenience.
    - Once you have opened an account, you can give your employer the bank number and your account number, and your pay is automatically deposited into your account on payday.
    - Some employers will arrange to deposit your pay

electronically with a check-cashing service, which you can then withdraw through an ATM card. This option may be more expensive and less convenient than having your pay deposited to a bank account.

Withdrawals

You can withdraw money from your account in several ways:

- If you have a checking account, you can write a check—to yourself, if you want cash, or to whomever you are paying.
    - Some accounts limit the number of checks you can write each month and will charge you if you write more than the limit.
    - The bank will probably charge you for checks and a checkbook. This is the fastest way to get your first checkbook, but you can often get cheaper checks from check-printing companies for refills.
- You can authorize automatic electronic withdrawals from your checking account for fixed monthly items, like rent. If you do this, it's

important to remember to allow for the withdrawals when you are writing checks.

- You can use an ATM card, a debit card that enables you to make deposits and withdrawals at machines.
    - Machines are available at times when banks are closed.
    - Most banks charge an extra fee if you use an ATM card in the machine of a different company.
    - Read the ATM agreement or ask the salesperson about charges for other ATM services so you will know if you are incurring them.
    - You may be able to use your ATM card at banks outside the United States to get local currency, but there may be an additional charge.

If you withdraw more than the balance in the account—called an *overdraft*—the bank will charge you for it.

Managing Your Accounts

No matter what kind of accounts you open, it's important to keep track of your money. Staying within the limits of your income helps keep you in charge of your life.

Bank statements. If you have opened a

checking or savings account, you will receive regular statements that list all the transactions in the account. Many banks now offer to send you this information online if you prefer.

- Checking account statements usually come each month.
- Savings account statements may be quarterly—every 3 months.
- A statement will list
    - bank fees subtracted and interest payments added to your account;
    - other deposits into your account;
    - withdrawals by check, electronic payment, or ATM;
    - how much money is in the account as of the date of the statement.

Statements may enclose your canceled checks or include copies of them.
If you have a checking account, you can use your check register—the booklet that comes with the checks—to keep track of the checks you write. There will be a place in the check register for

- the check number;
- the date you wrote the check;
- the person or organization you paid (the payee);
- the amount of the check; and, after you have subtracted it,
- the balance remaining in your

account.

There will also be a place to record deposits.

- Use the check register to enter the amount of any automatic electronic withdrawal you've authorized, on the date it's withdrawn.
- If you pay for a purchase with you debit card, enter that information, as well.

It's sometimes tempting when you're in a hurry to skip these steps. That's not a good idea, though. If you leave them till later, you may forget about them or get the amount wrong.

If you have a savings account, you can track your transactions by keeping receipts for all your deposits and copies of your withdrawal requests.

Banks do make mistakes, so it's important to review the reports you get and compare that information with your own records. The amount in your account on the date of the statement should be the same as the amount shown in your own records for that date. If it is not, look for

- *Checks you wrote, but the bank*

had not yet paid out. These are called *outstanding checks*.

- *Unrecorded deposits.* These may be deposits that you mailed, but the bank had not received by the date of the statement. Or the bank may have recorded electronic deposits or interest payments you forgot about or did not expect.
- *Unrecorded payments.* These may be electronic withdrawals from your account that you authorized but forgot to record, bank charges, or checks you forgot to enter.
- *Calculation errors.* Check your arithmetic to make sure you've added and subtracted correctly.

Most bank statements have directions about "reconciling" differences—making sure you and the bank agree on the amount in your account. The usual way to reconcile your records with the bank statement is this:

- Enter in your register any withdrawals or deposits you did not previously record.
- Subtract the amount of withdrawals you did not list in the register.
- Add the amount of deposits you have not yet listed in the register.
- On the bank statement, subtract the amount of any checks or other withdrawals that the bank has not

yet paid out. Add any deposits you made after the date on the statement.

The bank statement and your own records now have the same information and should be the same. If they are not, you can

- Review the amounts on checks to make sure that the amounts the bank shows are the same as the amounts you entered in your record.
- Check the bank's arithmetic—computers do "hiccup" from time to time.
- Check your own arithmetic.

You can find a more detailed description of this process at **hubpages.com**
If you still do not understand the difference between the bank's balance and yours, consult the bank. Some banks offer telephone service during evenings and weekends, so you may not have to take time off from work to do this. The bank's customer service representative should be able to help you find and solve the difficulty. However, if the difference is insignificant, you probably need not go to all this bother.
By keeping track of your money, you will avoid paying large fees for writing checks that "bounce." And if there's anything wrong, like a large withdrawal that you didn't make, you will find out sooner

rather than later.

Banking Terms

Financial institutions use a lot of jargon. Here is a short list of banking terms and their meanings. If you don't find what you are looking for, there are detailed lists at **Merchants & Southern Bank** or **AloStar Bank**

Account—Money deposited with a financial institution for investment and/or safekeeping purposes.

ATM—Short for *automated teller machine*.

APY (annual percentage yield)—The amount of interest earned on an account at the end of one year.

Balance—In banking, *balance* refers to the amount of money in a particular account. In bills, *balance* refers to the amount you owe.

Bounced check—A check that a bank has refused to cash or pay because you have no funds to cover it in your account.

Canceled check—A check that has been paid by the bank to the payee. Canceled checks have the date paid on the back. They may be mailed to the account holder each month along with the statement, or the bank may keep records that are available upon request. Canceled checks are valid receipts; they confirm the date you bought an item and how much you paid for it.

Cash—Currency and checks acceptable

for direct deposit by a bank.

Check—Any written document instructing a bank to pay money from the writer's account.

Checking account—An account for which the holder can write checks. Checking accounts pay less interest than savings accounts, or none at all.

Check safekeeping—The customer's checks are kept on record at the bank and the canceled checks are not returned to the customer.

Clear—A check "clears" when its amount is debited (subtracted) from the payer's account and credited (added) to the payee's account.

Currency—Anything used as a common medium of exchange. In practice, currency means cash, particularly paper money, or checks. Bankers often use the phrase "coin and currency" to refer to cents and dollars.

Demand deposit—A checking account.

Deposit slip—A form showing the exact amount of paper money, coin, and checks being deposited to a particular account.

Depositor—An individual or company that puts money in a bank account.

Endorse—To sign, as the payee, the back of a check before cashing, depositing, or giving the check to someone else. The first endorsement must be made by the payee to authorize the transaction. Later endorsements may be made by whoever receives the check.

FDIC insured—A deposit account insured by the Federal Deposit Insurance Corporation (deposit insurance offered by the federal government) for up to $250,000 per account.

Interest—The cost of the use of other people's money.

Joint account—An account held by two or more people so that all can use the account and all assume legal responsibility to repay.

Overdraft—A withdrawal order for more money than is currently in the account. If the bank refuses to cash the check, it is said to have "bounced." There is often a stiff charge for an overdraft.

Payee—An individual or company to whom a check is written; one who receives money as payment.

Payer—An individual or company who writes a check; one who gives money as payment.

Savings account—A bank account that pays interest in exchange for use of the money on deposit.

Service charge—The monthly fee a bank charges for handling an account.

Stop payment—An order to a bank not to pay a specific check you have written. If requested soon enough, the check will not be debited from the your account. Normally there is a charge for this service.

Withdrawal—An amount of money taken out of an account.

Budgeting: Spending and Saving

A budget is a plan to help you buy what you need and save for what you want. A budget helps you live within your income. You don't need to have a bank account to make a budget, but you do need to know what your income is likely to be. You also can make a temporary budget that reflects where you are now financially.

The main elements of a budget are

- **Budget period**

  You can budget for a day, a week, a month, a year—or even longer.

  - For general planning, a monthly budget is the easiest.
    - It's easy to calculate a month's income, and
    - it's a long enough time to smooth out the ups and downs of daily expenses.
  - For some purposes, you might want to make a yearly budget.

- **Income**

  The basis of a budget is your regular income from all significant

sources.

- It helps to think of income in two ways: The stated amount you earn, and the amount you actually take home. If you base your budget on the amount you actually take home you will have a realistic picture of how much is available for your needs.
- If you are self-employed or an independent contractor, remember to include estimated income taxes (state and federal), Social Security, and Medicare payments as part of your budget.
- If you have significant income from sources other than work, it's simplest to include the total amount as income and list the various taxes as expenses.
- It's a good idea to think of a budget as the "most likely" scenario. It's nicer to have money left over than to owe money you can't pay. If you base your plan on income that is certain, or even on the low side, you will be able to meet some unexpected

expenses along the way.

    - If you are expecting a raise, budget for your present salary until you get the new paycheck.
    - If a doctor gives you the range of an estimated cost of treatment, say, between $600 and $1,000, budget for the higher cost.

  - Small amounts, like interest payments from savings accounts and CDs, are best ignored for budgeting purposes.
  - Occasional gifts of money or one-time windfalls will give you a misleading total if you include them.

Expenses

Expenses are what you pay out during the budget period. Prioritizing is the first step in organizing and getting expenses under control. Suggested priorities are listed below, although you may want to add, subtract, or rearrange:

1. *Housing and transportation to and from work* are the most important expenses. A place of shelter is a basic human necessity, but you also need

income. If you don't have the money to get to work, you can't keep a job. If you can't keep a job, you soon won't have an address, either.

2. *Fixed, regularly recurring expenses*, like

- medications or childcare;
- taxes
- utilities not included in housing costs, such electricity, gas, and telephone.

3. *Savings*. Two things certain about emergencies are that

- they will occur (although you don't know when), and
- they will cost money.

> Assigning "what's left over" for savings too often means there are no savings, because there is nothing left over. But even a small amount saved regularly will soon add up.

4. *Expenses that don't necessarily occur in a regular or predictable manner*, like clothing and gifts. You can set aside a monthly amount for them, even though you don't necessarily use it all every month. This gives you a little fund to draw on when it's needed.

If you want to contribute to charitable

causes, it helps to put this in the budget. Otherwise, you might find either that you are giving money you really can't afford, or that you have nothing left over to give.

Savings

The purpose of saving is to provide funds for large items or long-term purposes, and to have funds available in case of emergency. Some people keep several savings accounts to distinguish between different goals:

- An account for annual, but flexible extras, like vacations or Christmas gifts. If you are saving for a fixed time, such as Christmas, you can decide how much, given your income, you can set aside for this purpose in the time available, and tailor your spending to the amount available for the purpose.
- An account for long-term large purchases such as education, a house, or a car. For items like these, your savings plan will be based on the likely cost of your purchase, and your purchase must wait until you have saved enough money for it.
- An account for emergencies only. Some experts recommend that you save enough to cover your essential expenses for six months. More realistically, others

recommend saving enough to cover expenses for three months.

Because the purpose of savings is to have the money there when you need it, it's best to place all savings in government-insured accounts, like bank savings accounts, certificates of deposit, or U.S. Treasury bonds, which you can buy in amounts as small as $25. The interest you earn on these accounts will depend on the type of account, the amount of money in it, and the length of time you commit to leave it in the account.

Calculating Monthly Expenses

Items like rent are fixed every month. To estimate other monthly expenses,

- When you pay for something with cash or a credit or debit card, keep the paper sales receipt. Collect all the receipts in an envelope.
- At the end of a month, sort the receipts into categories such as "Food," "Medications," "Clothing," and so on, and add up each category.
- If you think this was an unusual month, one where you spent a lot more or a lot less than usual, or had unusual expenses, save and sort your receipts for a second month.
- For items that vary from month to

month, you can keep your receipts for three months or more. Add up the bills for each category for several months, then divide the total by the number of months covered. For instance, if you spend $25 on clothing during one month, $75 the next, and $10 the next, you've spent $110 over the three months. You can budget this as $37 per month (rounding up to give yourself a little wiggle room).

Below are some of the usual budget categories:

- Rent or mortgage
- Transportation (If you drive, include car payments, insurance, parking, and gas here.)
- Other fixed expenses: childcare, medicine, and so on
- Household utilities: water, gas, and electricity, if not included in the rent; plus telephone, Internet access, cable TV. Costs of some utilities, like electricity, may vary from month to month, depending on the season, or how much you use them.
    - If these costs are not included in your rent, keep this in mind as the seasons change. Heating costs may soar in winter, air conditioning costs in summer.

    - Some utility companies will arrange for you to pay a fixed amount each month, based on yearly costs. This option eliminates the ups and downs, making it easier to plan.

- Savings
    - You can use this line to include money you are setting aside for school, vacation, or other big-ticket items.

- Food
- Sundries and supplies (like toothpaste, deodorant, laundry detergent, paper, and pencils)
- Entertainment and recreation
    - Note that this—things you do for fun and relaxation—is a budget item. This is an important part of your life. Planning for it means you can keep the costs under control on the one hand, and enjoy yourself without worrying about whether you can afford it, on the other.

- Clothing and gifts
    - It helps to allot a regular amount each month, even though you may not actually

spend it.

For realistic numbers when you estimate your expenses,

- Use regular prices, not sales or other unusually low prices.
- Allow for fairly predictable exceptions. For instance, if you usually get a ride to work twice a week, set aside transportation money for times when the ride might fall through.

Here is how a sample budget might look.

The Bottom Line

The bottom line is where you add up your expenses and compare your total expenses with your total income. It tells you where you stand financially.

- If your expenses are more than your income, you need to cut down on something or earn more money.
- If your income is more than your expenses, you are in good shape.
- If your income and expenses are exactly the same, you are in a risky place. You don't have any room for surprises, like an increase in gas prices.

Paying Bills and Transferring Money

Two important things to pay attention to

when paying bills are:

- Timely payments, which will prevent you from incurring costly late fees;
- Keeping receipts or other documents that prove you paid (not necessary for small cash outlays).

If you are working from a budget, you are more likely to pay bills in a timely manner because you will have the money on hand to pay them.
You don't need a bank account to pay your bills, although it is certainly more convenient. Following are some of the ways you can pay your bills.

Currency

Many payments are in cash. Groceries, gas, bus or taxi fare, and movie tickets may be some of these items.

- Cash is convenient and almost universally accepted in person-to-person transactions, and it's easy to know whether or not you have enough.
- Carrying large amounts of cash can be awkward or even dangerous.
- Cash is hard to track unless you get receipts, so you may lack proof of payment or an accurate knowledge of how much you spent.
- Organizations such as city bus

companies are increasingly turning to other means of payment that are more convenient for them.
- It is extremely risky to send cash through the mail, and many companies will not accept cash payments by mail.

Money Orders or Bank Checks

Money orders or bank checks are a way of sending money if

- you do not have a checking account, or if
- the person receiving the money will find it difficult to negotiate a check, or if
- you are making a payment to a company that will not take a personal check for the amount (auto dealers, for example, may not accept personal checks when you buy a car).

You can

- Use cash or a debit card at the post office for **paying bills** or to purchase a **money order** to send through the mail.
- Send money via **Western Union**, paying with cash or a credit or debit card.
- Get a check drawn on your bank itself, called a bank check, made out to the person or company you are paying. The bank will withdraw

the money from your account.

There is a charge for all these services.

Personal Checks

Personal checks are orders to your bank to pay the designated party the amount stated on the check.

- You can pay most routine bills—rent, utilities, credit cards, and so on, with personal checks.
- Some stores will accept personal checks if you have at least two IDs.
- Some supermarkets issue check-cashing cards that you can use to write checks for extra cash in addition to paying for your purchases.
- Most restaurants and gas stations will not accept personal checks.

Credit Cards

Credit cards are plastic cards issued by a bank or store. When you pay with a credit card, the card issuer reimburses the stores and collects your payment.

- The card issuer sends you a monthly bill, which, if at all possible, you should pay in full.
- If you pay less than the full amount of your bill, the issuer will charge a very high interest rate on the unpaid balance.
- If your payment is late, you may

be charged a "late fee." Be sure to note the date your payment is due and allow plenty of time for a check or money order to travel through the mail if need be.

- If you pay bills online, you will usually know the exact date the payment will be made.
- Credit card companies frequently send blank "checks" that they encourage you to use. Beware! These are loans and you will be charged interest if you use them. If you rip them up immediately, you will not use them by accident, nor can anyone else use them to defraud you.

Debit Cards

Debit cards are also plastic cards, but, like checks, they result in an immediate withdrawal of the amount charged from your bank account.

- If you use a debit card, keep a careful track of how much you spend.
- If you overdraw, the bank may charge you a steep fee for the overdraft.

Prepaid Cards

Prepaid cards are plastic cards that you load with a given amount of money and that you can then use until you have paid out all the money on them. This can

be convenient for people who don't have established credit ratings or regular checking or savings accounts.

- Once you open a prepaid card account, you can pay more money into it to keep it going.
- However, you will need to check the cost of a card very carefully because there is a wide range of possibilities.
- Issuers' fees usually include an activation fee when you open an account, plus a charge every time you pay into the account.
- Some charge for use of ATM machines.
- Some charge monthly "maintenance" fees.
- Others charge "inactivity" fees.
- Hotels, airlines, and car-rental companies honor some cards, but not others.

PayPal

PayPal is an online service that may be convenient if you want to buy something online, but you don't have a credit or debit card.

- You do need a bank account, which you register with PayPal, but you do not need to give financial information to anyone else in order to buy goods or services online.
- PayPal will forward payment as ordered and withdraw the payment

from your bank account.

- You can also use PayPal with a credit card, if you prefer, or
- You can use PayPal to transfer money to someone else who has a PayPal account.

Online Banking

If you have an account at a bank with online banking, you can simply order the bank to send a given amount of money to a given company.

- You can get a record of all the payments you've ordered.
- This is a convenient way to pay regularly recurring bills like rent or telephone, or practically any bill that has an account number for you.
- You cannot use online banking to pay companies that don't give you an account number.

Online banking fraud. The Internet has opened many opportunities for theft and fraud. Whether or not you bank online, it's important to be alert. One common scam is the "phishing" scam. You get an email that looks like it's from your bank, seeking to verify your account information. The email message has your name and other personal information, and it asks politely for your account number. A variation is the email that "alerts" you to the possibility that your account will

be closed if you don't immediately confirm various information requested. **But no reputable bank will send an e-mail asking for your account number, social security number, or other personal information.** If you respond, you will be giving that information to someone who plans to rob you.

Borrowing and Lending

Borrowing means obtaining money with the intention of paying it back. Money you borrow is called a *loan*, and the company or person from whom you borrow money is a *lender*. If you borrow a few dollars from a friend and pay it back the next day, the transaction is simple. Borrowing more than that can quickly get very expensive, so it's advisable to avoid borrowing except for major purchases like a house, a car, or an education. (There is a separate section about **education loans** elsewhere in this book.)

The charge for borrowing money is called the *interest rate*. You can think of the interest rate as a rental fee you pay for the use of the money. Interest rates vary widely, depending on how much you are borrowing or lending, for how long, and how the loan will be repaid. You can find a detailed explanation of interest rates at **FinancialWeb**. Some loans are structured with interest rates that change. In those cases, it is very

important to know exactly how the rates will change, and to do the actual arithmetic that will show how much you must pay after the change, and when you must pay it.

Loan Basics

For any money you borrow or lend that amounts to more than a small, friendly gesture, you will need the protection of a written agreement, signed by both lender and borrower, that sets out the details of the contract. Basic elements of a loan are

- The amount of the loan
- The interest rate—how much the lender is charging for the use of the money
- The dates and terms of repayment—whether fixed monthly amounts, a lump sum, etc.
- The amount of each payment
- Any collateral—security the borrower pledges as a guarantee of repayment
- Any penalties for late payments or failure to pay
- Date the loan is made
- Signatures of both lender and borrower

Any prospective borrower or lender who does not sign a document with this basic information is putting you at risk and may be exposing you to serious financial or

legal difficulties.

> *It is critically important to read any loan agreement very carefully before you sign it. All the terms should be what you expect; all blanks should be filled in, either with the required information or with N.A., which means "not applicable"; and both the borrower's and lender's names and signatures should be complete and correct.*

You can find a sample loan agreement at **PublicLegalForms.com** or for a small fee, you can create a customized loan agreement at **LoanBack**.

Co-signing a loan

If your credit isn't well established or a prospective lender doubts your ability to pay, you may be required to find a "co-signer," a person with better credit, who is willing to re-pay the loan if you cannot. Needless to say, this could become a serious strain on a relationship if a friend or family member suddenly finds herself obliged to pay back money she never owed. Consider long and thoughtfully before you ask anyone to co-sign a loan for you, or agree to co-sign someone else's loan.

Following are the three principal sources of loans.

Personal Loans from Friends or Family Members

In circumstances where commercial organizations would not lend, you may be able to borrow from friends and family members who know and trust you.

- There may be low or no interest on "friendly" loans.
- Nevertheless, a written agreement spelling out how much you are borrowing, how and when you intend to pay it back, and how much (if any) interest you are paying will help avoid misunderstandings.
- The disadvantage of a personal loan is the need to adjust the agreement if the borrower's or the lender's circumstances change unexpectedly. For instance, if the lender loses his job or falls ill, he may need the money back much sooner than anticipated, a situation that could result in serious stress on the relationship.

Commercial Loans

Commercial loans from a bank or other lender are another option.

- The bank or other lender will require evidence—usually paycheck

stubs to confirm your employment and income—that you can repay the loan at the rate agreed upon.

- The bank will also look for an alternative way of getting its money back, called *collateral*, if you cannot repay.

  For example, if you borrow money to pay for a car, the bank will probably use the car as collateral. If you can't make your car payments, the bank could take ownership of the car and sell it in order to get its money back.

- The bank will charge you interest for the use of the money, and will set a payment schedule telling you exactly
  - when payments are due,
  - how much each payment will be,
  - what portion of the payment is interest, and
  - what portion is repayment of the money you borrowed.

- Banks may also consider rearranging terms of a loan, if, for instance, you can assure them that you can resume or make up lost payments within a reasonable time.
- Some lenders will want you to have a "credit history," a record of

paying back loans on schedule. The easiest way to get a credit history is to open a charge account at a local department store, which you usually can do instantly. If you buy things at the store, charge your purchases and pay the monthly bill promptly and in full for several months – no matter how small the bills – you will have the necessary history.

- Alternatively, some lenders will ask for a co-signer, another person who has a good credit history, to sign on to the loan. This person then becomes responsible for repayment if you fail to pay as agreed.

Credit Card Loans

Credit card loans are the easiest to get, and by far the most expensive. You can almost certainly find better terms elsewhere.

- There is no extra paperwork because the interest rate and other terms and conditions are spelled out in tiny print on the wispy pieces of paper you receive when you open the account. If the company changes its terms, it will send you another wispy piece of paper with more small print to tell you about the changes.
- You get an automatic loan simply

by paying only a portion of the amount you owe each month. When you open the account, the company assigns you a "credit limit" and will lend you up to that amount without any further formalities.

- The company will actually encourage you to borrow from it. Your credit card bill will list a "minimum amount" or "current payment"—often more prominently placed on the bill than the total you owe—that you can pay each month.

  That "minimum amount" will be a tiny fraction of what you owe—as little as $10, for instance, on a $300 bill, but you will be charged a heavy interest rate on the balance—the part of the total that you don't pay. In fact, the interest charges may build up so high that you pay double the original bill or more.

- Another slick practice of credit card companies is to send a sheet of checks, as if you had money on deposit with the company. In fact, the checks are a loan against your credit limit, and you will pay interest on them from the moment you—or anyone else—cashes them.

- **Student loans** are government-sponsored loans to pay for education. You can find more information about this in the **Education** section.

Shopping for a Loan

Because you may find very different terms and conditions from different lenders, it makes sense to shop for a loan just as you would shop for the best buy in shoes or apples or anything else. After you have decided how much you need to borrow, try to contact at least two or three potential lenders.

- Usually, a bank where you have a checking or savings account is one prospective lender.
- Often, for large transactions like a car loan, the seller or car dealer may want to offer the loan; often, you can do better somewhere else.
- Places to avoid are businesses that offer quick cash, no questions asked. You are very likely to find yourself paying for that convenience.
- Whoever you borrow from should spell out in writing the loan arrangements described above. Beware of anyone or any company who tells you, "Oh, you don't need that stuff!" What they mean is, "I don't want to write that stuff down," and they probably have a

reason for that.

Some of the possible differences among loans from different lenders are

- different interest rates;
- different loan durations (i.e., repayment over two years vs. repayment over three years);
- different penalties for late payments;
- different rules for early payments (some lenders will charge you to pay off your loan ahead of schedule, or won't let you pay early);
- different valuations of your collateral.

It can be quite difficult to compare your options. Although it's always useful (and sometimes surprising) to calculate the total cost of the loan, other factors may matter as much or more:

- You may find one lender charges a higher interest rate, but offers better terms for early repayment, while
- Another charges a lower interest rate, but prohibits early repayment altogether.

You also need to consider your own situation.

- If, for instance, you anticipate a significant increase in your income,

you might prefer a loan with easy prepayment terms.

Or

- If you must watch cash flow very carefully, a loan with smaller monthly payments might be more appropriate, even if it has a higher interest rate.

As with any major transaction in your life, you will make better decisions about borrowing money if you take your time, think it through, and resist pressure to "Do it now!"

Public Assistance

For those who are unable to work, who can't find work, or whose incomes don't cover basic expenses even though they do work, state governments offer various kinds of help, all called *public assistance*. Grants are available for help with such needs as

- medical care
- food
- child care
- housing
- heating and other utility bills
- job training

Although supported by the national government, public assistance grants vary, depending on the state, and sometimes the city where you live.

- To find out what kinds of public assistance you might be eligible for, google "public assistance," plus your state.
- Most states also provide for "emergency assistance" if you are in immediate need of food or shelter. Emergency assistance comes through faster, and is usually time-limited.
- You can learn more about public assistance for housing, education, and job training in the relevant sections of this book.

Taxes

Local, state, and national governments offer important services. Taxes are the money the governments collect to pay for those services.

- The federal government provides Social Security, Medicare and Medicaid, education and other social welfare programs, and funds for interstate highways, the armed forces, the federal courts, Congress, and a host of other programs.
- State governments are the main source of payment for schools, public colleges and universities, and state highways. They also contribute to social programs like shelters, hospitals, and health care.

- County and city governments support public transportation, hospitals, roads and schools, garbage collection, police, and other essential services.

Types of Taxes

Taxes come in many forms:

- Sales taxes on most of the things we buy
- Excise (or luxury) taxes on high-priced items like jewelry and furs
- "Sin" taxes on things like alcoholic beverages and cigarettes, intended to increase the cost of using things considered unhealthy or undesirable
- Gasoline taxes, used to fund and maintain roads and highways
- Property taxes (directly if you own a home, or indirectly if you rent)
- Income taxes
- Capital gains taxes (if you make a profit on an investment)

Some taxes are almost invisible, like the tax on gasoline, which is usually incorporated into the per-gallon price.

Income Tax

Probably the largest tax most people pay is income tax, the portion of your total income collected by federal, state, and local governments. Because this tax

usually comes to a large amount, the government collects it in installments. The collection method differs, depending on whether you are self-employed or work for someone else.

Withholding for Employees

If you are employed by someone else, your employer will deduct a portion of your earnings each pay period to send directly to federal, state, and local government. This amount will vary, depending on how much you earn and how many people you are supporting with your income.

- When you start a new job, your employer will have you fill out a W-4 form, stating how many people you support, called *dependents*. The employer then forwards a portion of your pay each pay period directly to the government for your account.
- The more dependents you claim, the less the government withholds. Since there is no requirement to report the actual number of dependents, some people game this system by claiming more or fewer dependents than they actually have:
    - Some use withholding tax as a convenient savings plan. If you claim no dependents, not even yourself, the

government will withhold more money than you will actually owe at the end of the year. After you file your tax return, you will get a government check refunding your overpayment.
    - Others claim more dependents than they actually have. Less money is withheld from their paychecks, giving them more cash for immediate expenses. At the end of the year, they will owe the government money.
    - Neither of these maneuvers is really a great idea. It's nice to get a refund check from the government, but the same amount deposited in a savings account would have earned interest payments throughout the year, for a larger total amount in hand. Or, if you have claimed extra dependents to get more cash, you are simply postponing gradual payments you will eventually owe in a lump sum.

- Each January, your employer will send you a Form W-2, which

states exactly how much withholding tax was paid to which government (federal, state, local) on your behalf. The employer includes copies for you to attach to your federal and state tax returns, proof of the amounts you have already paid.

Withholding for Independent Contractors and Self-Employed People

If you own a business (even a part-time business) or work as an independent contractor, you must

- make quarterly tax payments (four times a year) based on your estimated income for the year, plus
- pay a self-employment tax to cover your Social Security and Medicare taxes.

At the end of the year, you must include in your tax report a form (called Schedule C or Schedule C-EZ) that details your income, expenses, and profit from the business.
As an independent contractor, you will also get a yearly form from anyone who hired you and paid you more than a stipulated minimum amount (which changes from time to time) stating how much that business paid you during the year.

- A copy of this form goes to the

government, so it's important that the amounts you report match the amounts the contracting company or person reports.

Even if you mainly work as an employee and work for yourself only a small part of the time, the government requires you to keep track of these earnings.
For details about all this, start at the **government Web site for self-employed** taxpayers.

Paying income tax

The law requires people to prepare and submit tax returns every year, detailing the amount and sources of their income. Every level of government that collects income tax will have its own form. Generally, this will include only the federal and state government. A few locations also have a city or county income tax. Tax law is complicated and frequently changes, and filling out tax returns can be a daunting ordeal. You can reduce the headaches of this process if you

- keep careful records,
- allow yourself plenty of time to work on the returns, and
- read the directions carefully.

In many states, the state tax return is based on information in the federal tax return, so you can save yourself time

and trouble by finishing the federal return first.

Keeping Records

The law allows the federal government three years to review tax returns and investigate if there are questions or problems. You should keep records relating to your income as well as copies of your tax returns at least for those three years, so that you can respond to this kind of investigation, which is called an *audit*.

Help for Low-Income Earners

To help low- and moderate-income earners offset the burden of Social Security and other taxes, the federal government offers something called the Earned Income Tax Credit. If you qualify, your income tax will be reduced by the amount of the credit. If your income is low enough, you may even end up getting a check back from the government that is greater than the amount of taxes withheld. Of course, in order to qualify, you must earn some income and file a tax return. You might want to **see if you are eligible**.

Protecting Yourself from Theft and Fraud

Money is so useful that it attracts people who would like to have some of yours. Here are some thoughts about protecting

yourself from thieves and "con men."

Basic Precautions

- *Keep a list of all your credit, debit, and charge cards, and your checking and savings accounts.* For each account, list
    - the issuing institution,
    - the account number, and
    - the phone number to call to report loss or theft of the card, checkbook, or savings information. You'll find this phone number on the back of plastic cards, and on statements from checking or savings accounts.

  Keep the list in a safe place and update it once a year. You may add or change accounts during the year and institutions may change their phone numbers from time to time.

- *Keep track of valuables*
    - Keep purses or backpacks that contain valuables where you can hold or watch them. Don't leave them hanging over the back of a restaurant chair or lying in an unattended supermarket cart.
    - Don't stuff your wallet into a

back pocket where it will bulge conspicuously.
    - If you walk on a dark or lonely street, keep valuables in your pockets, not in a separate purse or backpack.
    - If you use credit or debit cards regularly, develop a way to notice whether you get the card back after you use it for a purchase. For instance, if you make a habit of keeping your wallet in your hand until the card is back, you will notice if you find yourself walking away with your wallet still in your hand.

- *Check statements of all financial transactions* to make sure that the transactions charged to you are legitimate. A dishonest sales person can collect your account information off the card and use it in telephone or online transactions.
- *Be very cautious about people who approach you with offers relating to money. Con man* is short for *confidence man*, and refers to the criminal who gets your property by gaining your confidence. These people appear so warm, nice, and caring that they can fool others into
    - "lending" them money so

they can get to an important business appointment;
    - "investing" in fees that will be repaid with a handsome profit after they claim their inheritance (or whatever);
    - "helping" you change foreign currency into dollars, purchase a money order, and the like; or
    - other scams.

It's safest to keep business transactions in a business setting. Strangers, no matter how helpful and friendly, are not reliable.

Lost or Stolen Credit and Debit Cards

If your credit, debit, or other charge cards are lost or stolen,

- You need to notify the issuers are soon as possible so they can cancel the cards.
- The issuer is usually responsible for the cost of fraudulent purchases if the loss is reported promptly.
- You can save yourself considerable hassle, and perhaps money, by prompt reporting.

Online Scams and Fraud

In general, any online transaction involving money or personal information (such as online purchases) should be initiated by you, or come from an

organization that already has your personal information and therefore has no need to ask for it.

Simple scams. Familiar to many of us is the polite email from the nice person in Africa or the Caribbean who has an opportunity to buy into the biggest uranium find in history, but who needs $25 from you to raise the money needed to complete the transaction (after which you will get a fortune in return). A variation is the urgent email purporting to be from a friend or acquaintance whose money and passport has been stolen and who needs X dollars immediately for plane fare home.

- These simple scams must work, or there wouldn't be so many messages like this coming in.
- Of course, whatever amount you send, you have lost.

But if you give out your credit or debit card number, you could be exposed to even more loss.

Phishing. Increasingly, Internet con men are turning to a more sophisticated scheme called *phishing*. This scam involves an email purporting to be from a bank, insurance company, or other large, well-known institution.

- The email looks official, right down to the company logo.
- The email says that the company

needs to verify your account information for its records; it instructs you to click on a link that takes you to an official-looking Web site that asks for your account number and sometimes other personal information, such as date of birth or Social Security number.

This email is a forgery. **No legitimate business will ever initiate a correspondence that asks for personal information by email.**
A variation is the official looking email that threatens to close your account unless you immediately supply various personal information.

- If you don't have an account at the supposed sending institution, you'll know it's fake.
- But if you do have an account, you might be tempted.
- If you're worried, you can always call the company and ask.

Be especially careful when giving out identifying information online.

- Check to be sure that the little padlock that indicates a secure site is on.
- Online sellers do not need your Social Security number or date of birth for a legitimate transaction, or to open an account.
- Online "surveys" need only general

information about your age (usually a range), occupation, and so forth.

- Petitions you sign may want your address as well, but they are out of order to ask for more.

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