Lesson 19

But I Thought I Was Supposed To . . .

Because of email and social media, we are exposed to a lot of fake news, urban legends and myths that take on a life of their own. It's not unusual to read a post or an article that has enough truth in it to be somewhat believable, but there are aspects of it that seem suspiciously false. How do we know what to believe and what not to believe? The answer usually requires verification by someone who knows for sure, or your own analysis or common sense to guide you. A similar phenomenon occurs in sorting out financial decisions made by a person because someone else told them, "That's what you need to do". Let's explore some of those financial myths in this lesson.

Just last week, a group I was with discussed an error a fellow was making by maintaining a balance on his credit card. He had been told by someone he trusted that if he paid off the balance each month, the credit card company would likely close his account. He rationalized the company would conclude he didn't need the credit line if he could afford to pay the bill each month. A variation of this is the guy who maintained a monthly balance because he thought it would help improve his credit score by making a payment every month. He thought if he paid the balance in full and on occasion skipped a month without a charge, his credit score would suffer.

As we discussed in Lesson 17, we place ourselves at a huge disadvantage by not paying the credit card bill in full each month. We are accruing interest on each purchase beginning on the day of the purchase, if we don't pay the bill in full.

The techniques mentioned in the previous paragraphs are myths.

The credit card companies want our business. They don't love us any less by paying them in full each month. If we use the cards on a regular basis and are not delinquent in our payments, you can rest assured they will want to keep us as a customer. What is the credit score impact of paying the bill in full? The creditor reports our payment history and our average balance to the credit bureaus each month. From a reporting standpoint, it doesn't matter if we pay the minimum payment or the entire balance as long as we pay on time. However, think about it: paying less than the balance each month on an active account would result in the average balance typically increasing. A larger balance creates a larger debt to available credit ratio, which you learned is not a good thing. So, from a credit score standpoint, our score is more likely to improve by paying in full, because our average balance will be lower. I have paid my credit card account balances in full for well over 20 years, and my credit score has never suffered.

While it might not fall into the financial myth category, another mistake consumers make is buying a replacement house or car (or any other big ticket item) before selling the previous one. Usually the rationale is convenience, or in the case of a house, a soft housing market. **Regardless of the reason, it is a dangerous technique.** Almost all of the people I have talked with through the years that have purchased the second asset with the intention of selling the first immediately, didn't. The sale took much longer than had been expected and, of course, extra money was required to maintain two instead of one. In the house situation, there is almost always a second house payment involved and the budget comes under extreme pressure. **You may think we are beginning to overuse Proverbs 21:5, but once again, it applies: "The plans of the diligent lead surely to advantage, but everyone who is hasty comes surely to poverty".**

I hope you will weld Proverbs 21:5 to your brain. If you do, the Holy Spirit will alert you each time you may try to violate the principle. This scripture has saved me from a lot of poorly thought out and quick decisions that would have been extremely costly.

Another financial myth is when the consumer is told to use a debit card in situations when a credit card is more beneficial. I'll preface this discussion by restating a point we mentioned in Lesson 17. **If you do not have the personal financial discipline to make a credit card work for you instead of against you, then totally avoid opening a credit card account.** But, for those who are responsibly maintaining a balanced budget each month, the credit card has many advantages. **So, how do I know when it's better to use a credit card or a debit card? Check the links listed on page A-6 for more information, but we'll do a quick summary here.** I use a debit card for two purposes: to get cash out of an ATM or to get cash back when making a purchase because an ATM isn't convenient. As you know, you bank account is debited the instant the transaction is made. Make sure your debit card account won't allow an overdraft with a corresponding overdraft fee. The credit card, on the other hand, provides me with more benefits and more protection than the debit card. See **Figure 1**. **I must emphasize that the benefits listed are only of maximum value if the credit card account balance is paid in full every month and an annual fee and any other fees are avoided.**

Figure 1

Credit Card Benefits
Cash rebates/other awards
Often account opening bonus
Limited liability if lost or stolen
Grace period for payment of purchases
Insurance protection for rental cars
Product warranty in certain situations
Reports to Credit Bureau (builds credit)
Accepted where debit card may not be

One of my favorite financial myths that I've dealt with over the years is the conviction of so many home owners to maintain a mortgage so they can receive a tax deduction.

Pointing out the fallacy of this argument will take a few paragraphs, but I think you will appreciate the time spent. First of all, let's make some assumptions. The owner (Frank) is in a 15% to 25% tax bracket and he is itemizing his deductions when he files his tax return. Let's use the 25% tax bracket to make the math a little easier, but the argument is the same

regardless of the tax bracket. We'll assume that the interest portion of Frank's annual mortgage payment is $10,000 (again to make the math easy).

When Frank files his tax return, he adds up all of the expenses that he can include on his IRS Form 1040 Schedule A (itemized deductions) such as real estate taxes, charitable contributions, interest on mortgage, etc. We will keep it simple. Let's say his only deductions are the $3,000 he pays in taxes, the $10,000 in interest on the mortgage, and the $5,000 he gives to his church. It would look like **Figure 2**.

When a person itemizes deductions instead of using the standard deduction, the total of the itemized deduction is subtracted from adjustable gross income to compute taxable income. So, a higher itemized deduction total results in a lower taxable income amount. Consequently, less tax is owed to Uncle Sam.

Figure 2

Itemized Deduction	Amount	
Real Estate Taxes	$	3,000
Mortgage Interest	$	10,000
Gifts to Charities	$	5,000
Total	**$**	**18,000**

But let's think about the impact of the $10,000 interest deduction. Since Frank is in a 25% tax bracket, lowering his taxable income by $10,000 reduces his tax bill by $2,500 (25% of $10,000). Let's state the same fact another way – if he had paid off his mortgage and didn't have the interest as a deduction, the amount he owed Uncle Sam would be $2,500 more than with the deduction. But, think about this: if the mortgage was paid off, Frank would not have paid the mortgage company the $10,000 in interest! Sure, he would owe $2,500 more in taxes, but there would be $7,500 ($10,000-$2,500) more in his bank account. In other words, he's keeping a mortgage and paying $10,000 in interest so he can save $2,500 in taxes. That makes no sense to me. What if he paid off his home loan by using the accelerated payoff plan we discussed in Lesson 14? He would arrive at Milestone 9 much sooner. He would be totally debt free and have the option to give the same amount to his church that he had been paying in interest to the mortgage company. If he did, his Form 1040 Schedule A would look like **Figure 3**.

Figure 3

Itemized Deduction	Amount	
Real Estate Taxes	$	3,000
Gifts to Charities	$	15,000
Total	**$**	**18,000**

Frank would still have the $18,000 in deductions! Don't get me wrong. I'm not suggesting your motivation to give to the Lord should be to get a tax break. I'm just saying...

I would rather donate the money to the church rather than to the mortgage company. The end result is the same for your taxes, but the money is being used for far greater purposes.

Chalk up the idea of "maintaining a mortgage to get a tax break" as one of the better financial myths.

REFLECTION: Have you been operating under any financial myths because someone said it was a good thing to do or because you haven't thought through the action? Can you think of ways to increase your usable income or your "bottom line" by changing your thought process? Could you explain to a friend the fallacy of maintaining a home loan in order to receive a tax benefit? Identify and prepare to discuss with your group the statement or concept that was most meaningful to you in this lesson. **Record your thoughts:**

ACTION STEP: If you have a home loan and are itemizing your deductions, use the process discussed above to determine the tax benefit you are receiving and how much interest you are paying to realize the tax reduction. Use the Monthly Interest Calculator to aid in your computations. Continue tracking your daily expenses.

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