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Coming Into Cash: What to do with an unexpected windfall

Main article

You're just cruising through life when \$5,000 drops out of the sky and lands at your feet. It's not always too good to be true. It's actually pretty common to receive a windfall. It could be an inheritance, a bonus, or a bigger-than-you-expected tax refund. Regardless of the amount, it's important that you use it wisely.

Pay taxes and debt

Before blowing a windfall, find out if you'll owe taxes on it. Money from some sources--such as life insurance proceeds--is tax free, but that isn't always the case. Look for help at irs.gov and/or consult a tax professional. Set aside enough to cover this expense so you're not surprised by a big tax bill later.

Taking advantage of a windfall to pay down debt can save a lot of money in the long run. Making only minimum payments can stretch out the debt for years, substantially increasing the overall cost of the purchases. So paying off high-interest debt, like credit cards, should be a high priority.

Usually the interest rate on a car loan is also fairly high, so this loan should probably be your next priority. Student loans come after that. They add up quickly (about \$22,000 total for the average college grad), and paying them off will free up some money in your budget.

Further education

College education is usually a good investment. College graduates have higher earning potential than non-college graduates, especially in a recession. Plus, the majority of job sectors primed to see the most growth in the coming years (such as technology, education, and health care) require a college degree.

Ivy League educations might be out of reach, but \$5,000 can get you much further in a community or state college. Stretch money even more by applying for scholarships and financial aid.

Invest it

Another option is to make your money work for you by investing. Start with a savings or money market account, where you should keep an emergency fund that could tide you over for three to six months without income.

If you've already got your emergency stash set aside, consider investing in the stock market. Minimize risk by diversifying your investments. Savvy consumers can create their own portfolio, but beginners should seek the counsel of a financial advisor.

Buy a house

Now is a great time to use your newfound wealth to buy a home. Interest rates are at historic lows, and the surplus inventory in the marketplace gives you a good chance of finding a nice home at a great value. Strict regulations require more sizeable down payments than in the past, so putting a windfall toward a substantial down payment will help you get into a house and start building equity sooner.

Bottom line: Most Americans (72%) believe they'll leave an inheritance to their children or relatives. If you've come into some money, use it wisely by paying off debt, getting an education, investing or buying real estate.

Sources: moneycentral.msn.com; getrichslowly.org; demesne.info; msnbc.msn.com; collegeboard.com; salary.com; money.cnn.com; gallup.com; wsj.com; realtor.org; federalreserve.gov; news.google.com

Stats

The 11% average long-term annual return on money invested in stocks means your money could potentially double every 6.5 years.

Source: Susan Bradley and Mary Martin. *Sudden Money: Managing a Financial Windfall* (John Wiley & Sons, Inc., 2000), 172.

48% of Americans said they would pay off debt with a windfall of \$5,000, 47% would save it in a savings or a retirement account, and 3% would go on a shopping spree, according to a 2008 survey by Scottrade.

Source: reuters.com

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