

# Don't Get Caught in the "Credit Trap" - Use Credit Cards Wisely

First introduced to the public in 1959, and used sparingly for their first few decades, credit cards have become a fixture in our daily lives. From the convenience of not having to carry hard currency to the luxury of buying what we want, when we want it, credit cards promised a whole new world of freedom. The concept of credit wasn't new, but credit cards have made the process of getting - and using - credit to finance purchases simpler and easier for millions of everyday people.



Unfortunately, such freedom comes at a price. Americans now carry more than 225 million signature-based debit cards and have a whopping \$800 billion in outstanding credit-card balances!<sup>1</sup> If you're like most people, you probably have at least one credit card, if not a half dozen. And you probably carry a balance on at least one account, paying monthly interest as you go. If so, you may be shortchanging your financial future in exchange for a few consumer goods in the present.

## How Revolving Debt Works

If paid off monthly, credit cards are simply a convenient way to consolidate purchases into one billing entity, the company issuing the credit card, and making a single monthly payment. Although the company might charge a small annual fee, such use sidesteps any interest charges or card usage fees.

When credit cards are not paid off monthly, however, they become similar to loans from the bank in that they carry interest charges, minimum monthly payments, and a term for paying off the balance completely. Credit card companies frequently charge double-digit interest rates on outstanding balances. That's a steep price to pay for convenience and the ability to make impulse purchases!

## Think ALL the Costs of Credit

In selecting, or keeping, a credit card, make sure you know and understand all the costs, rates, and fees involved.

**Annual fees** - many credit cards charge an annual, fixed fee just for the privilege of having credit extended to you from the company sponsoring the card. Annual fees can often be avoided entirely by shopping for a credit card that guarantees no annual fee.

**Finance charges** - finance charges vary widely. If you plan to maintain an outstanding balance on your credit card, make sure to find the best interest rate on a card that meets your needs. Many cards offer you a low "teaser rate" for a specified period, then dramatically increase the rate you pay on outstanding balances. Some base your minimum monthly payment on a loan term that if the minimum payment is made consistently, could keep you in debt for 40 years or more.

**Tax treatment of interest** - unlike the interest paid on most home mortgages, second mortgages, and some home equity lines of credit, the interest paid on credit cards is not deductible from your taxable income.

Fortunately, there is a great deal of regulation of credit cards requiring full disclosure of all

relevant credit terms being extended by the card issuer. Be careful to review all credit documentation thoroughly before selecting a credit card for regular use.

### **Another Alternative: Debit Cards**

One fast-growing alternative to credit cards is a "debit card." This type of card is not a credit card at all; instead, it simply gives you card-based access to your bank savings or checking account. A debit card gives you the convenience of not needing to carry cash, or even checks, but you must be mindful that when used your purchases are being deducted directly from your existing account - once the account is empty, the card has no purchasing power until you make another deposit!

How you use credit says a great deal about your style of money management. If you would like to learn ways to reduce your dependence on credit, pay down current debts, and save or invest that money instead, we'd be happy to show you how.

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