IDEAS

PAYCHECK ADVANCE APPS

What to know before you download

Many users of paycheck advance apps return repeatedly, and there may be better alternatives for them. JENNY KANE/AP FILE

Annie Millerbernd NERDWALLET

Paycheck advance apps let users borrow a small amount of their expected earnings, usually in exchange for a small fee, and repay it on their next payday.

It seems like an attractive offer if you need extra cash between paychecks, and millions of users have accepted it. While it's possible to use these apps without harming your finances, some consumer advocates say they can lead to a cycle of debt.

If you're thinking of using a paycheck advance app, here's what to know before you download.

Fees framed as tips

When Jose Polanco uses the Earnin app to borrow from his upcoming paycheck, the app asks him if he wants to leave a tip.

The New York school administrator says he gives the app $8 for the $100 he usually borrows. He says he's persuaded by the message the app displays that leaving a bigger tip helps pay for users who can't afford to tip at all.

Optional tips are a common way these apps reframe fees. While usually not required, they're frequently encouraged.

Earnin CEO Ram Palaniappan says tips let the user decide what the service is worth to them rather than requiring a fee they may not be able to afford.

Some advances come with additional fees. Dave, another paycheck advance app, has three optional fees: a monthly $1 subscription fee, an express fee to get your money faster and a tip.

For a couple hundred dollars – the maximum

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Investment advice: National College Savings Day is May 29

Bray Creech
Guest columnist

I'm at the age where many of my old college friends now have kids who are headed off to college themselves. If you can tell me where all the time has gone, I'd appreciate it.

Recently, one of these friends' sons surprised me by theatrically announcing his plans in a "college reveal video" sent around to friends and family. In the video, this smart, engaging and compassionate young man divulged that he is headed to a large university in the Pacific Northwest to study environmental sustainability — and I couldn't be happier for him and his parents.

But even though their son is receiving scholarships and financial aid, I'm well aware that significant costs can still arise in higher education. So, being a somewhat nosy person — and because we've been friends for more than 25 years — I asked my friend if he had set up a 529 college savings account for his son.

"Absolutely! We did," he replied. In fact, he and his spouse opened the 529 account right after their son was born — a smart move, and one that prompted me to dedicate a column to 529 plans, using the real advice from this one family's success story.

Just to make sure we're all up to speed and on the same page: A 529 plan is an education savings account that can be established for anyone by anyone, but it is most often set up by parents and grandparents interested in funding education for their children or grandchildren. The number 529 comes from part of the tax code where this provision lives. And, in case it's not on your calendar just yet, May 29 is National College Savings Day. (Get it? Fifth month, 29th day. Clever.)

Earnings in 529 plans are not subject to federal tax and, in most cases, state tax as well, as long as withdrawals are used for qualified education expenses like tuition, room and board, books and a computer. Though these plans are often set up for another individual, the account owner retains full control over both the assets and disbursement of the funds.

There are no age limits on beneficiaries or contributors, and no income limits on contributors. And, unlike some other college savings plans, 529 plans allow contributors to invest from any state — regardless of whether the beneficiary lives in or plans to attend school in that state.

Additionally, since 2017, federal legislation has expanded 529 qualified expenses to include up to $10,000 annually for K-12 tuition as well as for costs associated with registered and credited apprenticeship programs. These plans now also offer a lifetime maximum of $10,000 to pay off qualified student loans for a beneficiary or their siblings.

I'll say it: 529 plans are great vehicles for education savings. But don't take it take from me. Take it from my friend whose son is headed to college this fall. He said he always advocates 529 plans to new parents, because these plans could help families with skyrocketing college costs down the road.

He then shared the following tips, approved and expanded upon by your friendly neighborhood financial advisor, which he attributes to the success of his son's plan:

· Don't just save, invest. While 529 plans offer short-term cash savings in money market instruments, consider making investments with more growth potential. College target date portfolios, like my friend's family chose for their son, are more growth-oriented at the start while the child is young. Then, as the child approaches his or her expected enrollment year, the accounts become more preservation-oriented to mini-

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Payments could change your family's financial life

Liz Weston
NerdWallet

Starting in July, most families with children will start getting monthly payments of up to $300 per child as part of the American Rescue Plan's expansion of the child tax credit.

The payments are scheduled to end in December, and it's unknown whether they will be extended. But even six months of payments could make a big difference in many families' finances.

For some, the money will be a lifeline to pay rent, food and other essential expenses. For others, the cash could be a chance to make lasting changes that could help them become more financially stable.

A bigger, better credit

The child tax credit dates to 1997 and started as a $500 credit designed to provide some tax relief to middle- and upper-middle-income families. Over the years, Congress expanded the size of the credit and made it available to lower-income people, too. In 2017, the maximum credit was raised to $2,000 and income limits were increased to $200,000 for single filers and $400,000 for married couples, after which the credit phases out.

The American Rescue Plan increases the maximum credit, but not for everyone. The new law adds $1,000 for children ages 6 to 17 and $1,600 for children under 6. But the extra amounts begin to phase out for single filers with adjusted gross incomes over $75,000 and married couples at over $150,000. The credit is reduced $50 for every $1,000 of income over those limits.

Taxpayers who are phased out of the extended credit might still qualify for the original $2,000 credit, although again the credit is reduced $50 for each $1,000 of income over the 2017 income limits.

The new law makes two other important changes. The credit is now fully refundable, which means more families can get money back if their credit amount is more than the tax they owe. Also, half of the credit will be paid out in monthly installments from July to December. The other half can be claimed on the taxpayer's 2021 return, to be filed next year.

The IRS will determine if people are eligible for the monthly payments using their 2020 tax returns or, if those haven't yet been filed, their 2019 returns, said financial planner Robert Westley, a member of the American Institute of CPAs' Financial Literacy Commission.

How to use the money

You know best what your family needs, but anyone who doesn't have an emergency fund should consider starting one, said Jennifer Tescher, founder and CEO of the Financial Health Network, a nonprofit that promotes financial stability for lower- and middle-income people.

A savings account with just a few hundred dollars is often enough to break the paycheck-to-paycheck cycle.

"Most unexpected expenses that people face are really in the few hundred dollar range," Tescher said.

Most low- to middle-income families make enough money to cover their expenses, but there's often a cash flow mismatch between when they need money and when it comes in, Tescher said. That can lead to late fees, bank overdrafts, utility shut-offs and other unpleasant consequences.

"Then, digging yourself out of the mess is time-consuming and expensive," Tescher said. Drawing from an emergency account, then replenishing it can smooth out those gaps.

Other ways to increase your financial health

Once you have a starter emergency fund, you might want to pay down payday loans, credit cards and other expensive debt, Westley said. The less interest you have to pay on debt, the more money you have for uses that you choose.

People also could start or increase their retirement savings, either by contributing to an individual retirement account or boosting their contributions to a workplace plan such as a 401(k). Although the tax credit money can't be directly placed into a workplace plan, you could use it to replace the contributions that come out of your paycheck.

You might want to save money for a down payment because homeownership is a common way to build wealth. You also could help your children's future financial health by saving for their education. Contributing to a 529 college savings plan can provide tax-free money for schooling, and many states offer a tax break or other incentives.

If you don't already have health insurance, the monthly payments could help you pay the premiums for policies purchased on the Affordable Care Act exchanges at HealthCare.gov. The American Rescue Plan passed in March also increased subsidies, and other improvements have reduced the cost of most policies. Health insurance can help you avoid potentially bankrupting medical bills if someone in your family gets sick or injured.

Having a plan for the money before it arrives can help ensure the cash goes where you most want it, Tescher said.

"Financial Health Network research has consistently shown that planning ahead and identifying specific financial goals is highly correlated with improved financial health regardless of income," Tescher said.

Apps

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amount you can borrow from most apps – the fees aren't as high as most payday loans or overdraft fees.

But asking users to decide how much to pay doesn't give them a chance to evaluate the full cost of borrowing in the way displaying an annual percentage rate would, says Marisabel Torres, director of California policy at the Center for Responsible Lending.

"Not calling it a fee and framing it as a tip, that's actually disingenuous to the user because then the amount that that product actually costs you is muddled," she says.

Risks include overdrafts

To sign up with a paycheck advance app, users normally have to provide proof of their pay schedule and income, and often access to their bank accounts so the app can withdraw the money they owe when they get paid.

Some of the apps say they'll monitor your bank account and try to avoid a debit if your balance is too low. Debiting a balance that's too low can cause an overdraft fee – a fee some apps market themselves as an alternative to – and you could need to borrow again.

It's not yet clear how often app usage triggers an overdraft fee, says Alex Horowitz, senior research officer with the Pew Charitable Trusts.

But an April report from the Financial Health Network found that 70% of consumers who used a service to access their earnings early returned to use them consecutively – behavior that's common with payday loans, he says.

"It's not just that they're using it multiple times in a year, it's that they're using it multiple times in a row," Horowitz says. "That indicates that they couldn't repay it without taking another advance shortly after to cover their bills."

Not a permanent solution

You may have cheaper alternatives if you need to borrow money, Torres says.

Credit unions and some banks offer small-dollar loans that are repaid in affordable monthly installments. A friend or family member may be able to lend you the money and let you repay it over time.

There isn't enough research to know if getting an advance from an app leaves consumers better or worse off, says Nakita Cuttino, a visiting assistant professor at Duke University School of Law whose research focuses on financial services and financial inclusion.

In 2019, the New York Department of Financial Services, along with several other states and Puerto Rico, announced an investigation into the earned wage access industry, of which these types of apps are a part, to determine whether they violate state lending laws.

When they're used to resolve a one-time emergency, Cuttino says, an advance may be cheaper and more convenient – and lowers the risk of overborrowing because of their low dollar amounts.

If you do borrow from one of these apps, understand how it'll affect your budget and make a plan to repay it, she says. And if you find yourself returning to borrow each pay period or incurring frequent overdraft fees, it may not be right for you.

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mize market volatility. He viewed this as a "set it and forget it" strategy that could work well over time. Keep in mind that regulations allow no more than two investment strategy changes per year.

· Start early. The sooner you start investing, the more time you have to grow your fund through the power of long-term compounding. My friend opened a 529 account just after his son was born — and some 18 years later, it has a healthy balance due to compounding.

· Set up automatic monthly contributions. Regular, monthly contributions over time topped the list for my friend as the biggest factor in his plan's success.

· Let family and friends contribute. In lieu of expensive toys that his son would soon be bored with, my friend encouraged his child's grandparents to contribute to the 529 plan for birthdays and holidays.

· Set a goal. Originally, his goal was to cover at least two full years of projected college costs for 2021-2025 — and he's happy to report that the plan is set to either meet or exceed that goal.

· Take advantage of your state's income tax deduction, if it has one. Some states offer a tax deduction for contributing to any 529 plan, including out-of-state plans, while other states offer potential tax breaks on contributions made only to in-state plans. In Maryland, my friend was able to take advantage of this, deducting up to $2,500 per year, per beneficiary, from state taxable income. As of 2014, however, North Carolina residents no longer benefit from a state income tax deduction for contributions made to a 529 plan.

Of course, there are other ways to save for college, from Roth IRAs to UTMAs and Coverdell Education Savings accounts. But, in my opinion, the 529 college savings account is the better choice — and I know a proud father with a successful kid who would back me up. "It all worked as we hoped it would," he said.

Bray Creech, MBA, CPA is a CERTIFIED FINANCIAL PLANNER™ professional with Joel Adams & Associates with securities offered through Raymond James Financial Services, Inc. Member FINRA/SIPC and is located at 545 Merrimon Avenue, Asheville, NC. He can be contacted at 828-251-9700 or bray.creech@raymondjames.com.