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Credit or Debit? How to Decide

Surprise: Your bank card isn't always the better option. By ISMAT SARAH MANGLA

Illustration by BRIAN STAUFFER

THE NEXT TIME you reach for your wallet at the grocery store or the mall, chances are you'll whip out a debit card rather than a credit card. Since 2000, the number of debit payments has more than doubled, while the number of credit transactions has fallen by nearly half, according to bank card advisory firm R.K. Hammer.

Paying with cash—which, after all, is what debit is a stand-in for—may seem like the smarter move. But it isn't necessarily. There are a few situations in which credit serves you better. As long as you routinely pay off the balance, choose credit if... →

WHEN DEBIT COULD COST YOU

In certain circumstances, a merchant will determine the most you could spend, then freeze that amount in your bank account. If you're not aware of the hold, you could overdraw.

Checking in



ACTUAL COST

\$900

FOR THREE NIGHTS AT A \$300-A-NIGHT HOTEL

WHAT THEY MAY FREEZE

\$1,200 FOR 5 DAYS

Filling up



ACTUAL COST

\$42.78

AT \$2.95 A GALLON, FOR A HYUNDAI ELANTRA

WHAT THEY MAY FREEZE

\$75 FOR 2 DAYS

Renting wheels



ACTUAL COST

\$350

STANDARD CAR FOR ONE WEEK

WHAT THEY MAY FREEZE

\$550 FOR 9 DAYS

SOURCES: Hilton Times Square New York, Shell Station in Manhattan, Hertz Car Rental at LaGuardia Airport

YOU'RE PLANNING TO MAKE A MAJOR PURCHASE

"Credit cards offer the strongest protections on purchase disputes," says Gerri Detweiler of Credit.com. If goods or services aren't delivered as stated, the issuer will battle with the merchant on your behalf. Until the problem is resolved, the charge is suspended, and no interest accrues. With a debit card, however, the money is gone from your account and you have to wrestle the merchant to get your cash back. Your bank may help, but there's no guarantee.

Thus, it's worth using credit if you're about to spend a hefty sum on something—be it a TV or a home repair—and especially if you're making the purchase online, where what you see is not always what you get.

Other reasons to use credit for big buys: You may get increased warranty protection and insurance against theft of the item. Use a Visa credit card, for example, and the manufacturer's warranty may be extended up to a year. Check your card agreement to see what your card offers.

YOU'RE BUYING GAS, CHECKING IN AT A HOTEL, OR RENTING A CAR

When you use debit for those transactions, the merchant—to avoid being caught short—figures out the maximum you could spend, then puts a hold on your bank account for that amount.

For example, when buying gas, you prepay your purchase. And since the gas station doesn't know how many gallons you'll use, it picks a big number. "They'll block \$75 whether you're filling up a moped or an SUV," says Greg McBride of Bankrate.com. You can't access the excess that's frozen until the transaction is finalized, which can take up to 48 hours.

The stakes are higher when checking in at hotels and car-rental counters, which give themselves leeway for incidentals and damage. You could have hundreds or thousands frozen for days, which could trigger overdrafts or bounces on other payments. So secure a hotel or car with a credit card. (Bonus: Some cards also offer decent secondary auto insurance.) You can always make the final payment with debit.

YOU WANT BIG REWARDS

"Debit rewards have gotten better over the years," says Curtis Arnold of CardRatings.com, "but still I've never seen a program that comes close to the best-of-breed credit card programs." (See page 94 for a list of them.) Citibank's debit cards, for example, offer one point for every \$2 spent, and you need 8,000 points to get \$50, so you're earning a mere 0.31% on every dollar. In comparison, many credit cards offer at least 1% cash back.

Bear in mind, too, that many debit cards offer their top benefits only when you sign for purchases rather than use your PIN, as banks get more money from retailers on signature transactions. (The Citi card gives one point for every \$3 on PIN purchases.) And some merchants—Wal-Mart, for example—steer you toward the PIN option.

YOU DON'T VIGILANTLY MONITOR YOUR ACCOUNT

Legally, if your credit card or its number is stolen, your liability is minimal—\$50 max. With debit, the law can leave you on the hook for considerably more. Visa and MasterCard, however, extend the better protection to signature-based transactions on debit cards displaying their logos. So it's pretty much a wash on liability.

That said, credit still has a major advantage: If your debit card or its number is used, the money is gone, and you'll have to jump through a few hoops to get it back. In the meantime you could bounce checks or miss bill payments. The more times you use your debit card, the more you're potentially exposing its number to scammers. So if you don't have the time or energy to review bank transactions a few times a month, use a credit card instead. That way, it's the bank's money that's on the line, not yours. ■