5 Credit Card Myths We Should All Stop Believing

Description

When you check your credit score, you hurt your credit. If you pay the minimum on your balance, you'll help your score. And don't forget to close out any cards you don't use.

Wrong, wrong, and, yep, wrong. Though credit cards are simple to use — swipe, pay, repeat — you'll often hear things that are, well, questionable. The problem: taking the wrong credit card advice can come back to haunt you, hurting your credit score, costing you in fees, or leading to lost opportunities.

So, let's bust five credit card myths you'll hear the most.

1. Cards with annual fees are a waste of money

Truth: you should compare the annual fee with the extra rewards to see if the card is worth it.

Rewards cards come with annual fees, either because their rewards programs are more lucrative or because you have bad credit, and the company is charging you more to use their card.

If a credit card with an annual fee has higher reward points, do a quick cost analysis before you dismiss it. For example, if a cash-back card costs $99 and has 2% cash back on all purchases, then you'd need to spend at least $4,950 to earn $99 in rewards ($4,950 x 2% = $99). After you spend $4,950, you start pocketing money.

But don't stop there. Next, compare the card with annual fees against a reward card with *no* annual fee. So, let's say your 2% rewards card has a counterpart — a 1% cash back card with no annual fee. If you were to spend only $4,950 within the year, the card with no annual fee would be the better deal: you'd earn $49.50, and you wouldn't have to pay $99 for the card.

At what point does the card with annual fees become more profitable? The answer — $9,900. At $9,900, you've earned $99 on your 1% card and $99 on your 2% card ($198 in rewards minus the $99 annual fee). So, if you plan to spend at least $9,901 within a year (not unrealistic by any stretch), the rewards card with an annual fee is more advantageous.

2. Carrying a credit card balance helps your credit score

Truth: carrying a balance increases your credit utilization ratio (amount of credit you're using versus the total amount of credit you can use), which could have a negative impact on your score.

Not to mention that carrying a balance on your credit card from month to month kills your card's grace period and forces you to pay APR on your balance.

The reason people think carrying a balance is a good thing is they've probably heard something like, "if you keep your credit utilization ratio around 30%, you show lenders you're using your card."

I don't know where people get "30%," but as far as I know, it's only a rule of thumb. In fact, the rule of thumb is to never carry a balance that's *more* than 30% of your total credit line. For example, if you have $20,000 in credit, and you're carrying $10,000 across your credit cards, you're probably hurting your credit score.

Yes, you don't want to stuff your credit card in a drawer and never use it. Having a 0% credit utilization doesn't help either. But don't carry a balance on your card to increase your credit score. It doesn't work. It's a *myth*.

3. You should cancel cards you're not using

Truth: when you cancel a card, you could hurt your credit utilization score.

Even if you're not actively using a credit card, consider the consequences before cancelling it. Closing a card means you'll have less available credit, which, if you currently hold a balance on your cards, could increase your credit utilization ratio. This is only the case if you carry a credit card balance, however, which leads me to the next myth:

4. Never cancel a credit card

Truth: you should cancel a credit card with annual fees if you're not using it.

If you pay off your credit card balance each month, then cancelling a card won't have a negative impact on your credit score. The only time I'd keep a credit card open is if I've had the card longer than any other, as the longer the account history on a card, the more positively it will impact your credit score.

5. Credit cards are financially irresponsibly

Truth: credit cards, when used responsibly, can help you build credit and earn rewards.

Credit cards aren't financially irresponsibly. People are. If you can pay off your credit card in full and on time each month, you can enjoy lucrative rewards, build your credit score, and take advantage of free perks, such as travel insurance, extended warranties, and price protection on purchases.

Question what you hear

Believing credit card myths could lead to bad practices that hurt your credit score and prevent you from earning rewards on your card. Before you believe what you hear, dive into it to make sure it's true.

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