Financial Planning with Variable Income

If your income fluctuates as a result of the type of work that you do, there's a few simple things you can do to smooth out these anticipated financial swings.

Just because your income is inconsistent doesn't mean your life has to be. With a little planning, you can steady your income, reduce uncertainty and prepare for the future.

Turning Variable Income into Steady Income

The biggest impact of earning variable income is more complexity when balancing your budget. The key to overcoming this complexity is to establish a system that makes your income steady. Here's how:

1. **Project your income –** The first step is to forecast, as accurately as possible, what your monthly earnings will be for the next 12 months. To do this, look at your income for each month over the last year and determine whether you will be earning similar amounts in the future. Take into account seasonal fluxes, business growth and economic conditions as best you can. When faced with whether to be conservative or aggressive for projection purposes, go conservative; extra money should be a bonus, not a necessity.
2. **Determine your monthly constant –** The next step is to determine the amount you will pay yourself each month, regardless of how much you earn that month. If your earnings don't fluctuate widely, set this number at the minimum amount you expect to earn per month. This conservative approach means you know you'll always make *at least* that much, and sometimes more. If you experience big swings in income, it's better to use an average method, so that in months with more income, you can save for the lean months.

> Resist lifestyle inflation. It'll be tempting to reward yourself during the good months, but rather than spend down your extra earnings immediately, give yourself a longer-term reward and save it for those lean months.

3. **Budget –** Now that you've come up with a number you can rely on month to month, it's time to budget that money. Treat that number for budgeting purposes as if it's exactly what you make, no more, no less. Resist the urge to put things in the budget because you are counting on extra income some months. The goal is to have a budget that works regardless of whether you bring in more that year or not.

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4. **Establish two accounts, business and personal –** Now that you have set a monthly earnings amount, it's time set up two separate accounts. The first is your "business" account, where all of your earnings go—regardless of whether you are a true business owner or not. The second account is where you'll pay yourself each month, leaving the extra funds in your business account.
5. **Monitor, then recalibrate –** Review your budget and cash flow on a monthly basis to make sure you're following through with your plan. After 12 months, re-calculate your monthly constant and budget accordingly. If you have leftover money in your business account, make a careful plan for the extra cash, rather than spending it.

Other things to keep in mind:

- If your average or minimum monthly earnings aren't enough to cover all your expenses, you'll need to prioritize. Make a list of the most important expenses to the least (not necessarily largest to smallest, or even most urgent to least). Then each month, pay as many as you can, starting from the top of the list and working down. Once you start to make more, or have a month with extra, you can start to cover more of the list.
- Build up a large emergency fund, larger than someone on a consistent paycheck would need. Since you can rely less on a consistent income, you'll need to make sure that you can survive for several months with little to no income.
- Resist lifestyle inflation. It'll be tempting to reward yourself during the good months, but rather than spend down your extra earnings immediately, give yourself a longer-term reward and save it for those lean months.
- Don't forget to pay your taxes. If you're self-employed, you'll need to make sure and be diligent with your estimated tax payments. Many will choose to take this from the business account, but you may also budget for everything, including taxes, from your personal account. If you're an employee but have variable income because of commissions, be sure and look at your tax situation toward the end of year and make sure you're on track. If not, you may have to increase your withholdings.

More than Budgeting

While a variable income has a clear impact on your budget, it also affects your entire financial plan.

Retirement

When you have earnings that are unpredictable, it's easy to focus on the short-term rises and falls, rather than long-term stability. But that doesn't make retirement saving any less important. It's critical that retirement contributions be a part of your monthly budget, even if you can't save much at first. The most important thing is to start. If you get a large influx of money, save it rather than spend it. You'll thank yourself later.

Investing

Everyone invests differently, and proper investing should focus on a personalized plan you create with your advisor. That said, it may be helpful for those with an inconsistent income to invest more conservatively. If you are a small business owner, you're investing heavily in your own business. As a result, your financial future rests heavily on the success of your company. To hedge this risk, consider investing more conservatively than you might otherwise. This allows your investment portfolio to keep your net worth from fluctuating wildly, even if your business tends to be more volatile. If you have accounts that you may need to draw from in the future in case of emergency, also considering a more conservative investing approach.

Another way to reduce risk due to income that's reliant on one particular industry is to avoid that industry in your investment portfolio. For example, if you work in real estate, it may be wise to not invest much in the real estate sector. If your industry takes a turn for the worse, you'll be less likely to face career trouble at the same time your investments also take a nose dive.

Insurance

If you have variable income, it may be that you are more of a risk-taker, willing to trade consistent income for the chance of greater earnings later, or you may be of the mindset that you must save as much as possible to get ready for a dip in income. In either situation, it may be tempting to try and skimp on insurance. While saving money on insurance is a good thing, foregoing important insurance coverage usually isn't. In fact, for many with variable incomes, insurance such as disability or business insurance is even more important, especially for those who are self-employed. Make sure that if you are disabled or experience liability that you, your income and assets are protected with proper insurance coverage.

Of course, all of these are simply guidelines. There are an infinite number of variations on the variable income theme and each has its own set of complications. In the end, the best plan is the one that's tailored to your situation and talked through with your advisor.

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