Introducing 'Living with Money', SEP IRA's, 401(k)'s, & More

Tim Mullooly: Welcome back to the podcast. This is episode number 208 of the Mullooly Asset Management Podcast. This is Tim Mullooly

Tom Mullooly: And I'm Tom Mullooly, and, Tim, before we get into our questions this week, you have a little bit of news.

Tim Mullooly: Yeah, that's right. Kind of exciting. Been working on it for a while now, and it's slowly coming to fruition. We are going to be starting a new podcast.

It's going to be called **Living with Money**.

The goal of the podcast is to help our listeners become more financially literate and understand the basic principles of personal finance and how to work with their money, and just be comfortable making better decisions with their money, because we've noticed a lot of the questions that we answer on the podcast and from clients are really basic stuff that you'd think people, adults, should know, and maybe they just weren't taught that in school or didn't pay attention and missed those concepts, so it's things that we want to touch on and have everyone learn through some educational episodes, with me and Tom going over some topics.

We're also going to have a lot of guest interviews, as well. Some finance people will be some guests, but we're also going to tie in people from different industries, as well, like local business owners around our area, and just interesting people in general.

We want to hear their story and how they've lived with their money and what they've done to make their money and how they can help people either better use their money or just understand more about their financial situations.

Tom Mullooly: I think one of the first interviews is going to be with someone who's got a couple of side hustles going on.

Tim Mullooly: That's right.

Tom Mullooly: I think those things are great stories that other people need to hear, that you don't need some six-figure job right out of college. You make your own luck and you make your own success.

You don't need to have the education or the diploma from the Ivy League school. You just have to have a little bit of hustle.

Tim Mullooly: Right.

Tom Mullooly: We've got a very special guest coming up in one of the very first episodes that's going to talk about that, but basically it's Money Management 101, Living with Money, which'll be found at livingwithmoney.com.

Tim Mullooly: And on iTunes and SoundCloud, Stitcher, all over the place.

Tom Mullooly: And as Barry Ritholtz says, "Where finer podcasts are sold." Are podcasts sold? Can someone tell Barry well, you don't sell podcasts, dude.

Tim Mullooly: Maybe that's the joke.

Tom Mullooly: But we've got some questions that we want to cover this week.

Tim Mullooly: Sure. Yeah, before Living with Money comes out, we're going to continue to do our mailbag questions. Let's dive right in with the first question today.

What's the best thing to do with excess wealth at age 30?

Tom Mullooly: Give it to Tim Mullooly.

Tim Mullooly: Hey, if they want to.

Tom Mullooly: The question goes on to read, I have excess funds and I'm unsure what to do with them. I'm 30 years old with a stable job and single. I've already contributed to reach my company match on my 401k and maxed out my Roth IRA contributions.

I've already set aside one year of emergency funds. This person's doing it right. Now I still have excess savings, and I'm unsure what to do with the money.

First world problem, I know, but what do you recommend, Tim, to help grow my wealth?

Tim Mullooly: Just reading the details of this question, it says the person reached their company match on their 401k. It doesn't necessarily mean that they maxed out their 401k, so that's one potential area they could look to increase their savings. Just make sure you're maxing out the 401K and not just reaching the match.

Tom Mullooly: But, Tim, one thing in the question that wasn't clear was does this person own their own home yet? That's not really in the question, and if they don't, I would tell them, hey, start socking money away for a down payment.

Tim Mullooly: Right. The term ... we were talking before we turned the mics on, the term excess wealth, is kind of funny for an age 30-year-old person.

Tom Mullooly: Have a kid. There's no such thing.

Tim Mullooly: Unless you're planning on not buying a house or not buying a new car or not having kids or anything, excess wealth isn't really a thing.

Tom Mullooly: It's temporary.

Tim Mullooly: Yeah. For the time being, if you're not planning on buying a house or going out and renting something, you could always just open up a standard taxable brokerage account and put the money in there if you want to invest and watch it grow.

Otherwise, leaving it in the savings account for a down payment or potential family ... other big purchases down the road.

Tom Mullooly: Like a lot of these questions, we're going to need more information to give you a precise answer, but it was very clear ... Tim picked up on it right away, that this person is contributing just enough to meet the company match.

If they already own a home, then they need to think about, hey, maybe we should be putting more into the 401k so it can compound, tax-deferred, at some higher rate than just sticking it in the bank.

If they don't own a home, then that would be the next thing that I would tell them to start socking money away for.

Tim Mullooly: Yeah, if they want to own a home.

Tom Mullooly: Right. Yeah.

Tim Mullooly: Again, need more information, but they kind of cut out our usual answer to what the answer would have been, saying they already set aside one year of emergency funds.

That's usually our go-to in terms of what people should be saving money for. So good for them for having all these things in place already at age 30.

Tom Mullooly: They're doing all the right things.

Tim Mullooly: Right.

Tom Mullooly: Let's go on to the next one.

Tim Mullooly: Sure.

Tim Mullooly: The next question asks:

"Can I still open a 401k if I'm already retired?"

Summary real quick says, I'm 68 years old and retired in 2006.

Tom Mullooly: Eleven years ago.

Tim Mullooly: Can I start a 401k now? Is it too late? Answer?

Tom Mullooly: Yes, it's too late. Anything else we want to talk about?

Tim Mullooly: Maybe they're talking about opening an IRA, but they most likely have to get a job and start working again and un-retire if they wanted to get a 401k.

Tom Mullooly: I think there's a jargon or language problem in this industry, because we have clients, Tim, that call up and say, "I want to go over my 401k."

Now, they left their job six or seven years ago and they took their 401k and they rolled it into an IRA. The money's actually in an IRA, but they still think of it as their 401k.

Tim Mullooly: Right.

Tom Mullooly: Part of being a good advisor is having good listening skills and being able to translate the lingo in your head. Okay, so that client still calls his account his 401k, but we know-

Tim Mullooly: Yeah, you got to kind of dig through and realize what they're talking about. So it's listening skills and listening comprehension skills to try and understand the misused terminology.

Tom Mullooly: Right. A 401k needs to be business-driven. It's a business or company retirement plan. Unless this 68-year-old retired person owns a company, I don't know if a 401k is really for them, and I think, Tim, you were closer to the mark in this person may be asking can I have an IRA?

Tim Mullooly: Right. But they're already 68 years old, they're going to have to start taking money out of the IRA at 70-1/2. The window is very small there, as well.

Tom Mullooly: It's closing. If they have earned income from a job, they can put money into an IRA up to a certain threshold, $6,500. But they're going to have to start taking it out, as Tim just mentioned, in two years, when they start turning 70-1/2. Let's move on.

Tim Mullooly: Sure.

Tim Mullooly: The next question asks

'What are the benefits of rolling over a 401k into an IRA if I'm not working?'

Tom Mullooly: I love the summary on this one.

Tim Mullooly: Right.

Tim Mullooly: My financial guy, that's us-

Tom Mullooly: That's us.

Tim Mullooly: We're financial guys.

Tim Mullooly: Anyway, my financial guy wants me to roll over my 401k into his suggested IRA. I'm 67. What's the advantage of doing so if I'm not working? It seems I'll stay pay either way when I take withdrawals.

Tom Mullooly: All right. My guess is what he's talking about when he says I'll still pay either way when I take withdrawals, is when I have to take my required minimum distribution, starting at age 70, it's still going to be taxable income.

Tom Mullooly: He's right about that, but why would his "financial guy" want him to roll his 401k into an IRA?

Tim Mullooly: The first thing that comes to mind for me is maybe the 401k that the money is in right now isn't so hot.

They don't have great investment options or the ability to put money into good funds, so the rolling it into an IRA option is good because once it gets into the IRA, you're not restricted to the limited number of options in a 401k plan.

Tom Mullooly: But, Tim, what if his 401k has 50 different mutual funds to choose from? Does he need to roll it over into an IRA?

Tim Mullooly: No. There's no need to do that. In some cases, it might be better to leave it in the 401k, because some 401k plans have pretty low negotiated fees with the funds that are in the plan, whereas if you were to take the money out of the plan and move it to an IRA owning the same funds, you'd probably have to pay higher fees outside of the plan.

Tom Mullooly: That's right. It's the difference in many cases between wholesale and retail. If you worked for a company that has 3,000, 10,000, 25,000 employees, your plan has probably got some pretty good discounted rates on the expenses inside your 401k plan.

On the flip side, if you worked for a local company that had four employees, you are probably not in a great plan. You're probably paying retail rates.

The difference is, once you leave your 401k and roll it into an IRA, now it's going to really be up to your advisor to pick and choose the right funds for you.

Now the right funds for you may be some low cost exchange traded funds or it could be some high fee mutual funds or it could be in a tax-sheltered annuity which is a disaster, but it really depends.

Tim Mullooly: It depends also how much you trust your advisor.

Tom Mullooly: It has a lot to do with it. So yes, you'll stay pay either way when you take withdrawals, because it's going to be taxable income to you, but you're going to have to read the fine print and find out if it's really in your best interest.

The advisor will get some kind of fee or commission by rolling it over into an IRA. Know that upfront.

Tim Mullooly: The next question asks,

"As a newly eligible employee at a small business, can I set up my SEP IRA at a different bank or institution?"

No. Moving on.

Tom Mullooly: That's right. If you're an employee, you don't really have a say where the plan is set up. The summary goes on to say I work at a small business with two owner employees. After three years of employment, I am now eligible for a SEP IRA contribution.

That's great. The two owners have used a local financial institution to make their past contributions, but I would like to open a new account at my existing bank because their bank has high fees and a lack of investment options. Is that allowed? No.

Tim Mullooly: Maybe you can talk to the owner employees and convince them to switch the plans to your bank and make them see that your bank has better investment options and lower fees, but unless they move the plan, you're kind of stuck with where they have it.

Tom Mullooly: That's right. So unfortunately, a lot of information on that question, but the answer's still no.

Tim Mullooly: Right. Let's move on to the final question for this episode. It asks

"Why am I being taxed so much after withdrawing my 401k and taking out a loan?"

Tom Mullooly: Oh, boy. That's our big sigh of the week.

Tim Mullooly: Save the best for last. The summary says I am 57 years old and I lost my job. After losing my job, I took out my 401k. I also took out a loan and was taxed 20% on this. Then I got taxed 20% for the money I withdrew from my 401k. Why isn't the balance on my tax owed not 20%?

Tom Mullooly: Okay, dude. You got bad advice or you got no advice, and so I feel really bad for you, because you're in a world of hurt right now. Because you're 57 years old and you're not working.

That's for starters. I hope you do find employment so you can sock more money away for retirement, because you just took a 20% haircut and you didn't need to do that.

Tom Mullooly: There are roughly three out of 10 participants in 401k plans have loans against their balance. You need to understand something. When you have a 401k loan, there's a provision in all plans ... I'll underscore that .. all plans, that if you separate from service, either because you were terminated or you quit to find another job, whatever, if you separate from service, the loan must be repaid within 30 days.

Sometimes it's 60 days. But it's either 30 or 60 days. It's never longer than that. If you do not repay the loan, the loan becomes a taxable event for you, and because this person is 57, it's categorized as a premature distribution, prior to age 59-1/2. So it is taxable and subject to 10% penalty, as well. It's a bad situation.

Tom Mullooly: But wait, there's more.

Tim Mullooly: Exactly. So not only do they have that to work through, they also said that after losing my job, I took out my 401k, which means they just took the money out of their 401k.

I don't know ... like Tom said, if they got no advice or just really bad advice, because they're 57 years old, so again, that's taking a distribution from a 401k before you're 59-1/2.

Tom Mullooly: The whole thing becomes taxable, plus a 10% penalty tax on top of that. So if you took $50,000 out of your 401k prior to age 59-1/2, the $50,000 becomes taxable, plus the next to last line on your tax return, include any penalties or interest. $5,000, 10% of your IRA. So what can someone do instead, Tim, in this kind of situation?

Tim Mullooly: Instead of just taking the money out as a distribution?

Tom Mullooly: Yeah, instead of just taking out the whole 401k account.

Tim Mullooly: They could roll it over.

Tom Mullooly: Yeah, they could roll it over into an IRA. It's a tax-free event. Okay, they roll it into an IRA, and then they only take out what they need, as needed.

Now you can set up these 72T distributions, where you're taking out equal installments on a yearly basis. You don't have the under 59-1/2 10% penalty. You can do things to get around that 10% penalty. You don't need to do this.

Sometimes investment advisors and brokers get a bad rap because they sell products that have high commissions or fat fees or something like that, but this is a case where just a quick phone call to any investment advisor, even the folks in the call center at Fidelity and Vanguard would tell someone, "Hey, don't be silly.

You're opening yourself up to a lot of taxes by doing something like this." But these loans, I really think people don't understand.

If you leave the company for whatever reason, if the loan's not paid back in full between 30 or 60 days, depending on the plan, there will be a payback, and it's either 30 days or 60 days.

Whole thing's going to be taxable and usually, most people who have loans are under 59-1/2. So it's a tax penalty on top of that.

Tim Mullooly: Yeah, not a good situation. Hopefully this person can figure something out. I don't know.

Tom Mullooly: Right.

Tim Mullooly: But anyway, that is going to do it for episode number 208 of the Mullooly Asset Management podcast. Just want to say thanks for listening, and in the next couple weeks keep an eye out for Living with Money.