Tax Withholding, Budgeting, & Tips for 2019 - Transcript

Tom Mullooly: Welcome back to the Mullooly Asset Management Podcast. This is episode number 239. I am one of your co-hosts, Tom Mullooly, and along with me is Brendan Mullooly.

Brendan M.: Ready to get going. I think we have some beginning of the year reminders for people in this episode, right?

Tom Mullooly: It's a good time of year to be talking about these kind of things, because I think it makes a lot of sense. If you let the year slip away from you, if you do these check-in things in March or April, you're already behind the eight ball. We're recording this second week of January, and people are getting or about to get their first paycheck for the year. Good time to be doing this.

Brendan M.: And I've seen over the last couple weeks, several articles that are touching on some areas that we want to today, like there was a good one from CNBC this week about checking in on your withholdings for 2019. I think that that is a pretty good starting point for most people out there, because that's the beginning of the funnel so to speak, in terms of financial decisions that you have. The top of it is your gross income and you want to manage it from there.

Tom Mullooly: We want to manage cash flow properly so let's start at the top of the funnel. Let's jump right into this.

Brendan M.: Yeah. This article was talking about taking a look at your W-4, which pretty much everybody should be familiar with to some extent. That's where you're going to elect withholdings for federal and state taxes that come out of your paycheck. Reviewing that at this point in the year is a good idea, because if you've started a new job or you've had your income change at all over the last 12 months, or you haven't looked at it in a couple of years, if things have been status quo, it's a good time to check in, to make sure that you are not only withholding enough, because nobody likes tax surprises, but not withholding too much either.

You want to find a sweet spot I think.

Tom Mullooly: That's important. If you're habitually getting a refund, I'm sure someone has told you that you're giving the government an interest free loan over the course of 12 months. On the flip side, like Brendan said, if you're always finding that you're coming up short and you have to write a check in April of the following year, you can take steps by adjusting your W-4 to increase your withholding throughout the year, so it doesn't become a problem for you.

Brendan M.: I mean, discrepancies there in either direction. I'm thinking specifically of if you are over withholding, if you can fix a problem like that, the next area that I think you should be looking at is not on the W-4, but it would be through payroll at work nonetheless, but how much you want to send to your retirement accounts. Maybe if it's through work, you're doing it through payroll, but if it's not directly connected to your job, that's the next step.

If you can correct a mistake in terms of being over withheld, you can then and I would recommend doing this if you're not hitting your maximums for retirement savings, you can take that percentage that you were being over withheld on and just directly send it to your retirement savings through work, 401(k), 403(b), 457.

Tom Mullooly: There's some new limits for 2019 for retirement planning contributions. Do you want to walk through some numbers on that?

Brendan M.: In 2019, you can now send up to $19,000 per year into your 401(k), 403(b), 457 plan, at work. Additionally, if you're over age 50, you can send another $6000 a year to hit a maximum of $25,000.

Tom Mullooly: I'm just going to hit the pause button there. $25,000, married couple can now put 50 grand a way in a year through their 401(k) or other retirement plan at work?

Brendan M.: Yep.

Tom Mullooly: Pretty good deal.

Brendan M.: Yeah, and on top of that, IRAs now are up to $6000 per year as well, with still the same $1000 of catch up contribution if you are over age 50. That could be another 14,000 between a married couple as long as they are qualified to send into traditional Roth. I mean, everybody can send into an IRA. It's just a matter of whether it's deductible or not.

But our friend Bill Sweet shared some numbers on Twitter back at the beginning of the year, just as a good reminder, and it ties in perfectly with what we're discussing today. If you're paid two times a month, he broke down dollars and cents, what you need to send into your 401(k) to hit these new maximums. If you're looking to hit the $19,000 annual maximum contribution, that would be $791.67 per paycheck, to hit your maximum, and if you are over age 50 and looking to hit the $25,000 maximum, that's going to be $1041.67 per paycheck.

That'll put you on track at this point, maybe a little behind, because you have gotten one or maybe even two paychecks by the time you're listening to this, but those numbers should give you an idea of the ballpark, dollars and cents, that would need to come out of your paycheck to hit these maximums.

Tom Mullooly: That's if you're paid two times a month. Of course, if you're paid every other week, the numbers are going to be different. You're going to have 26 pay periods instead of 24, so these are good numbers. Likewise, we have new numbers on the IRAs as well, that would be $500 per pay period.

Brendan M.: A lot easier. 500 a month-

Tom Mullooly: 500 a month.

Brendan M.: ... for the IRA, to hit the maximum at 6000. Nice and clean now, with a round number as the maximum. And 583 a month if you're going to hit that $7000 contribution limit there.

Tom Mullooly: Why is it important to check these kind of things at the beginning of the year? I mean, we've already talked about how it's important to, if you get 24 checks in a year, to spread this out over 24 equal payments, but what does this do in terms of setting people up for cash flow as they go through the year?

Brendan M.: Well, if you are thinking about this in terms of I used the term funnel before, you're starting at the top of the funnel with what you're earning in a year. Taxes are coming off of the top right away from your paycheck, so you want to make sure first stop on the business, you're making sure you're not making a mistake there in either direction, as discussed.

Then, I think immediately the next one you want to do is take care of these automatic saving contributions. We touched on retirement plans through work, IRA would be more self-directed. In addition to that, I think you want to look at regularly sending things, money, to things like an emergency fund or a shorter term savings goal, like if you're saving up for a down payment or something like that, or you have a vacation fund that you fill up throughout the year.

You want to look at the savings next because you want to get all of your obligations so to speak, out of the way. When you can do that, and look at them in hindsight, you want to look, now's a good time to look at where you're at for 2019 moving forward, but you can use 2018 as the laboratory to see how everything worked out and take a look at what you made in 2018, and then put all of these different savings things, as well as the taxes, into percentage terms and see these big line items come off of the top.

Because that's going to guide the next step which is what you're spending, and obviously you have different categories of spending that'd be good to look at in percentage terms too, but really, if you're making smart decisions with taxes and your savings plan, the spending is going to be a little bit easier. You back into that aspect of it.

Tom Mullooly: I think people tend to forget the old maxim of pay yourself first. They get their paycheck and they pay their car loan, they pay their mortgage, they pay down a credit card, and they have yet to pay themselves. Then, they get to the end of the month or the end of the pay period, there's very little money left and they say, "Okay, maybe I'll get that in the next check." Not really a plan.

Brendan M.: Yeah. I think you want to automate these savings decisions so that that isn't happening. If the plan is to just save what's left over, I don't think that's going to be very successful.

Tom Mullooly: I agree.

Brendan M.: You can take a look at and these will come not right away in 2019, but you're going to get 1099s and W-2s over the next couple of months from employment and other income that you may have earned over the course of 2018. A good time to review and put these numbers into percentage terms when you look at them, a lot of times these tax forms are just getting chucked into a drawer so that you can bring them with you to your tax preparer, or accountant.

Tom Mullooly: But there's a lot of information on them.

Brendan M.: There's really good information on them, and obviously your accountant is going to learn this information about you, but there may not necessarily be a sit down where they're going to review and give you guidance on that. They may just use it to prepare your taxes, depending on your relationship with them, and you could learn a lot about your personal financial situation by just going through those documents line by line and they're pretty straightforward.

They're going to tell you exactly the information that you need to know.

Tom Mullooly: One of the things that you had mentioned before we even turned on the microphones was to look at how much money you saved over the last year, as a percentage of your income. Do you want to talk a little bit about that?

Brendan M.: Yeah. I think it's important to look at it as a percentage of income because I know we've discussed this on the podcast before. We have these contribution limits for things like 401(k)s and IRAs and it's great that they're rising. At the same time, depending on what your income level is, and the lifestyle you lead, you could max out your 401(k) every year for 20 or 30 years as you work, and it may not be enough, even with investment returns over two or three decades, to support that same lifestyle in retirement.

You want to make sure there's an alignment between those two things, because these limits are limitations set by the IRS each year. They're not necessarily recommendations in terms of if you're hitting these numbers, like you're going to be good to go in retirement.

Tom Mullooly: Yeah, I think another way of saying what you just mentioned was if you're maxing out your contribution at work, it doesn't mean you can check the box and say, "Okay, retirement's done." It may or it may not be.

Brendan M.: For some people, hitting the maximum of 19,000 for a calendar year, depending on the gross income you're starting from, may be beyond reasonable. That might be 40% of somebody's income, and that's not going to happen either obviously, and they shouldn't beat themselves up to try to get to this 19,000 number, like it's the magic bullet and everything will be great if they can just max out.

It's a good goal to have, but you've got to put it into the context of your situation and so if you're looking at it in percentage terms of your income, I think that intuitively makes sense to me because the assumption it's making is that is that if you're saving 10-20% of your income, no matter where you are on the spectrum in terms of gross income, you're doing a good thing, I think, in my book, if you're in that range of percentage.

Tom Mullooly: I'm going to venture a guess and say that very few people know what percentage they're actually saving in a year. I mean, they may know, "Okay, I maxed out my 401(k)" but they couldn't tell you how much is in the bank versus how much was in there 12 months ago. They may have had a situation where they had to dip into their emergency resources, and spend some money, too. That's something that tends to get overlooked.

I mean, we've had some conversations with people who actually had an emergency account, had an emergency, but never really refilled the pot, either.

Brendan M.: That's a really great thing to assess, with all these other topics we've discussed today. I am of the belief that with an emergency fund, it makes a lot of sense to have a regular percentage going into an account like that, because it's not as if like what you just said, you can't just drop six months' of expenses into there, and then forget about it forever, because what happens when you dip into it? What's the plan to refill it?

So, to have something going in there, whatever the percentage is, in addition to your retirement savings, going into this rainy day fund, I think it makes a lot of sense and if you go to reassess the situation because you've dipped into it, or something happened over the last year and now you're looking at things and you're like, "Well, I only have two months of expenses" or, "We have 6 and we used to have 12 and I'd like to be at that level again," it's drifted to the bottom end of the range that you're comfortable with.

Tom Mullooly: But a situation like that, that could take another 12 or 18 months to get the number from 6 months to 12 months of resources, without killing yourself.

Brendan M.: It's going to depend, and I think that's why you want to consider it in the context of all these other savings decisions, because it may be the kind of situation where you want to lower the percentage going towards another one of your savings plan. You might want to lower the contribution rate for the first half of 2019 to the 401(k), to refill the emergency bucket, if you can't rearrange other parts of your cash flow to make it happen. Because you don't want to set up a goal to refill your emergency fund and figure out that, do the math, it's going to take me two years to refill this.

That's not a great plan because what happens if between now and those two years, something changes? I think refilling the emergency fund, if it has been diminished, should be a top priority to tackle right away. If it means sacrificing in other areas, whether it be spending or other savings area that you have, I think that makes a lot of sense to me at least.

Tom Mullooly: Let's say you've been putting money into retirement accounts, and you have an emergency account, and you have money going into savings and/or investment, what's left?

Brendan M.: At that point, I think you're onto the spending aspect of things, and obviously there's going to be more important parts of spending than others, like your mortgage or your rent, and bills and any debts that you're paying down, student loans, things like that. But you can prioritize these spending categories.

Again, probably good to look at it in terms of percentage terms of your income. That can be eye-opening. "Wow, I spend X percentage of my income as just discretionary, fun stuff every month." It's important to have that part of your plan defined so that it doesn't get crazy or out of hand, or you're not doing any of it and you're living too frugally and you don't need to.

But I'm of the belief that if you're doing all these things right, that we've discussed down the list here, that if you are spending what is left over after you're doing all those things you just said, that's not the end of the world. I think that that's okay.

Tom Mullooly: I think it's completely okay, and I don't think that folks should beat themselves up if they're doing all the other things. I think the biggest takeaway for me is a reminder at the beginning of every year, you've got to pay yourself first. No one else is going to do it for you. If you don't take care of your savings and retirement, no one's going to do it for you. I wouldn't rely on social security to bail you out.

Brendan M.: So, there's no magic to doing this in January. It's convenient, because New Year, everybody seems to be in this kind of a mode, but really, you can do this kind of a checkup at any point throughout the year. It just happens to be convenient right now, especially because you're just starting over fresh with taxable income for a New Year, so if you're starting with something like tax withholdings, could be as good a time as any to take a look at that.

Tom Mullooly: Good stuff from Brendan. Thank you very much for that. That's going to wrap up episode number 239. Thanks for listening and we will catch you on the next one.