Taxes, Trading, and Asset Location - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 343. I am Tom Mullooly and joining me today is Tim Mullooly. Hello.

Tim Mullooly: Hello.

Tom Mullooly: I think we're going to talk about how H&R Block makes money.

Tim Mullooly: So I saw this yesterday, the day before it was the big ad on the homepage of MarketWatch. So you know that a lot of people were seeing this ad and it was about how to get a refund advance loan. And this concept just rubs me the wrong way of taking a loan out for an advance on your tax refund. There are so many other ways that you could get around having to do something like this and not having to pay money to take an advance on money that is your money.

Tom Mullooly: Right. It's a little maddening to think that getting a tax refund should not be a surprise.

Tim Mullooly: Right.

Tom Mullooly: Well, from our side of the desk, it should never be a surprise. For some people, I guess it is.

Tim Mullooly: Yeah.

Tom Mullooly: But if you know that you're getting a refund, you're doing something wrong during the previous calendar year.

Tim Mullooly: Or that's your personal choice. And like you said, that shouldn't be a surprise to someone like-

Tom Mullooly: Right.

Tim Mullooly: … We've talked about how people view tax refund. Some people view it as forced savings and they get the money back and they know that that's coming. They know they can expect a big refund every year, but they said in the article that some people… Usually when you submit your tax return, the IRS will pay out a refund in 21 days or about three to four weeks. And they said for some people, even three to four weeks is too long for them to wait if they need this money to pay their bills. And that made me think like, if you need this money to pay your bills, you need to adjust your withholding so you get more money in your paycheck on a weekly, monthly basis. That will help you pay your bills.

Tom Mullooly: Right. That is the crux of the issue. I feel that means you're over withholding and you need to get this money back in a hurry. You could, as Tim just said, just adjust your withholding through the calendar year and you'll have more money each pay period in your pocket.

Tim Mullooly: It shouldn't be a roll of the dice or like a game when you go to get your taxes done.

Tom Mullooly: Yeah.

Tim Mullooly: Am I going to get a refund or am I going to owe money? It shouldn't be a flip of the coin or like you don't know what's coming.

Tom Mullooly: So, in the eighties, waiting for your tax refund check to arrive in the mail. They didn't have direct deposit. So you had to wait for your tax refund check to show up in the mail. We would file our taxes in the spring and we would get checks in June, sometimes July. The idea now, most times when you're getting a refund, you can put your routing number and your account number right on your return and the money will be deposited into your bank. So the whole idea of getting or an advance on your refund just doesn't make sense to a lot of people.

Tim Mullooly: Yeah. And they were saying that you can get these advanced loans in different increments. Some as low as like 200 or 300 bucks up to maybe $3,500, almost $4,000. They also have said that there is a lot of places charge interest rates. They charge interest on these loans. And that's where the idea for me, it doesn't make sense to pay money. There's other processing fees and stuff involved with taking out these loans, paying money to get an advance on your own money.

Tom Mullooly: Right.

Tim Mullooly: It doesn't make sense to me. And they pointed out how places like H&R Block have 0% interest, but they're still processing fees involved with that. So I guess as an absolute last resort, if you didn't have time to adjust your withholdings and you're in a pinch, it's good that this is available, but you should try everything in your power before having to utilize something like this.

Tom Mullooly: When they started doing these tax refund advances in the nineties, a lot of firms quickly fell in trouble with this because they were charging interest. And you may only be borrowing the money for 30 days, but when you did the math, the interest rates that you were being charged were an annualized rate of 30% and 35% interest, which is unconscionable. But there's folks that unfortunately, because of their situation, our friend Tyrone talks about the unbanked.

Tim Mullooly: Right.

Tom Mullooly: This is why check-cashing places are still in business today, because they're folks that just don't have the banking setup to be able to deposit money, and then wait a few days to get it. They rely on it. You take such a haircut when you have to go to a check-cashing place. This works on the same premise that you're going to take a haircut to your tax return so that you can get the money now.

Tim Mullooly: Right. Yeah. From a moral, ethical standard, it feels a little slimy to do that to someone because they most likely don't have any other direction to go in.

Tom Mullooly: Yeah. 25 years later, these tax refund advance systems have been around, they kind of learn their lesson, but let's be clear about something. You're basically getting an unsecured loan from a place like a tax preparer, like an H&R Block. They don't do this for free.

Tim Mullooly: Yeah, definitely not.

Tom Mullooly: And ads on The Wall Street Journal and MarketWatch are not cheap.

Tim Mullooly: That's where it really grabbed my eye. It wasn't just some article buried deep in the… You had to scroll down on MarketWatch or Wall Street Journal to read about it, it was front and center when you opened MarketWatch. Front page, top banner ad, sponsored post. So they want people to use this kind of thing because they know that they can make money off of it.

Tom Mullooly: So when they advertise on MarketWatch, front and center, they're really appealing to folks that may not have a lot of experience with tax refunds and processing, all this stuff, which kind of leads into another article that caught both of our eyes.

Tim Mullooly: Yeah. It was directed at day traders and Robinhood users and tying into the whole GameStop fiasco a couple of weeks ago. But in The Wall Street Journal, it was talking about how Robinhood traders and taxes and what they need to know about going into tax season right now. They told the story of a 38-year-old guy who day trades for fun. He said that he enjoys it, but he recently got the first part of his 1099 for a small portion of his trades that was 34 pages long.

Tom Mullooly: 34, 34 pages of transactions. And I think his quote was, "I can't make heads or tails of this."

Tim Mullooly: Yeah. He says, "I have no idea what it means." He usually self-filed his taxes, but now he says he's going to have to hire a professional to come in and do his taxes for 2020, because of all of these day trading transactions that he did.

Tom Mullooly: Now, this particular gen admitted to doing 200 trades per day. The market's only open from 9:30 to 4:00. How do you jam in 200 trades a day?

Tim Mullooly: Yeah, that's a lot. That's a lot of trading. And I think we've mentioned it before, but one of the things that people trading or flipping stocks, whether it's every day, intraday or anything less than long-term trading, your after tax returns are what matter, right? So you could make 100% percent on a stock that you flipped in two days, but short term capital gains rates, you could end up having to send a third of that back in taxes and-

Tom Mullooly: Depending on your bracket. Sure.

Tim Mullooly: … Yeah.

Tom Mullooly: But I want to stick with this 200 trades a day topic for one more moment. This particular fellow also said that he had netted a profit of $8,000. 200 trades a day. That's a lot of work.

Tim Mullooly: Yeah.

Tom Mullooly: That's like digging a ditch with a spoon every day.

Tim Mullooly: Right, 200 trades a day, 34 pages to start with in 1099s, all for $8,000 when you're going to have to hire a professional to come in and do your taxes now. How much is that going to cost?

Tom Mullooly: It may be a big chunk of this profit.

Tim Mullooly: Right. So, yeah. File that under the, is it worth it category.

Tom Mullooly: So let's move on to this tax angle with this, because these folks that are buying and selling on Robinhood or other online brokerage firms, they don't have the friction that we used to have with commissions. Like, "Oh, you got to factor in how much this is going to cost to get in and then get out."

Tim Mullooly: Right.

Tom Mullooly: But the tax bill will always be present. That's never going away.

Tim Mullooly: Right. And they were pointing out in the article about using losses to offset some of the gains that you have and stuff like that. But they also pointed out the point that if you buy and sell and then buy back the same security within 30 days, that's a wash sale.

Tom Mullooly: Wash sale.

Tim Mullooly: So you can't use the losses that you generated. You have to wait 30 days and there are just rules I think that people don't understand when they get involved with Robinhood and these trading apps, because a lot of people, it's their first endeavor into the market. It's their first account. It's their first time doing anything with stocks. And there are just a lot of rules that people aren't aware of.

Tom Mullooly: So if you take a gain on a position, you can sell it and go back into the very same position. I don't know why you would do that, but you are certainly entitled to do that. However, what Tim is alluding to is the wash sale rule. If you sell something and recognize a loss on it, you can't buy back the same position for 31 days and still be able to take that loss off your taxes. You can do it-

Tim Mullooly: Yeah.

Tom Mullooly: … but you won't be able to use the loss that was generated on the first go around.

Tim Mullooly: So I think that there's been a lot of confusion in terms of trading. And if you go back to what happened with GameStop, with margin and options and short selling, it's just a lot of people not understanding the rules and not understanding what they own and what they're buying and selling, but also another article that pointed out people not understanding the types of accounts that they have was from Think Advisor-

Tom Mullooly: Scary.

Tim Mullooly: … Just the headline alone. There was a link within the article that we're going to talk about as well, but just the headline from this Think Advisor article was enough for someone within the industry to kind of shake their head or scratch their head a little bit. It said, " Investors Embrace Taxable Accounts for Retirement Savings."

Tom Mullooly: I eat chocolate bars as a way to lose weight.

Tim Mullooly: Exactly. Yeah. To someone well-versed in finance, almost, that's like an oxymoron.

Tom Mullooly: Right.

Tim Mullooly: Investors Embrace Taxable Accounts for Retirement Savings.

Tom Mullooly: Before we get into the article, let's just kind of talk about the concept first and then we'll dig into the numbers. Using taxable accounts for retirement savings. There is a little grain of truth in that-

Tim Mullooly: Right, you can do it.

Tom Mullooly: … because you can do it because if you put money into a retirement account, there are no taxes while you are growing this account and then you can grow it by either a buy and hold.

Tim Mullooly: Yeah.

Tom Mullooly: Or by frequent trading or whatever. You can skin that cat a couple of ways. When the money does come out of the retirement account, it will be… No matter what kind of capital gains you had, when it comes out, it will be recognized as ordinary income just as if you earned it in a salary. There may be a little bit of an arbitrage in the sense that if you have money that you're investing, it's possible that your ordinary income when you're retired, maybe low enough so that your ordinary tax rates may be the same or lower than a capital gains rate.

Tim Mullooly: Right.

Tom Mullooly: But why take that chance?

Tim Mullooly: Right.

Tom Mullooly: Why would you do that?

Tim Mullooly: Yeah. For me, I think it's more… A lot of these apps, Robinhood, you can't open a retirement account.

Tom Mullooly: No. Why? Because it requires paperwork.

Tim Mullooly: Right. So all of the accounts that you open at Robinhood are taxable.

Tom Mullooly: There's one other thing I'll add with this Robinhood business. They were defaulting people to open margin accounts.

Tim Mullooly: Right.

Tom Mullooly: You had to opt out and I'm sure a lot of people didn't even read the terms of service or understand what they were doing. And so there were a lot of people who had margin accounts, didn't even know they had them.

Tim Mullooly: Right. And that goes to the point that I was saying before, people just not understanding, not only the investments that they have, but the accounts, the type of account that they have as well. Like you said, there's tax deferred growth in retirement accounts that you can buy and sell things within an IRA and not necessarily have to worry about the-

Tom Mullooly: Current income taxes, right?

Tim Mullooly: … transactional taxes. Yeah. You'll pay it eventually. But I think it's more people just wanting to use Robinhood because they heard about it from someone or from somewhere and not knowing that it's a taxable account versus a retirement account, or that there's even a difference.

Tom Mullooly: Yeah. Again, to sound like the old fogy in the room, someone wanted to open an account early in my career. It was like, "Okay, when can you come down to the office?"

Tim Mullooly: Right.

Tom Mullooly: And we're going to fill out this book, this account application, and then we're going to process it. And then we're going to deposit your check and then we'll talk about what we want to buy.

Tim Mullooly: Yeah.

Tom Mullooly: So technically at that point in the eighties, you had seven business days to settle a trade. So you could buy something on a Tuesday and not have to pay for it until the following week.

Tim Mullooly: Yeah.

Tom Mullooly: Now it's a two business day settlement after the trade date.

Tim Mullooly: Yeah.

Tom Mullooly: So trade date plus two. But now, apps like Robinhood have made it so easy that you can open an account right on your phone and then hook in your bank account and transfer money.

Tim Mullooly: Yeah.

Tom Mullooly: Hey, if you live in New Jersey, you can do Betfair New Jersey or whatever it's called. So if you can gamble online on your phone, well, I guess this is the same thing.

Tim Mullooly: Right. And they said in the article, there was survey results. I'm not saying that these survey results speak for the entire population of the country, but of the people that were surveyed, they said 66% of people had never opened an account before.

Tom Mullooly: This is pretty interesting because FINRA co-sponsored this survey and we'll link to it in the show notes, but they actually… Sometimes when surveys get done, you find out when you read the fine print that, "Well, we surveyed 57 people, and this is what we got."

Tim Mullooly: Right.

Tom Mullooly: FINRA actually surveyed 1,300 people, which is actually a pretty good sample size.

Tim Mullooly: Right.

Tom Mullooly: And they did this in November. Yeah. Tim was saying two thirds of the respondents were opening accounts for the very first time.

Tim Mullooly: And 27% of those wanted to invest for retirement. I like to give them the benefit of the doubt that they're just naive to the fact of what type of account they're opening, not necessarily choosing a taxable account over a retirement account.

Tom Mullooly: So, FINRA actually stated that with no minimum and low minimum accounts now widely available… That's not true, the barrier to entry has fallen, allowing greater access than ever before. No minimum accounts, that's kind of how I got started in my career.

Tim Mullooly: Mm-hmm.

Tom Mullooly: Basically if you could fog a mirror, come on board, let's go. In the last few years, you could open an account online with Schwab, with TD Ameritrade, with E-Trade, with a lot of these discount brokers, but having the apps now on the phone, make it a little more sexy and a little more easier to do.

Tim Mullooly: Yeah. And the barrier to entry is not even paperwork or clicking on an actual computer now, it's just downloading something on your phone, which takes 10 seconds.

Tom Mullooly: Right. So 57% of the folks that were surveyed by FINRA said that they opened a new account in 2020. So more than half of the people that they surveyed said, "Yeah, we opened a new account this year in 2020."

Tim Mullooly: And that fits in line with what we saw throughout the year 2020. The trend of trading and Robinhood and these apps really skyrocketed when the pandemic came and we've talked about how sports shut down and everything. So people were bored or they were sitting at home. So that makes sense.

Tom Mullooly: Yeah. So it was interesting by age, how they broke it down. They had a couple of different age brackets. The first one being ages 18-29, 41% of the people who were surveyed, 41% of them in that age bracket, 18 to 29. Started with less than $500 and another 26% in that age bracket said they started with between 500 and two grand. So two thirds of the folks in the 18 to 29 bracket started with $2,000 or less with this.

Tim Mullooly: I feel like that makes sense. It's young people, whether they're in school or just got out of school, they're just starting to set up their lives and get jobs and earn money.

Tom Mullooly: Now, on the flip side, people who were surveyed that were ages 60 and over, 6% of those people started with $500 or less, 8% of the folks who were aged 60 and over, invested somewhere between $500 and $2,000. So 14% of the people who are 60 and over started with two grand or less. This is speculation. This is gambling money.

Tim Mullooly: Those are the bored people.

Tom Mullooly: Yeah. This is Vegas money.

Tim Mullooly: Yeah.

Tom Mullooly: Yeah. What-

Tim Mullooly: Hopefully.

Tom Mullooly: … was interesting… Yeah, only I hope so. So of the people who were 60 and over, 52% of the people who are aged 60 and over started with $25,000 plus, that's very interesting.

Tim Mullooly: Yeah. It's not necessarily chump change. That's a good amount that they're putting into an app like this, or a trading account essentially.

Tom Mullooly: Yeah.

Tim Mullooly: So you hope that of that 52% putting money, that type of money in that, they have a lot of money. I hope that it's… Hopefully $25,000 isn't - not 25% of their money. You know what I mean? Like if you're putting $25,000 into a trading account, I hope that's like 5% of your worth-

Tom Mullooly: Right.

Tim Mullooly: … or less.

Tom Mullooly: Yeah. One more other tidbit from this article was, of the existing accounts, not people who had opened new accounts, these are what they called… They deemed these holdover accounts. So people who already had online accounts, 72% of the respondents with holdover, existing accounts said that they were saving for retirement with this account. Nearly three quarters of the people with existing accounts said, "This is really for retirement."

Tim Mullooly: Yeah, that's a lot.

Tom Mullooly: In a taxable account.

Tim Mullooly: In a taxable account, hopefully if they're investing in a taxable account like this for retirement, that they're not trading it or the positions that they have have been held for over a year, at the least-

Tom Mullooly: Yeah.

Tim Mullooly: … More of a longer term buy and hold strategy as opposed to flipping in and out of stuff.

Tom Mullooly: So, Tim, what's the message that you would… If you could speak to all of these people who answered the survey, what is the message that you would deliver?

Tim Mullooly: I think we talk about it a lot here, just like knowing what you own and that's important, but also knowing where you own it. And like we said in the beginning, you can save for retirement and invest for retirement in taxable accounts, you can do it.

Tom Mullooly: Sure.

Tim Mullooly: Are there more optimal ways to do it? Sure, but… So hopefully to these people, if you're doing it that way, hopefully they're going about it wisely.

Tom Mullooly: When I was a stockbroker, I would cold call business owners. And some of the answers that you would get when you would cold call a business owner and ask them, "What are you doing about retirement?" And they would say, "Every dollar that I make goes back into my business."

Tim Mullooly: Yeah.

Tom Mullooly: Or, "I'm sitting in my retirement plan. I own the building." Or something along those lines. Having a retirement plan, 401(k), a self-employed kind of a plan, it may not be appropriate or suitable for everybody, that's okay. But for most people, you really ought to consider socking some money away for retirement in the proper channel.

Tim Mullooly: Right.

Tom Mullooly: So Tim, you raise a good point that you got to not only know what you own, but you got to know what your options are when it comes to putting the money in the right place.

That's going to wrap up episode 343. Thanks again for tuning in. And we will catch up with you in the next episode.