# Ep107: Triage Your Finances

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PATTI BRENNAN: Hi, everybody. Welcome to the "Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives. I'm going to set this Ask Patti Brennan series up a little bit differently for you today.

We often get questions about savings – what should I do with my savings? If you're like everybody else, there's a limited amount of cash flow that we all have. What's the first and most important thing that you should be putting some of that excess money into? What would be second? What would be third, fourth, etc.?

Think of this like I thought about when I was a nurse. It's triage. Where do you get the biggest bang for each buck? What would be second? What's third and fourth, etc.?

Number one. If you are currently working and if your employer provides a 401(k), I will have to say that putting as much as you possibly can into that 401(k) is going to be the highest and best use of your excess cash flow.

In fact, when kids come in to or office and they've just graduated from college, they are typically the children of existing clients. They send them to us because they say, "Patti, my kids don't listen to us. They don't listen to me at all. Will you talk to them about what to do with their benefits and their 401(k)? Because we wish that we had met with you 20 years ago."

We'll meet with these kids. I always tell them, the line in the sand is 10 percent. When you get out of school, put 10 percent of your income into the 401(k). The only question is, within that benefit do you do the pre-tax 401(k) or the Roth? That answer's going to be different for everyone listening to this podcast today.

If you think that your income is going to rise in the future, you might consider the Roth option instead, especially if you're young, because the more time you have before retirement, the more powerful that tax-free benefit will be.

First and foremost, put the money into the 401(k). Let's say that you've been working, you're in your mid-50s, the kids have graduated from college. Those huge tuitions are over, and you've got excess cash flow. By the way, when I say excess, anybody over the age of 50 can put in $27,000 on a pre-tax basis or into a Roth 401(k), that's the limit.

What if you say, "Well, I've got more capital that we could invest. We've got more cash flow we could invest." I'd say the second thing is ask your employer if they allow for after-tax 401(k) contributions. Boy, I'll tell you what, if they allow for that, you can set yourself up for an incredible retirement future. Here's why.

There's a strategy that if you max that out, let's say that between your contributions and in your employer contributions that $67,000 per year, one way or the other gets invested into your 401(k). Now your $27,000 and their match is pre-tax. The rest is after-tax. You might say, "Patti, why bother, I'm not getting any current tax benefit from that."

Let's say that you're 10 years away from retirement. Let's say that that money...to keep the math simple is $20,000 extra per year. You're putting that money into the after-tax, the earnings on it go into the pre-tax. Guess what?

When you retire over 10 years, you've accumulated $200,000 in that side account. When you retire, if you choose to roll your money over, instead of requesting one check, you're going to ask for two.

You're going to get a check for the pre-tax amount of your 401(k) and put that into a pre-tax IRA, and you're going to take that $200,000 and put it into a Roth IRA. You've already paid taxes on that money, so you don't have to pay taxes again on it. Now, you have $200,000 growing tax free for the rest of your life.

It's probably one of the best things that you can leave to the next generation. It's one of the best things a child can inherit.

Within your own employer there's some pretty neat things, pretty neat strategies that you can take a look at. Many companies, publicly-owned companies provide a benefit where you can buy the stock of the company at a discount. As a rule of thumb, we often see about a 15 percent discount. Wow, that's a 15 percent rate of return almost instantly.

That's another alternative. Now this is after-tax money. If you do that and you sell the stock, you're going to get capital gains treatment, but that's a pretty nice way of saving money and it's even better because it's often automated.

First and foremost, look at the 401(k). Secondly, look at the equity compensation type of plans at work. In addition to that, for those of you who are still working, once you've looked at those two strategies, you may or may not qualify for a Roth IRA. If you're over the age of 50, you can put up to $7,000 into a Roth IRA.

If your spouse is working, they can as well, or if they are not working, they can do a spousal IRA. What's the advantage there? The more you can get in this tax preferred tax-free accounts, the better. What if your income level is such that you don't qualify for the Roth? Then you might want to consider doing the backdoor Roth.

Basically, you would put that same $7,000 into an after-tax IRA, similar to an after-tax 401(k), except this time, I don't want you to invest the money. Let it sit in the money market account. Then you convert it into a Roth IRA. There is no income level. Then you simply convert that after-tax IRA into a Roth.

The greatest thing about this is there's no income limitation when it comes to Roth conversions. You may not be eligible to contribute, but you can certainly convert one. If it's been sitting in a money market account, good news, bad news, yes, you haven't made any money, but you also, haven't got a tax liability when you convert, and now you've got another 7 or 14 thousand dollars growing tax free as well.

Again, we're doing triage. Look at 401(k), Roth or regular, look at after-tax contributions to your 401(k). Look at equity compensation plans. Look at Roth IRAs on top of that or backdoor Roth. Those are for those people who are currently working. Those were all retirement savings accounts. If you have access to a high deductible plan, boy, everybody should be doing an HSA.

That truly is the only free lunch where you really have left when it comes to tax planning. The money that you put into your HSA goes in on a pre-tax basis, it grows tax-deferred. As long as it's used for healthcare-related costs, you take the money out tax-free. It is literally triple tax free. There isn't anything else that we get that except in those high deductible plans and HSAs.

For those of you who may be tuned in and you own a business, you've got some pretty attractive savings options also. Certainly, you could set up a 401(k) for your employees. You can have a matching program on that, etc. Keeping in mind that maximum of $67,500, if you're 50 years older or older.

In addition to that, especially given where tax rates might be headed, depending on your current age, you might want to investigate a pension plan. The pension plans with big corporations seem to be going by the wayside, but for small businesses, they can be a real home run. A defined benefit or a cash balance pension plan is something where you may not be limited to $67,500.

We've had people putting hundreds of thousands of dollars into their own pension plan account. Getting a full tax deduction, how's that for a win-win right. You're saving for your own retirement, and you're getting a huge tax deduction. Talk to your advisor and see whether or not that might make sense for you.

If you have minor children and you are a business owner, you might consider putting them on your payroll. I'm not suggesting that you pay your six-year-old $100,000, but if your kids are of age where they can legitimately contribute to your business, they can answer phones, file, scan.

I've talked about this before. I think it's good in general, in terms of them understanding, what your business is all about, learning about your work ethic, etc.

If you're paying minor children, you don't have to pay FICA tax and neither do they. It's a great way of teaching your children important life skills, and you could set up a Roth IRA based on their wages for them. That's another great win-win situation for everybody involved.

If you have children that you'd like to save for college, these are savings triage, and it's usually based on priorities, what's most important to you. You've got 529 plans.

529 plans are great in terms of being used for college education or any form of advanced education, you can use up to $10,000 of a 529 for high school as well. For parents and even grandparents, it's a great way to stash money on a tax preferred tax-free basis.

A lot of times people come into our office, and they've seen an advertisement, or somebody's doing one ofthese dinner seminars and they're hearing about annuities. I hear about these wonderful annuities. They've got all these tax benefits. Should I consider an annuity for a portion of my savings?

I would say that there can be some attractive options as it relates to those products. I would be careful. I'd put that on the lower part of this triage list because there's a lot of other really good options. Annuities are great because they're tax-deferred, but when you take the money out, you're paying ordinary income taxes on what you receive on the profits.

That's not often the ideal scene for most people. If you instead invested in, for example, an index fund with low turnover, granted when you sell it, you're paying taxes, but for most people, that's a 15 percent tax instead of what would be ordinary income. It's not taxed as favorably. That's number one.

The other option, a lot of people come in after meeting with that insurance agent and say, they also talked about me getting some whole life, or universal life, or variable universal life. As with anything I'm open to all of it, I would say that these products are on the bottom part of the triage.

I would also say when it comes to the life insurance, because there's lots of fees associated with this product, it's really important to make sure they need the life insurance. I wouldn't do it for cash value accumulation.

In spite of the fact that a lot of times these products are sold based on the fact that you can borrow money out of the cash value in the future. When you borrow from the cash value, it comes out tax-free.

That is true. However, there is a cost to that. It's coming out of the cash value and you're paying interest on that loan. In addition, you've got to be careful because if you take that money out and it really bleeds that cash value dry, you run the risk of that policy lapsing.

Let me tell you something, you talk about a negative income tax result that it's not pretty. Be careful. I'm not saying don't do those things. Be aware of how they work, how it's going to fit into your overall plan and look at some of the alternatives that might also be available to you.

Everybody is different. Everybody's needs are different, and the triage needs to be adjusted accordingly. Today I wanted to give you some of the alternatives that a lot of people aren't aware of, like those equity compensation plans or deferred compensation plans, or backdoor Roth, or the ability to stash a lot more into your 401(k) and then be able to roll it out, tax-free.

Know what's out there and then decide what's most important to you. Ultimately, the real metric to look at is when are you going to need that money back? Because that's what investment is. You put it in, you save it today for some point in the future and that can also guide your decision.

Thank you so much for joining us today. I love doing this topic for you. Please if you have any questions, go to our website at keyfinancialinc.com. I am Patti Brennan, thank you for joining us today. Key Financial Wealth Management with wisdom and care.