EPISODE 1719

[00:00:00] FT: So Money Episode 1719, Ask Farnoosh.

[INTRODUCTION]

[0:00:05] ANNOUNCER: You're listening to So Money with award-winning money guru, Farnoosh Torabi. Each day, you get a 30-minute dose of financial inspiration from the world's top business minds, authors, influencers, and from Farnoosh herself. Looking for ways to save on gas or double your double coupons? Sorry, you're in the wrong place. Seeking profound ways to live a richer, happier life? Welcome to So Money.

[EPISODE]

[0:00:31] FT: Welcome back to So Money, everybody. We are in September, almost in the home stretch of 2024. The summer is unofficially over with Labor Day in the rearview mirror. Our kids are finally back in school. They started back on Wednesday. I've been crawling my way back to the real world this week. I've been pretty quiet on social media. Haven't sent out any newsletters. Instead, I've been trying to figure out my kids' schedules, which looks like a matrix in the fall. That being said, I feel like maybe it's just because I'm on my third cup of coffee. I feel ready to get back into the swing of things in September while we're already in it. Promises exciting episodes for all of you.

In fact, we have a whole lineup of episodes later this month on affording children in America. This is on a lot of voters' minds, and these episodes are really dedicated to those of us who are considering having children, or who have just found out that we're about to become parents. How to afford the costs leading up to the arrival of your child, and then all the considerations from childcare to baby gear in that first year.

We have experts from the financial world, from the pediatric world, as well as the career world to help us answer questions about how to do it all, how to afford it all, not just financially, but also our careers. How to navigate your job, your ambitions, your professional ambitions while now being a caregiver? What can we expect from our employers? What are our rights? How can we advocate for ourselves? Stay tuned for all of that later this month.

Make sure if you're not subscribed to So Money that you hit that button because that ensures that you get all the newest episodes as they go live. If you're in the So Money Members Club, this month, we're going to be talking about whether or not you should be buying that house. If you've been on the fence, eyeing prices, looking at the slim inventory, and thinking, "Hey, interest rates are falling. In fact, mortgage rates fell to their lowest level in more than a year recently. Is this really the time to strike?" We are going to talk about buying versus renting in our workshop this month, which will be at the end of the month.

If you're not in the So Money Members Club, this is a great time to get engaged in our community. I provide monthly workshops on various financial topics. We have office hours where you can drop in and ask me your money questions. You get commercial-free access to this podcast. Plus, you get to interact with like-minded folks who care about their finances. You can go to somoneymembers.com to join.

We've got some excellent questions from our audience members to tackle this Friday, including my thoughts on adding your child as an employee in your business. Some people are doing this. Are they doing it right? Do I recommend it? Another question about whether it's ever too late to open up a college savings plan, a 529. An audience member is looking to go back to school herself in the next few years. Is this the right place to save? And we have a 401(k) conundrum in the audience, involving what to do with 401(k) funds when your employer is discontinuing the 401(k).

But first, let's go to the Apple podcast reviews section and pick a reviewer who will get a free phone call with me. Plus, I'm sweetening the pot. You get a free month's access to the So Money Members Club to enter to win this. You just write a review for this show. If I happen to pick it on a Friday episode, you get a free 15-minute phone call with me, and I'll invite you to join our So Money Members Club for free for 30 days to see if you like it. Hopefully, you will, and you'll become a lifer. But this week, let's say thanks so much to LBryant1, who left a review a couple of weeks ago, calling the show a long-time favorite podcast. "Farnoosh, your content never gets old. I've been listening back to old episodes for years since finding your podcast, and I can never get too much. Thanks for what you do." Hey, my pleasure.

I'm so happy you're going back into the archives. I wonder, will people ever go back into the archives? There have been over 1,700 episodes. It's almost a 10-year show. For those of us who do listen to this show using the podcast app on our iPhones, you may have noticed a recent update a few months ago. Actually, it's been longer than that, maybe almost a year now. Apple decided that the podcasts were not going to automatically refresh for you if you hadn't been engaging with the app in a number of weeks, and all the archived episodes are no longer being stored in the app. They wanted to free up some space. Just FYI, if you want to binge on earlier episodes, you can still do that. You just have to trigger it yourself now using the Apple Podcast app, it's not automatic.

But listen, LBryant1, thank you so much for your review. You can email me, farnoosh@somoneypodcast.com. Let me know you left this review, and I will send you a link for us to find a time to chat, and I'll send you a code to join the So Money Members Club. Remember, this month we're going to be talking about housing, whether to buy, whether to rent, and so many more webinars in store this year. You can also DM me on Instagram, @farnooshtorabi, let me know you left this review, and I'll follow up right away. Okay, let's hit the mailbag.

[ASK FARNOOSH]

[0:06:08] FT: First up is Lori in the audience, and she wants to know my thoughts on adding your child as an employee in your business. She says,

[0:06:15] L: Hey, Farnoosh. I was chatting with a friend the other day, and she was wondering if she should add her two-year-old son as an employee in her company. Two years old. She uses his photos to promote her business. I have no idea, and I'm sure you've talked about this on your podcast in the past, and I found it interesting. So, I thought I'd ask you your thoughts and opinions on the topic. I'm sure she's not the only person who's ever had this idea or question. Thanks so much.

[0:06:43] FT: All right. Lori, this is an interesting question, and it has come up. I haven't done a deep dive on it, but we do hear from tax experts and entrepreneurs who run their own businesses about how there are benefits to adding your children onto your payroll. You pay them, but then there are tax benefits to your business. Also, that income that your child is earning can now be used to fund a Roth IRA, which we know all the tax benefits of that.

If you search this online, on social media, a lot of people talk about how this is like a back door to creating millionaires, to leading your children down the path to millionaire status. Because imagine, opening up a Roth IRA for your child at age two and fully funding that every year. That compounding, tracking the US stock market or a diversified portfolio, you will have a boatload of money waiting for your kid by the time they're young adults.

Here are some things to consider. First, the IRS has specific guidelines around paying a child as an employee, and the tax benefits tied to that. The rules vary depending on the child's age, and this is where the council of a tax planner can come in handy. You have to be sure that the work is legitimate and that the wages are reasonable for the services that your two-year-old, in this case, provided.

How much would a modeling agency pay your child for similar work? I don't know the answer to that. But when you pay your child, you want to make sure that it matches or is commensurate with the going rate for a modeling session. The other thing you want to keep in mind is child labor laws, which again, vary by state, and there's usually restrictions on the types of work and the number of hours that minors can perform. A two-year-old may be too young to be classified as an employee under these laws, even if the photos are being used for the business. So here, you would want to consult with a legal professional in addition to your tax specialist to just figure this out. Someone who's specializing in employment law would be helpful. So, those are just some considerations. You want to make sure that it's IRS compliant, that it's labor law compliant.

As an alternative, instead of making your kid an employee of your company, your friend could also consider compensating their child indirectly by setting up a custodial account or contributing to a savings account or education fund for that child. These don't offer tax breaks for their business. But if the goal, and this is where you could ask your friend, what's the goal here. If there's just a bigger goal of having the child have access to money when they're older, to create a savings account to help them start earning sooner than later. There are ways to accomplish that without the complexities of making your child an official employee.

One thing I just want to bring to everyone's attention, because this could spread. But in Illinois, and this is just one state, but again, this could become a wider law. Illinois has passed a new law just this summer, in July, requiring parents who use their children in monetized social media content, they have to set aside part of the earnings for the child. So, for example, I just had a partnership with SkinCeuticals. I was the only one in the Reels. Had I used my children in those Reels, and if I was living in Illinois, I would be subject to this law.

What it says is that parents have to put 50% – 50%, that's a lot – of the earnings into a trust account for the child, which they can then access when they become 18 years old. This applies if the child is in at least 30% of the content in a 30-day period. This law was designed to essentially protect kids from financial exploitation. There are a lot of parent influencers out there that are leveraging their kids, essentially, financially monetizing from their children. I think I agree with this law. I don't know if I agree with the 50%. But I think it's important that if you're going to use your kids to run your business, and you're profiting so much from them that they get some of that when they get older. It just makes sense.

Lori, thanks for your question. It was really interesting, and we don't cover this in my affording kids special this month, but it's definitely fun to talk about. Anne in California has a question about 529 plans. She wants to go back to school in another two to three years to get a bachelor's degree. She asks,

[0:11:30] A: Would there be a benefit in setting up a 529 for myself for this short period of time, or would it be better to set up something like a CD instead of a certificate of deposit?

[0:11:42] FT: The California 529 plan does have a few investment options within their 529. So, when you open up a 529 in California, you can choose from different portfolios. There's an age-based portfolio which adjusts its asset allocation over time. So when you're younger, the investments are more aggressive, and then as you get closer to college, the portfolio shifts to more conservative investments, like bonds and money market funds. There's a static portfolio you might be able to choose from, which is a fixed allocation of stocks, bonds, and assets. You can choose if you want an aggressive, a moderate, or a conservative allocation. Then, they have individual fund portfolios, and you can choose from specific asset classes, like stocks, US stocks, international stocks, bonds, and socially responsible investments.

What I would say to you, Anne, is that if you wanted to do the 529 plan, although it's just a few years for you until college, it's not typical for someone to open up a 529 plan with such a short time horizon. But if you did want to do that, because 529 plans offer tax benefits, which can be advantageous, there's tax-free growth, earnings on the investments grow tax-free as long as the funds are used for qualified education expenses. You've got tax-free withdrawals from the 529 plan, so they're not subject to federal or state income tax, again, if used for qualified education expenses.

California does not offer a state tax deduction, unlike other states. But that being said, the 529 overall is a pretty great tax-friendly investment vehicle. The question really becomes, should you be investing this money over just a short period of time for a goal that you want to meet in that period of time? Generally speaking, we don't want to invest money that is needed before the five-year mark. Why? Because if there are major dips in the market, if there is another major economic recession, and it takes a toll on the US stock market, that can take years, in some cases, for a recovery. So, by the time you're going to college, you may not have what you started with, or barely what you started with, because of the unpredictability and the volatility in the market.

If you hear this and you're like, "No, but I still want to invest in a 529 plan." I would say, within the California 529 plan, as I mentioned, there are these different ways that you can invest. I would go with the most conservative allocation, where you're going to be primarily invested in bonds and cash equivalents for lower risk. I would not be in anything aggressive, not even moderate, something really conservative, because you want to be sure that you have this money for college in the next few years. You don't want to risk that.

Again, the 529 plan has those tax benefits. So, that could be really attractive. If you want to go outside the 529 category, the alternatives would be a high-yield savings account. This offers more liquidity, there are no tax benefits. At worst, you're going to have the money that you started out with. At best, you'll have a little bit of growth in there. The CDs that you mentioned are another alternative. They offer fixed returns over a set period of time, and the CD rates are pretty decent. Right now, the average for a three-year CD is between 4.3% and 4.7%, depending on the institution.

Credit unions and online banks tend to offer the most competitive returns, that's guaranteed. Unlike a high-yield savings account, where you could start today at 5%, but by the end, it's maybe half that. We know the Fed is going to be lowering interest rates starting this month. You might want to go with the CD, because it's a guaranteed, locked-in annual percentage yield. But with that comes less liquidity. If you know you don't need to tap this money until you go to college, then I would say the CD is probably your best bet. All right. I hope that helps to narrow down your decision.

Then, last but not least, Kristen has a 401(k) situation. I'm a little upset with her company about this, but what are you going to do? She says,

[0:15:58] K: Hey, Farnoosh. My employer is transitioning our retirement plan from a 401(k) to an IRA. We've been told we need to move that money to avoid losing it. Would you recommend converting that money to an existing Roth IRA that I have, or opening up a new traditional IRA, and rolling the 401(k) money into that? I want to make the best financial decision and also be conscious of not having too many of the same account. Any advice is helpful.

[0:16:29] FT: All right, I'm surprised that your employer isn't giving you more guidance on this, other than just, "Better move your money." It's a little disappointing. But let's talk solutions. It's not clear to me from what you wrote, whether the company is going to automatically transfer your money from the 401(k) to an IRA, maybe, perhaps within the existing financial institution if you do nothing. Or, it's requiring you to take the money from the 401(k) and find your own solution. But nevertheless, here's what I would recommend.

You already have a Roth IRA, which is a fantastic retirement savings vehicle. If you can afford the tax bill, because there will be a tax hit, I would roll over the 401(k) dollars into your existing Roth IRA. This would simplify your concern about having too many accounts. It would be considered a rollover Roth IRA, and so the money that you transfer will be taxed as ordinary income in the year of the rollover because your Roth contributions were made with after-tax dollars. If you expect your tax rate to be higher in the future, this could be a good time to do the conversion and pay the taxes at a lower rate.

Once the funds are in a Roth, they're going to grow tax-free, and your qualified withdrawals in retirement are going to be tax-free. But again, you want to be sure you can afford the tax bill, so talk to your accountant, your tax planner, and try to figure out what that hit could be. If you don't want to pay taxes, then you want to roll this over into a traditional IRA, which is more of an apples-to-apples conversion. It's more straightforward. You won't have a tax liability.

The thing you want to avoid is having this 401(k) money get sent to you in the mail in the form of a check or just cashed out somehow. Because then, you're going to lose a lot of value. You're going to get hit with taxes, you're going to get hit with an early withdrawal penalty, which could eradicate effectively 40% to 50% of the money in the 401(k). If you want to keep the funds intact, you want to take these steps to either roll it into a Roth or into a traditional IRA between the months of October and the end of the year. All right. Thanks so much for your question, Kristen.

I hope you enjoyed this new episode of Ask Farnoosh, and promising all new episodes this month. If you ever have a question for these Friday episodes, it's very easy to get in touch. You can go to somoneypodcast.com and click on the Ask Farnoosh button at the top right, drop your question in there. You can also leave me a voicemail, which will air on the show with your permission, and you can DM me on Instagram.

You can email me, farnoosh@somoneypodcast.com. somoneymembersclub.com, if you want to learn about our lineup of workshops through the end of the year and how to join the club for more access to our community and help getting your questions answered. I hope your weekend is So Money.

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