EPISODE 557

[ASK FARNOOSH]

[0:00:32.6]

FT: Welcome back to So Money everyone, I'm your host Farnoosh Torabi. It's Friday, which means it's all about you this day. We're going to cover your financial questions, everything from Roth IRA's to investing in your education, credit card debt, and the benefits of living at home with mom and dad.

As always, our friend Sophia joins us with all of the questions. Sophia, how are you doing?

[0:00:53.3]

SY: I'm good, how are you?

[0:00:54.5]

FT: I'm doing well, what's anything new happening in your world? Any So Money moments to share with us?

[0:01:01.3]

SY: I maxed out my Roth IRA for this year.

[0:01:03.5]

FT: Woohoo, good job.

[0:01:05.3]

SY: That's been awesome, yeah. Then, I did a few other things with my financial planner as well so I'm feeling good about my finances.

[0:01:13.5]

FT: I mean, the fact that you have a financial planner in your 20's, that's pretty rock star of you I have to say.

[0:01:18.9]

SY: Thank you. Yeah, my parents were nice enough to set me up with theirs and, you know, the woman I work with is really great and she says that I'm actually not one of her youngest clients, she has a couple of others but I am amongst some of the younger clients that she does have.

[0:01:38.6]

FT: I like to hear when financial planners cater to the younger generation because, you know, I think it just shows that they think long term and they're not just after you for your money because clearly when you're in your 20's, you're not in your prim earning years yet, you know?m It's nice to know that they're investing, a portion of the reason to focusing on millennials because you guys are the future.

Speaking of the future, we have some people here who are concerned about retirement. Jennifer has a question about her Roth IRA, right?

[0:02:08.2]

SY: Yeah. So she and her husband have a combined income close to or maybe at the threshold of where you can open a Roth IRA. So her income is variable so she's not sure if they would be over the limit by the end of the year. She's wondering if they open a Roth IRA and their household income ends up exceeding the limits, would they be penalized?

[0:02:28.3]

FT: She keeps talking about we and with a Roth IRA, the IRS does not allow couples to open up a joint IRA, Roth IRA. Just FYI, in case that's where her line of thinking was. Jennifer, you and your husband can each separately open up Roth IRA's and just to give you a little sense of the income threshold; so there are income limits for people who file their taxes jointly, married couples and there are also income limits for everybody else, but in this case because she said she said she's married, I'll tell you that if you file your taxes as marriage filing jointly, your income must be less than $184,000 to contribute up to the limit, which this year is $6,500.

If your income is between $184,000 and $194,000, you cannot contribute up to that limit, the contribution is reduced and the IRS has calculators on their website, IRS.gov, to help you figure out what that reduced contribution limit would be based on how much you make. So keep that in mind, and this is income that you make separate from your husband and it's not a combined income, it is your individual income.

So if you think that you're going to make less than $184,000 then you can safely contribute to a Roth IRA and the other thing too that you shouldn't be aware of is that you can contribute to Roth IRA up till April 15th. You might be for example, this is the 2017 pack season. We are currently in 2017, so in 2018 you'll be filing your taxes for this year 2017. You have until April 15th 2018 to contribute to a Roth IRA or a traditional IRA and have that be counted towards your 2017 taxes.

So by then, hopefully you will know whether or not you made enough to still qualify for the Roth IRA and at that point, you can contribute the entire amount. My advice is maybe to save the money in a separate account like a savings account that you anticipate putting into the Roth IRA but then doing it all on a lump sum maybe next year once you actually know how the year panned out. Does that make sense?

Because the truth is yes, if you contribute to a Roth IRA and you're not making too much, you might have to take that money out. You won't get penalized, actually this happened to me one year. I contributed to a Roth IRA and then I got a book deal and a bonus and I wasn't expecting either of those things on top of my salary and so I was disqualified, obviously, to contribute to that Roth IRA even though I already put money in. I called the bank, explained to them what happened and it took it out.

Fortunately that money hadn't been invested yet, it was just a base like cash contribution that I made and that's something else to consider too, is you can actually contribute to the Roth IRA. Just keep the money in cash for the time being, don't invest it and then that way, if you end up making too much, you can take out that contribution penalty free and you don't have to pay taxes on any gains because you didn't have any gains, does that make sense?

Really it's like two options here; you can wait till next year, closer to April 15 to kind of figure out how your income panned out for 2017 if it was within the threshold then you can safely contribute to a Roth and do that within the early months of 2018 or you can contribute now but just don't invest the money, just keep it in cash. So in the event that you do end up over earning, you can take it out and not risk any penalties and you can work with the bank to help you transfer that back into your bank account. Good question.

Again, it doesn't matter what your combined income is, it's just your income and only you can have a Roth IRA and your husband can have a Roth IRA. You can't have a joint Roth IRA, according to the IRS. All right, I should get an honorary degree in accounting or something. I will tell you, I was terrible at accounting in college even though like, you know, taxes is part of the accounting course. I took accounting in the summer because I thought it would be easier.

I thought summer courses — and traditionally, summer courses are a little more relaxed, but not this particular accounting class. I ended up getting a B but it wasn't without a lot of effort. I thought it was going to be an easy breezy A. Nope. That was a great credit course, that hurt my GPA a little bit. But anyway, side bar.

Next is Isabel and she has a few questions regarding her finances. Let's tackle the first one, which has to do with her 401(k).

[0:07:09.6]

SY: All right, she's 34, single, and making $41,000 a year. She works as a receptionist in a medical office. Her boss offers a 401K which she started putting money in two years ago and now has $8,000 saved there. She believes he offers a company match but so far she's only seen that he puts $1,000. She contributes $200 a month so she's wondering, should she contribute more?

[0:07:35.9]

FT: Okay, the first thing I would say to Isabel is learn the 401(k) policy. If your boss actually does offer a match, figure out what that is, make sure that he is committed to that and then the other thing I would say is, you know, you're 34 and assuming that you have been saving into a retirement account since your 20's and that you have some retirement savings and that this is just an ongoing thing for you that continue to put 10, 12% into a 401(k), including the match, is great. I don't' know percentages, I know she said she's contributing $200, her boss is putting in a thousand, she's got about $8,000 so far.

It doesn't sound like you're doing as much as you probably should be doing in order to keep track with just how much you'll probably need in retirement at 65 in the next 30 years. Do what you can to get to that 10% as much as possible, every year. That for you, I mean, okay, that's like $4,000 a year but if your boss is putting in a thousand, then maybe you only have to do three and to combine together, you're getting to that $4,000 a year contribution. Then once you end up making more money, obviously put more towards more retirement. Does that make sense?

Hopefully that answers your first question and then she has another question about traditional versus Roth?

[0:08:58.0]

[0:08:58.3]SY: So, her question is, she opened a traditional IRA but now isn't sure if that was the best choice over a Roth IRA? Her plan was to switch it to a Roth once I hit 55 so she can skip the taxes, is what she mentioned.

[0:09:12.1]

FT: Okay. She's making $41,000 a year, she definitely qualifies for Roth IRA. I would do a Roth IRA. She's got a 401(k) already at work, which allows her to reduce her taxable income today and then pay taxes on the contributions and retirement. We always talk about diversifying your tax exposure in retirement. A Roth IRA does the [inaudible] to contribute money today and not get the tax benefit today but get the tax benefit in retirement withdrawing that money basically tax free in retirement.

Now, what she's talking about is maybe doing a Roth conversion but that's in 20 years and I don't know if the Roth conversion — it's a some new law and it could change. Betting on that is not necessarily a good plan and the other thing to keep in mind is that, yes, people love a Roth conversion because their withdrawals are tax free in retirement. But once you do that conversion, you do have to pay income tax on the amount that you convert that year.

So it's not like you're just able to never pay taxes, ever. You have to pay income tax on the amount that you convert and then from there, once whatever you additional add to that Roth in retirement, you can withdraw tax free. So just keeping that in mind. So I would do a Roth. I think that might be a good way for her to diversify her tax exposure in retirement and because she's young and makes enough to do so, take advantage of it.

All right Alexandra, she's a financial planner and she's asking me a question?

[0:10:42.5]

SY: It's a question about her education. So right now, she's working as a financial planner for a firm that's known nationwide and she's been working with them for the past six months. She loves what she's doing and she wants to start taking courses towards pursuing this CFP but her district manager likes to see that you've been with the company for a year and are in track with meeting your annual goals before they approve for tuition reimbursement. So she's wondering should she maybe take one class, pay for it by herself, to get the process started?

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FT: Yeah, she could do that. I'm a firm believer in investing in yourself. It's great that her company has this tuition reimbursement plan but of course, it sounds like there are some restrictions to it. I would talk to your district manager and just say, "I totally understand where you're coming from. I have six more months to hopefully prove to you that I am very serious and that I am hitting my targets and I am worthy of this tuition reimbursement. But I am really eager to get the process rolling and was thinking about taking a class and paying for it out of my own pocket."

"Would this be something that perhaps in a year or in six months rather you could reimburse me for if you feel I deserve it? And if not that's fine but I just wanted to let you know where I am," so I think it's important to keep that transparency with your employer. Let them know that if you're going to do this, you plan on doing this, you're going to pay for it out of pocket and whether or not they will reimburse you as something that you can hopefully negotiate with them but be more certain to that if in six months you want to continue taking classes that they are going to actually fulfill their end of the commitment here and maybe talk to some other colleagues who have gone through a tuition reimbursement with the company, and ask them how the process was.

Was it easy? Did they give them a lot of hassle? and I totally get what your employer is coming from because of they're going to invest in your education. They want to make sure that you're happy there, that you plan on staying there, that they want to basically pay for your education and then you leave because that doesn't really help them out. So they're obviously being very conservative about it but I really respect and love hearing that you want to get this rolling and that you are ambitious

And you should do what you want to do and if it's just one class and you can afford it, great and there's also the lifetime learning credit, which might be able to help you save some money on the cost of this course ultimately. It's a credit that the IRS provides for people who are pursuing undergrad, graduate and the professional degree courses. Including this CFP course that's going to improve your job skills and eligible tax payers can qualify for up to two to $4,000. This could help to offset some of the costs of that course so keep that in mind as well Alexandra.

All right, Bobbie, love that name, is that a man or a woman?

[0:13:44.7]

SY: I think it's a she, I'm not sure?

[0:13:46.7]

FT: Okay, what's on her money mind?

[0:13:49.4]

SY: So she has two credit cards with $12,000 limits and she wants to have a zero balance on both of the card by the end of this year and then once the cards are paid off, she wants to know what your recommendation is for the credit limits? She says that one card is what they use for everyday expenses and pay off at the end of each month and then the other one is one that she's had for a long time and has been working towards having a zero balance on. She's wondering should she lower the spending limit on one or maybe both of the cards?

[0:14:17.8]

FT: I don't think she should lower the spending limit on any of the cards. You know, lowering the spending limit, which is basically your credit line actually hurts your credit score. So I wouldn't do that, I mean what's the point? If anything I would say raise the limit on the card that is either for her every day expenses even though she is paying it off every months. It's nice to have a little bit of a cushion or an added cushion.

But even more so perhaps for the other card where she is still carrying debt and I think yeah, that might be the one I would raise the limit on because essentially what you are doing with that card is you're lowering the debt to credit ratio and that is good for your credit score. So I would call up the credit card company for the card on which you are working to get out of debt on and hopefully you've had a good run where you have been paying more than the minimum, you've been on time with your payments.

If you have a pretty good credit score, you could probably qualify for additional credit. It's basically an extension of the limit that you had on that card. So if you have let's say $6,000 on it maybe they could increase it to $10,000 or $15,000 or if you have $12,000 on it maybe you could extend it to 15 or $20,000.

This is not so that you, Bobbie, can then go up and run more debt obviously. It's more so that you can well, one, maybe when times get tough have a little bit more access to credit, not that I would encourage that but who knows what happens in life. But more importantly, this is going to help to increase your credit score. I do this. This is actually something that I have talked about on the Today's Show as a quick fix to your credit score.

It only works for people who have good credit and have been paying their bills on time, to call up your credit card company and say, "Can you raise my credit limit?" That sounds counter intuitive. Like if you're trying to get out of debt why would you raise your credit limit? But I am assuming here also that you are going to be responsible with that credit. You are not going to be actually using it. It's just more to have it there to reduce your debt to credit ratio, which is 30% of your credit score.

The people in this country with the highest credit scores, people who have 750, 780, 800 credit scores, their debt to credit ratio is less than, I believe, 6% at any given time during the month. If they have a $1,000 credit limit, then they're only using $60 bucks off of that $1,000, which sounds crazy. But the point is, the higher your credit limit, the lower your debt to credit ratio could potentially be.

So I wouldn't reduce spending limits. I would raise spending limits and that may sound weird but hopefully I explained why it works in your favor and good luck Bobbie. I think that it's great that you are focusing on your debt. I think the question came from a good place but I think you probably weren't thinking about the counter intuitiveness of why having a higher spending limit is actually a good thing.

All right, we've got a 25 year old, we basically got your clone here, Tracey, right?

[0:17:19.1]

SY: Yeah.

[0:17:19.5]

FT: She's 25 and she's got a question about what she should do, where she should live, tell us what's her situation?

[0:17:25.3]

SY: Yes, as you mentioned, she's 25 and she lives at home with her parents and she has a daily commute right now totalling three hours. She's thinking of moving to the city to be closer to work and in the burbs where she lives now, she needs a car to get around and her car is ready to be scrapped. So either she'll have to buy a new one out of her savings, which is currently around $12,000.

But if she moves, she'll be able to put away $700 a month in savings, and if she stays home for another year or two, she'll save 1,200 a month but will wipe out her current savings to buy a new car. So she says, "If I move, I'll save less a month but I'll be able to use my current savings to start a retirement fund and pay toward my student loan debt of $6,000." So, what should she do?

[0:18:11.3]

FT: Yeah, so gosh this commute, three hours. It sounds like she lives in New Jersey area, and commute to New York.

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SY: Yeah, it's a long commute.

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FT: That's my guess, typically I would say living at home with your parents is the biggest cost savings but I get it, she has to get a new car and that's going to be an additional expense. If there is a way around that Tracey to not have to get a new car to use public transportation, to get a carpool going, I mean, that would be, hopefully, a way to find a happy medium where you could stay home and save and not have to incur auto expenses to the extent of having to get a new car and simultaneously still save, simultaneously still fulfill retirement and pay off student loans.

That's a lot, but it sounds like she's done the math and it sounds like moving might actually be a better use of her time and also a better way for her to actually get ahead in her financial life. If you are going to move out of your parents' house, you've got to be really careful about how much you are going to spend on rent. I would say get a couple of roommates, even if your commute is an hour away now from your job instead of 10 minutes, that might still be a way to find a more affordable housing.

But if you actually have done the math and believe that moving will enable you to start saving for retirement and pay off those loans and you can't currently do that at home because you have to get a new car then I think you know what to do.

The only way I would see staying at home with your parents would work, allow you to save for retirement, erase your student loans, is if you found a way around this car issue. Can your parents lend you their car? Do they have a second car? Can you find a really cheap lease on a car? I don't love leasing cars but sometimes if the monthly payment is just $300 a month for a couple of years, which is maybe all the time you need to really be living at home anymore, that could be a way around it instead of plunking down thousands and thousands and thousands of dollars for a new car.

Do you have a friend at work you could carpool with? So if there's a way around that transportation issue from living at home then living at home would probably the most cost efficient thing. But then again, you know, that three hour commute that's going to hurt.

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SY: It does.

[0:20:41.2]

FT: That's going to hurt and I don't know if it's the kind of commute where she's driving. So she's not even on a train where she could read or do work or do something more productive with her time. She's literally driving and stuck in traffic so that's not a great use of your time. So if you move to the city and you don't have that three hour commute anymore or you move closer to your job and you don't need that three hour commute anymore, I would say find really exciting projects for yourself.

Imagine that you got three hours back a day, that's how many hours a year? That's like over a thousand hours a year that you are going to have to do something else with, which is exciting. Gosh, you could learn a new language, you could go travel, you could bring in an extra income stream, and you wouldn't even have to use all of those thousand hours.

So be very thoughtful and strategic about how are you going to manage your time now that you are closer to work to actually make more use of your time and so good luck Tracey. I know, I mean, it's counter intuitive, I always thought that living home with your parents was the best way to save. But if you're driving and if you had a new car, that could really offset the savings that you are making by living at home.

So good luck Tracey, let us know what you decide to do and thank you to Bobbie, and Alexandra, and also Isabel and of course Jennifer for your question about Roth IRA's. I hope you guys have some more direction now and as always, you know how to reach me right? Go to somoneypodcast.com, click on "Ask Farnoosh", you can leave a question via audio or you can write in your question and we will add it to our Friday episodes. Thank you Sophia.

[0:22:24.3]

SY: Always.

[0:22:25.6]

FT: And congratulations on your maximization.

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SY: Thank you.

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FT: Of retirement and it’s always good to know that millennials are getting the financial love that they need.

[0:22:37.1]

SY: Well how could I not practice what you preach?

[0:22:40.8]

FT: Yeah, that would be awkward wouldn’t it?

[0:22:42.1]

SY: It would, it would be very awkward.

[0:22:43.6]

FT: If you were in a lot of debt, you were spending like crazy, yeah we’d have to have a little conversation.

[0:22:49.5]

SY: Definitely, there would have to be a So Money intervention.

[0:22:52.5]

FT: Well any who, I hope you have a great weekend everybody and I really, again, appreciate the questions and hope your weekend is So Money.

[END]