How To Pay Zero Taxes

Scott A. T.: Broadcasting from One Dallas Tower, welcome to the Financial Rock Star Show. I'm your host, Scott Alan Turner, ready to help you get out of debt, save more money, and retire early. On the show today, I'll be answering your questions about money, business, and life. If you have a question you'd like answered on the show, visit GoAskScott.com.

Oh, and oh yeah, in the studio with me, as always, producer Katie, who's slowly wasting her life away watching Peaky Blinders, some Amazon or Netflix series.

Anywho, last calendar year, last tax year, we converted $100,000 from an IRA, which we hadn't paid any taxes on, to a Roth IRA, and in the process, paid zero taxes. Let me repeat that, and slow it down, just to make sure you heard it right. Not because I'm trying to brag. I just want to get you the picture of it. Had $100,000 in money that we had not paid any taxes on yet. It was in an IRA that had accumulated over the years. Converted it to a Roth IRA, which will grow tax-free, and we paid $0 in taxes. Meaning we are never going to pay taxes on that money.

"Hold on, Turner. That doesn't make sense. An IRA, you pay taxes on that, when you take it out, or when you do something with it. Pull money out of it later on in life. It's taxed as ordinary income. How can you do that and not pay any taxes on it?" A traditional IRA, like you may have a 401k, 403b, 457 SEP IRA, simple IRA. That is money put away for retirement with pre-tax money. You haven't paid taxes on it yet. You're supposed to pay taxes on it at ordinary income rates when you retire and you start pulling that money out of your account, and spending it. Instead, you don't. You keep 100% of the money and never pay taxes on it.

I hope I've got your attention. This can happen to you, if you've got a 401k, 403b, 457 SEP IRA, simple IRA, traditional IRA, a tax-deferred account where you haven't paid one penny in taxes yet. Imagine if you had $100,000 in a 401k, which, hopefully you will someday. You may have that much money in there already, or in traditional IRAs, somewhere out spread around your different retirement accounts. Maybe you're working towards it. You haven't paid any taxes on it yet. In retirement, it's going to be taxed as ordinary income. Say the taxes are going to be $20,000, and I'm just making up that number. Instead of paying $20,000 in taxes on $100,000 in income, with $100,000 in investment growths, you pay zero. You get an extra $20,000 in your pocket. In your face, Uncle Sam!

Taxes are important. Some people spend an inordinate amount of time figuring out how to make an extra 1% in their investments. "How can I save half a percent on my investment expenses?" Is a 60-40 stock versus bond split better, or an 80-20 stock versus bond split? Is it 9.6% I'm making on my investments year over year, or 9.8%? Can I handle the low return because of the low risk, if I go 60-40 stocks versus bonds, versus an 80-20?

A lot of people spend a lot of time majoring in minor things. While asset allocation, picking the right investments, investment expenses, they are all important, once you've got your plan going, and you're following it, move on. Move on to bigger and more important things than trying to save .02% in expenses on your investments. If you want to hack your spending plan, should you focus on your housing, which makes up a third of your expenses, or what you spend at Starbucks over the course of a month? Hint: It's not Starbucks. If you want to hack your spending plan, should you focus on your transportation costs, which might be several hundred dollars a month, or buying Cheerios versus Walmart Toasty O's? It's not Toasty O's.

If we're going to spend a third to a half of our income over our lives paying taxes, where are the biggest potential savings? In figuring out how to go from a third of taxes down to a quarter? A half of your income to a third of your income in taxes, or switching from a robo-advisor that charges 0.3% to one that charges 0.2%? Or a Schwab index fund that charges 0.4% to a Vanguard fund that charges 0.3%?

Back to my point that I started off with. I have $100,000. Is it more important to have it at Betterment, paying 0.515% per year to manage, $150? Or a Vanguard paying 0.6%, $600, because they give me a personal advisor? Or to save $20,000 in taxes? Don't get me wrong, the minor stuff is very important as well, especially when it comes to investment fees. The yearly investment fees you pay on $100,000, that can add up to tens of thousand dollars in savings over a period of 20 years, or hundreds of thousands of dollars. Over $100,000, depending on how long you're putting it away for.

I just want to set the stage for a couple of reasons. One, if you're one of those people who they love investing, you love digging into all the weeds, and the mutual funds, and you spend a lot of time on that, that's wonderful and great, if you become an expert investor and reduce your fees, increase your returns a little bit. What if you thought about taxes? Think of the huge consequences of not paying attention to your taxes over a period of 10, 20, 30 years. What kind of tax planning have you done? Are you thinking ahead, down the road, for when you do retire?

A lot of people just say, "401k. I'm going to be on my employer-sponsored plan. I'm going to not pay taxes on that income now. I'm going to save for the future, 20 years down the road, 30 years, 10 years, whatever it happens to be." That's wonderful. It's awesome, but do not neglect the opportunity for saving money on taxes. In order to do that, we need to understand taxes, how they work, what opportunities there are now and in the future when we need that money. Along the way, strategies we can take to reduce our tax bite, now and later on. Those are some of the things we're going to start digging into.

That may or may not fire you up, and that's okay. It's like, "Oh, taxes. I hate doing my taxes." I was so excited to hop out of bed the other day and start thinking about this show. I was thinking about it the night before. I was like, "Oh, I'm so excited to wake up tomorrow and start working on this taxes. I was, because it was so interesting to me as I started digging through my tax return from last year, which I did not prepare, and I started looking at all the numbers, like, "How do they do this? How does the imperial federal government figure this out, and what's this tax deduction over here? Then we've got these credits and exemptions. How did I not pay taxes on this money? How can I present this in manageable, understandable pieces, because it's taxes, which incredibly complex." There's a bajillion lines to the tax code. Nobody understands it.

Even in just this introduction here, I had to whack the whole thing in half. I'm not even going to get to the topic that I was planning on covering today. As I looked ahead at my notes and how extensive they were, it's like, "Well, I can't do an introduction and get into some of this stuff, because it would take up 20 minutes and people's eyes would glaze over."

I just want to get you guys excited about taxes. No, we're not going to get excited about taxes. We do get excited about saving money, and when you start going through this stuff and seeing the quantity of cash that you can save by taking some of these strategies and implementing them in your own lives, that is what is exciting. There's some foundational stuff, there's some groundwork we've got to lay first in order to understand how this stuff is going to apply, and then when we get into the actual implementation of it, where it applies in your own life, how you can take advantage of this. Every situation is going to be different, because everybody's got different types of retirement accounts, whether you have retirement accounts or not. You may not have even started them yet. The younger you are, the more opportunity there is to plan ahead for the future, but even if you're already in retirement, and you've got some retirement accounts, there can still be opportunities to have money that you haven't paid taxes on yet, and convert that into other types of funds where you don't have to pay taxes on it.

Again, taxes, boring. Hard to understand. Saving money, exciting. Exciting stuff. Everyone should get on board with that. It's not difficult stuff. A book recommendation I have for you. Here's your simple action item, is pick up this book. It is massive. It's massive. It's called "How to Pay Zero Taxes." This book is about how to pay zero taxes. It's by Jeff ... Probably won't get his last name right. Schnepper. Schnepper. A new edition comes out for every tax year, so he keeps up with all the tax codes, and updates it. The byline is: "Your Guide to Every Tax Break the IRS Allows. Hundreds of tips and techniques to preserve your income through exclusions, credits, deductions, shelters, and smart investments." 800 plus pages is this book, and you think, "That's way too much." Well, you read a few pages a night, put you to sleep real quick probably, but that prospect of having more cash in your pocket, pocketbook, saying, "In your face, Uncle Sam. In your face." Keep more of your money. That should be exciting. Forget that we're talking about taxes.

That's the stage. Tomorrow, we'll start digging in.

Another story about athletes getting ripped off by having someone else mismanage their money. This is from an article on ESPN. It's about Jake Peavy, a baseball player, and Mark Sanchez, NFL quarterback. There's a quote from Peavy, says, "Between 2011 and 2016, Narayan," the guy who allegedly had ripped them off, "invested approximately $15 million of my funds in a ticket business without my authorization. This represents the vast majority of the personal funds that he managed for me. To date, I have yet to receive a return on any of my funds used to invest in the business." The article goes on, "All of the athletes said they hired Narayan in part because he represented himself as a devout Christian involved in charitable causes, and claimed to be a certified public accountant." The SCC, Securities and Exchange Commission, says Narayan has never been a CPA. In a statement, washed up NFL quarterback Mark Sanchez said he had agreed to make only a $100,000 investment in the online ticket company, and, "Because it is such a risky investment, I would not have knowingly invested additional funds in the business, much less committed millions of dollars to the company."

These athletes had the wool pulled over their eyes, from somebody who has presented himself as being a legitimate businessman, a legitimate investor, and he got into their accounts, and cleaned them out. How can you and I protect ourselves and learn from this? How can we keep somebody who we trust from wiping us out? Number one, protect your social security number. Don't give that out. Number two, don't give access to your checking accounts. Don't let people get into them. If they want money, you can do a wire transfer. You can write them a bank-certified check, but certainly don't give them access to your checking accounts. Diversify, spreading your funds around as much as possible. A little over here, a little over there. This company manages this money, that company manages that money, rather than having it all in one place where somebody can go in and wipe it all out. The most important of all is, be observant. Check your money. Check your accounts. Know what's going on.

For five years, this guy Jake Peavy had invested, on his behalf, $15 million, without his authorization. How did he not know the money was gone? That's my question. I guess he wasn't just paying attention. He's just out playing baseball. Well, that's understandable. What, are there 183 baseball games a year? Who has time to check their accounts? They're on the road all the time, playing games every day of the week. I guess he just didn't check his accounts. Maybe the guy was handing him paper statements, or showing him fake computer screens. That's a possibility as well. I log into my accounts, at the brokerage firms, and I see what is in them.

In the end, if someone wants to steal your identity, someone wants to steal your money, they can. If they want to go to the extreme lengths, find somebody who can create a fake ID for them, fake social security card. Learn how to forge your name. Steal the PIN you use for your cards. Show up at your bank. Withdraw all your money. Unless the bank happens to use one of those fingerprint systems. I don't know if ours does or not. If there are hackers out there who want to get into a computer system, they will find a way to get into a computer system. If there's somebody out there, friend, family member, trusted business associate, who wants to steal your identity, and go to the extreme lengths to do so, they can do it. They can do it. Be vigilant with your personal information, your accounts, and if you ever have any questions about legitimacy, ask somebody. Say, "Is this legit? Should I be concerned? What should I do to protect myself?" That's the best that we can do.

Damien from parts unknown asks about robo-advisors and the Motley Fool. Says,

Damien: "Your getting started with investing video for Betterment, I noticed you said it's a great way to start investing. Past that, I don't have the time to spend trading with my job and family. I'm in my mid-30s, of good income, in the mid-$100,000 range." Nice. Nice work. "My wife stays at home with three kids under the age of five. I've saved a little under $100,000 in retirement. Have about $60 in cash accounts. I know that's too much. Do you recommend Betterment for someone like me that is farther down the line investing? If not, is there a service you do recommend? Additionally, do you have any thoughts on the Motley Fool? I'm doing a trial year with their stock advisor, and investing in the company's recommended that I understand."

Scott A. T.: Mid-30s with $160,000 tucked away? That's a nice chunk of change. The Motley Fool. I don't think I've mentioned that before on this show. I am intimately familiar with the Motley Fool. That is a service, kind of, that I stumbled on when I first learned about investing. Rule-breakers, rule-makers. The guys who run Motley Fool have had a radio show for a very, very long time. Late 90s, if not earlier, if I'm not mistaken. Yes, the Motley Fool. If you're not familiar with the Motley Fool, I'd generally say it's a stock picking service, website, program. They talk a lot about individual stocks. There's a number of good articles on their website, in general investing advice, for learning about investing stuff. At the end of the day, I'd just classify it as a stock-picking site.

Stock pickers, they're the ones that are in the media. Their goal is to get advertising dollars. If they didn't talk about individual stocks each day, or each week, they wouldn't have anything to talk about. You can only say so much about an index fund. There's just not a whole lot to say about it. "Index funds. Wow." Whereas you can talk about individual companies all day long, and how they're doing in the marketplace. On the Motley Fool's website, on the bottom of every article, is a little clickbait, I would call it. Like, "This is the one secret that will cause Apple to go through the roof." Or, "This company is partnered with Apple. You need to click on this link to check it out and make bajillions of dollars."

The bottom line is this. A yearly report published by an organization called Dalber, D-A-L-B-E-R, shows consistently, since 1994 they've been doing this research, the average investor earns less, in many cases, much, much, less, than the average stock market return. Whether they'd be picking mutual funds, or individual stocks. When you're looking at the past 20 years, average mutual fund investor underperformed the stock market by nearly 5%. In 2014 alone, the average mutual fund investor, meaning the person who's going out and they're picking their own funds, underperformed the stock market by slightly over 8%. That's not good, when you're trying to go it alone, pick your own stocks.

This is what I used to do. This is how I lost a bunch of money. I used to go to the Motley Fool. I did the research. I bought Caterpillar on their recommendation, through one of these portfolios that they talked about. Lost a bunch of money. I did the research. I looked at Caterpillar. I thought I knew about Caterpillar. It makes sense, right? They make trucks. They move earth. Who doesn't need the earth moved? Construction projects. They're all over the place.

Here's the thing about stock tips. Once you get the information, it's already been acted on. I hope that makes sense. By the time you get the newsletter, everybody else has already bought it, done something with it, or sold it. You get the information late. It's called, haven't mentioned this before, the efficient market hypothesis, if you wanted to do some research on that. It's the efficient market hypothesis. That is all I'm going to say about it. I'm just going to tell you the name. Sometimes on the show, we might be talking about Michael Kors at the outlet malls, and whether that's a good deal or not. Whether you should buy his clothes at the outlet malls. To go from there, and then to drift into efficient market hypothesis, the cats that are listening to this show, they'd be in an uproar. They would say, "Go talk about cat food. Let's not talk about this deep stuff."

Or not. Do you want to go learn about that? Feel free. It's a little bit in the weeds for this show.

A robo-advisor. Should that be a good option for you? You said in your e-mail you don't want to spend a lot of time investing. That is another reason not to try to pick individual stocks and get out of these newsletters and stuff. Services, all that. There are professionals who do this full time. Can not beat the market. For you to do it part time, sorry, you might win occasionally, but over the long haul, you're in your mid-30s, talking about 30 years out, just not going to happen.

What are your options? You can figure out your own funds, your own asset allocation, and doing the rebalancing yourself once a year. There are certainly sites that will tell you, "Buy this, and this, and this and this and this. These mutual funds, and these percentages, based on your risk tolerance." There's something that you can look at called the three fund portfolio. That is the total stock market index fund, the total international stock market index fund, and the total bond index fund. Three funds. One, two, three. That just buys everything. It's excellent diversification. It's pretty simple to do. A lot of people do it. It does better than most other options.

Next, you can get an advisor, if you want to pay somebody for a couple hours of their time, to look over your situation. Option number two. Less work on your behalf. Costs a little more. Next one, go with a robo-advisor, as you mentioned. I think Betterment would be a fine, low cost option for you right now where you are in life. It does the asset allocation for you. You just peg your risk tolerance, your retirement horizon. It's a good risk of funds. It's a low cost. Spend time with your family. Enjoy the kids.

Some year, when you have more time, and you want to dig in a little more, you might find something that performs a little bit better, but when we're comparing something like a three fund portfolio where you're buying everything, compared to going with Betterment, if you're looking on the first couple, three, five years, the amount of money between the two that it's going to grow is a little bit insignificant. When you're talking 20, 25, 30, 40 years, it can be significant, but in the short term, you've got time to play with and just enjoy life. Pick a good solution, and then over time, make the decision to learn a little bit more. Maybe do one of those other options and get a little bit better solution.

Go pour yourself another cup of coffee. I'll be back in a few seconds.

Hey, nation. Scott Alan Turner here. Now, for those of you that are my long time listeners, you know I'm not one of those guys on the radio who promotes every product that shows up on their desk. You're never going to hear me trying to get you to buy sheets, because who cares about sheets? Or recommending you to spend your hard-earned money on blinds, because curtains are cheaper. No. I have a name to uphold to you, the Rock Star Nation.

If I were to recommend something to you, I would tell you about the Sugar Shack. Offering all kinds of high quality sugar to meet your daily dietary needs. Brown sugar, in both light and dark varieties. Granulated sugar. 3x powdered sugar, 5x powdered sugar, and even the king of powder, 10X powdered sugar. Raw cane sugar, sugar cubes, sugar packets, even individual sugar cubes in portable packets, guaranteed to pass inspection at airport security lines. Take that, TSA. Even seasonal varietals, like maple syrgar in the spring, and honey in the summer. Mmm. High fructose corn syrup? You won't find that garbage at the Sugar Shack. Sugar Shack. Tell them Scott Alan Turner sent you.

Norman says,

Norman: "I am currently struggling to keep my nerve with the market fluctuations that are going on. I'm making regular weekly payments into my superannuation fund, using dollar cost averaging, but the value of the fund is reducing because of the falls in the share prices. Instead of investing in superannuation, I could be paying more off my mortgage." So, superannuation. Hopefully I'm saying that right. Superannuation. That's a company pension plan. That's a term used in Australia.

Scott A. T.: In the dot com bubble crash, I was a bad investor. One of my money moron moments. I tried picking individual stocks, and when the market tanked, I rode it all the way to the bottom. That's what most people do. We buy when stocks are at their highest, and we sell when they're at their lowest. That's the exact opposite of what you should be doing. Market timing does not work. Study after study after study, after study after study, shows this. By Nobel Prize-winning economists, college researchers, all kinds of studies out there. You can't time the market and win. Investing is for the long haul. 5, 10, 15, 20, 25, 30, 45, 50 years. There's countless studies of dollar cost averaging, and show that people do better by doing exactly what you're doing, which is buy month after month after month, year after year after year, during the highs, during the lows, when it's tanking, when it's crashing.

In 2008 and 2009, our last market correction, as the market slid down 50% in value over a period of 18 months, my wife and I, we invested month, after month, after month. Rode it all the way to the bottom. We invested a lot of money. As much as we could. That year, I had earned more money than I have ever had in my lifetime. I bought, and bought, and bought, and bought, and bought.

Most of my net worth is tied into the stock market right now. 60% to 70%. What am I doing? 2016. Market's going to crash, right? Everybody's calling it, saying it's going to crash. What am I doing? Nothing. It's money I'm not going to use for decades. If my investments lose 50%, I will have the exact same number of shares that I do today. When the market comes back in so many years, I'll be right back where I started. The market earns 10% over time, over a period of decades. Is the market going to tank this year? Well, many people think so. Others do not. Do I care? No. Do I care if I lose half of my net worth on paper? No. I don't need the money right now. If I lost half my net worth in some risky business venture, oh yeah, you bet your butt I'm going to care. I know the stock market is going to come back, because it's historically proven to do so. I don't even think about it.

Would I pull all my money out to pay off my mortgage that has a guaranteed return on your interest rate? I would make sure I'm saving 20% towards retirement, then I'd work on putting more towards the mortgage. Keep on buying, people, as the market goes down. You'll be able to buy more shares. When the shares increase in price, you will make more money. That's how dollar cost averaging works. That is how wealth is built. Trying to guess when to get in and out of the market means that you've got to have some kind of crystal ball to see into the future. If you can do that, you are in the wrong business, my friend.

I get it. People are worried about losing some of their retirement, because of the horror stories in 2008, 2009. The people who got killed, were A, they were in individual company stocks, and that company tanked and never recovered, or they got out at the bottom after the crash, and they never got back in. They weren't in it when the market came back up. They never made back their money. They got scared, lost a bunch, and that's their frame of mind. "I lost half my money." Well, you lost half your money, because you sold it at the bottom, and you didn't get back in. You should have stayed in. You would have made your money back.

It's emotional, but smart investing requires logic. The type of logic that Mr. Spock of Star Trek has. Logic is found in research and studies. Go out and do your research on dollar cost averaging, market timing, you will find it does not work. The winners are the one that stay in for the long haul. Live long and prosper, Norman.

Big win, Rodion, 100%, absolutely, completely out of the hole. Doesn't owe a penny to a single person. Completely debt-free. Says,

Rodion: "I'm on my way to financial freedom, saving money and working, looking for a better job and more to save for my retirement." Congratulations, dude. You did it. You're in the band.

Scott A. T.: Financial success is not determined by your knowledge, but by your actions. That famous quote is from me. Those are the words.

That's it for this episode. I'm your host, Scott Alan Turner. Rock Star Katie is my producer. All the links mentioned in the show are available in the show notes on ScottAlanTurner.com. If you have a question you'd like answered on the show, visit GoAskScott.com. Thanks for listening.