# 30: All About 401(k) Plans


## Full Episode Transcript

**With Your Host**

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Welcome to The Wealthy Mom MD Podcast, a podcast for women physicians who want to learn how to live a wealthy life. In this podcast you will learn how to make money work for you, how you can have more of it and learn the tools to empower you to live a life on purpose. Get ready to up-level your money and your life. I'm your host, Dr. Bonnie Koo.

Welcome back, everyone. Today, we're going to talk about 401(k)s. They're probably the most well-known type of retirement plan, so I wanted to spend a whole episode chatting about them.

Most of us only know about them in the context of the plan we get access to when we get a job. But there are also some other types, like the individual or solo 401(k), if you're self-employed. And then, there's a specific type of a 401(k) known as a self-directed 401(k). We're going to go over all of these today.

So, first, let's talk about general rules. The 401(k) is a plan that an employer sponsors. Meaning you can't just go and open one yourself unless you're employed. You could be the employer as well, and then you can open a solo 401(k).

So, there are IRS rules for the 401(k) and then there are rules of the actual plan that you have. By the way, the reason why it's called the 401(k) is because it's literally named after the section in the IRS code. So, for this, it's something like part 401, subsection K. Yeah, not very creative, right?

So, the plan rules are generally more restrictive than the IRS rules because there's the rules that the IRS make saying, "This is a 401(k). This is what you can do with it, et cetera." But then each individual plan can also do what they want, as long as it follows the IRS rules.

Let me give you an example. Right now, the IRS code says that an employee can take out a loan against a 401(k) up to $50,000. Now, just because the IRS says you can do that, doesn't mean that your plan lets you take out a loan.

A good example of this for 2020 is with the CARES Act. So, in case you're listening to this not in 2020, the CARES Act was one of the stimulus bills passed by congress where you were allowed to take up to a $100,000 loan from your 401(k). So, this is above and beyond the normal $50,000. And you could wait up to a year to start repayment. Now, just because the CARES Act was passed, does not mean your plan will actually allow you to take $100,000 out.

Now, let's talk about the cost of having a 401(k). Now, most plans charge a fee. Sometimes, it's a very nominal flat yearly fee. Sometimes called an administrative fee. And then sometimes, there are transaction fees for every time you make a trade, meaning whenever you buy or sell something.

And then, there's the cost of whatever you buy. For example, for the most part, most of us who have 401(k) plans are going to invest in index funds or ETFs. And then those have an inherent cost known as the expense ratio. So, if you have a list of the funds available for your 401(k) in terms of what's available for you to invest in, next to the name of the fund, there's generally a percentage next to it called the ER, or expense ratio.

And so, that's just a small fee that you'll be paying as well. Now that we're talking about index funds or ETFs, what can you invest inside of a 401(k)? So, for a 401(k), you can actually technically invest in anything. However, like I said, most plans will give you a list of index funds or ETFs. Some of the better plans will actually let you open your 401(k) anywhere else, so you can have more say in what you invest in.

Now, I want to say real quick, I'm talking only about 401(k)s. 403(b)s, while similar, are slightly different. They're very similar in terms of the amount you can contribute per year and things like that. But they differ in that 403(b)s are for nonprofit companies. So, a lot of hospitals will fall into that, right? And within a 403(b), you can only invest in an index fund or an annuity. So, that's an important distinction there.

So, before we move onto more specifics, I want to briefly talk about asset protection. Meaning, if the unthinkable happened and you were sued above your malpractice limits or you were sued personally for something else, is your 401(k) protected against creditors, against bankruptcy, et cetera?

So, the good news is that employer-sponsored 401(k)s that are not individual 401(k)s are protected by something called ERISA. You don't have to quite understand what ERISA means. But just know that an employer-sponsored 401(k), so if you're someone who's employed by a private company or a private practice, your plan is protected against creditors.

Now, I mentioned, unless you have a solo 401(k). So, that's an important distinction. An individual or solo 401(k) is not ERISA protected. So, that's something to keep in mind. How big is this risk? Is this something you really have to worry about?

Now, this isn't an episode about asset protection. However, I will say that many physicians and other high-income professionals, we kind of overestimate our risk. Now, obviously, your risk depends on many factors. And I'm not going to cover that today. But just know that if you do have an individual or a solo 401K, it is not technically protected by ERISA, okay.

Okay, let's get into some more specifics. So, as you know, if you have a 401(k), you know that you have a contribution limit per year. Now, there's two types of contributions. There's the employee, which is you, and then there's your employer contribution, if any. So, many of us work at a place and you know that you can contribute up to – in 2020 at least - $19,500 a year.

Most of us will just kind of average that over a year. So, when you log into your plan, you kind of elect how much you want to contribute per year. And every plan does it differently. Sometimes, you have to pick a dollar amount. And sometimes, you pick a percentage.

Now, the plan should automatically stop contributions once you meet that annual max per year. Again, in 2020, it's $19,500. And generally, it goes up a little every year to kind of keep pace with inflation.

Now, think of the 401(k) as a bucket. So, the total bucket is $57,000 in 2020, meaning that your employer can contribute $57,000 minus your $19,500 contribution. Now, most employers are not that generous. But there are very generous employers out there.

Now, I had a 403(b) plan as my first job out of residency. And I forget the exact percentage that they contributed, but it was something like $20,000 a year, which is pretty awesome, right? But still, you can see that I still quite get that maximum bucket of $57,000 a year. I think it was more like $54,000 when I was working, but you get the point.

So then, you might ask, well how do you actually fill up that $57,000 and some other provisions? So, let me give you some other examples. So, some plans let you do something called an after-tax non-Roth contribution. Now, I have a previous episode where I talked all about Roths, including Roth IRAs, including the mega backdoor Roth IRA.

Some 401(k) plans will let you do something called an after-tax non-Roth contribution. What does that mean? That means that beyond the $19,500, which is generally pre-tax, but it can be a Roth contribution instead, you can actually contribute above that amount. But it doesn't count towards your employee maximum of that $19,500 in 2020.

So, why would you want to do this? I recommend going back to the episode on Roths to find out more about the mega backdoor Roth IRA. But basically, if you're allowed to contribute non-Roth after-tax contributions, then you could potentially fill up that $57,000 bucket.

Now, I don't recommend going to above that you miss an employer contribution, if there is one, because that wouldn't make sense because that's just free money. If you're able to do these non-Roth after-tax contributions, then you can actually move or convert that amount directly into a Roth IRA. And that is pretty powerful, right? Because generally speaking, the Roth IRA annual contribution limits are on the lower side, around $6000.

One thing I want to add is that if you are 50 or older, you get a little bit of a break. You can do what's called a catch-up contribution, which is an additional $6500 in 2020. So, what does that mean? That means that you can do your $19,500 contribution but you can also do an additional $6500 on top of that. Not only that, but that bucket of $57,000 also goes up accordingly. So, now it's $57,000 plus an additional $6500 if you want to fill up that whole bucket.

Now, I want to say something about employer contributions. So, when you get your job and you get all your documents, I want to make sure that you ask human resources for a document called the SPD, which stands for summary plan description. This is basically the bible for your specific employer plan.

Here, you will find all the information about what your plan allows and what the rules are. So, it's a document that your HR person can definitely give to you. They don't usually give it out from the get go. You'll get more like a distilled summary version of what's allowed.

If you really are curious and want to know all the rules, then you can ask for this document and they should be able to send it to you in a PDF form. And so, one thing that will be listed there and should be in your summary anyway is how do employer contributions work? Meaning, how often will they contribute or match? And also, are you vested automatically?

So, what of vesting? Vesting is sort of the process where, if your employer does give you a contribution or a match, do you get to keep that money right away or do you have to wait a certain amount of time? Now, there's two types of vesting. There is cliff vesting and there is gradual vesting.

So, I had gradual vesting at my first job. What does that mean? Well, it kind of is what it sounds like, right? So, gradually, over time, I would be vested. I forget the exact specifics, but it was something like after year one, I was 10% vested. After year two, I was 20% vested. You get the point.

And I think I had to be at the job for five years to be fully vested. So, what that means is if you leave a job before your fully vested, whether it's cliff or gradual, you may not be able to keep all of that employer match or contribution.

Now, this is something that kind of makes sense, right? A lot of employers will institute this to kind of promote loyalty, because they want you to stay at the job. Cliff vesting means that you have to wait until a certain date before you get vested completely, versus gradual.

Now, I want to talk about two things in terms of using your 401(k). Many of you probably know that, if you try to remove money before you are 59.5, you'll be slapped with a 10% penalty in addition to paying income taxes if you made pre-tax contributions.

So, while this is true, many people don't know that there's something else called the SEPP. Which stands for substantially equal periodic payments. I'm not going to go into the details, but I just want you to know that there is a way to take out money before the age of 59.5 without facing that early withdrawal penalty.

Now, this is something that, once you do, however, you have to keep taking the money out. This isn't a one-time thing, so you can- just take your money out tax-free, or rather penalty-free. But I just want you to understand that, let's say you do retire early and you want access to your 401(k) but you don't want to pay that penalty. You want to look into that thing called SEPP or substantially equal periodic payments.

Now, I've said a few times that you can make pre-tax or Roth contributions. And so, that's important to note. Not all plans will offer a Rot contribution. All plans will offer a pre-tax contribution option, also known as a traditional contribution. So, people always ask, should I make a pre-tax contribution or should I make a Roth contribution?

And that question is kind of hard to answer because it depends on so many factors, how you're planning to make your money or retire, et cetera. So, it really depends on your tax burden at the end of the day.

Most physicians are in a very high-income tax bracket. Couple that with a high cost of living area that has high state taxes and maybe even high local taxes – I'm thinking places like California, New Jersey, New York State – then a pre-tax contribution would make sense because every dollar you pop into your 401(k) is one less dollar of your gross income. And so, that just makes sense.

So, when you leave the job, what do you do with your 401(k)? Generally speaking, there are three options. Again, it depends on the actual plan. So, many people will just leave it at their job. And many plans allow you to do that.

Another option is to roll it over into an IRA, which is an individual retirement account. This is not the same as a Roth IRA. And so, this is an IRA you can open up at Vanguard, Fidelity, Charles Schwab, places like that.

And then, the third option is to roll it over to the next job's plan. I'm personally in favor of simplifying and consolidating accounts just so you don't have to keep track of multiple accounts. Also, remember, most plans have some sort of administrative fee. And so, you're going to reduce your overall fees by having a lesser number of accounts.

So, if you don't have a job right away or don't know if you'll have one, or sometimes the new job, unfortunately, will not let you even open a 401(k) until you've been there for a year – that does happen and that's a common question I get asked, "Can you do anything about that?" No, because it probably is the way the plan works, meaning it's part of the SPD, or the summary plan description. And they can't make exceptions just because you ask. It's just the way the plan is.

So, I want to talk about solo 401(k)s or individual 401(k)s. This is a specific type of a 401(k) plan that you open if you are self-employed. So, some common examples for physicians are those of you who are locums or those of you who are 1099 employees.

Now, even if you are a regular W-2 employee at a hospital, you might have a side gig where you're doing things like expert witness work or maybe some consulting, et cetera. In which case, you're getting 1099 income, in which case, you can open up a solo 401(k).

Now, do you have to open one? No. But it's a great way to reduce your tax burden. Remember, any amount you contribute pre-tax will lower your gross taxable income.

Now, remember what I said. There's the employee contribution of $19,500, then there's a total bucket of $57,000 in 2020. Now, if you have multiple 401(k)s, you're only allowed to do one $19,500 employee contribution across all of your 401(k) plans. However, you still have that employer contribution, which can be the full $57,000, right?

So, if you are an employed physician and you have 1099 income, you probably can't do that employee contribution of $19,500 in your individual 401(k). But you can do an employer contribution.

And so, the next question might be, how do I know, or how much can I put in as an employer? That's a great question. I generally just ask my CPA how much I can put in. But the quick and dirty math is about 20% of your net income. Net income meaning gross income, minus any expenses that you're going to write off on your taxes. It's around 20%. It's not quite 20%, but that's a quick and dirty rule to kind of see if you have enough money or income to put into your solo 401(k).

So, the next question I get is, where can I open an individual 401(k)? There are so many places. But the big custodians like Vanguard, et cetera, they pretty much all offer an individual 401(k) plan. They're generally limited, though.

Now, these places like Vanguard, Charles Schwab, Fidelity, I'm pretty sure their individual 401(k) plans are free, meaning they don't have any administrative fees. They just have the fees associated with the funds that you purchase.

But be sure to read the fine print because they are free, they kind of give you a cookie-cutter individual plan, which is probably fine for most of you out there. But if you want more features, meaning you want the ability to take out a loan – remember, it's $50,000 – or you want some other options, you're probably not going to get them at these types of plans.

And one thing I do want to say is that at the time of this recording, Vanguard's plan, I don't recommend. And that's only because they don't allow rollovers, meaning if you have a solo 401K, and let's say you switch jobs and you want to move your employee A, employer A's money into your solo 401(k), you can't do that. Which is kind of unfortunate because that is a big perk of having a solo 401(k), that you can roll over other types of accounts into it.

Now, I opened a solo 401(k) a few years ago and I opened up at TD Ameritrade. What's great about TD Ameritrade's plan, at least at the time when I opened it, they had a Roth option. I don't know if Vanguard offers one, but that's something that you want to have the option of. That's something you want to look into.

Now, I've actually since moved my solo 401(k) out of TD Ameritrade into a different plan. I specifically created a self-directed 401(k). So, that's what I want to talk about right now.

So, what is a self-directed 401(k)? So, it kind of is what it sounds like; self-directed. Meaning that you get to direct the investments, which means you have a lot more choices besides the regular stocks or ETFs or index funds or annuities, et cetera. You have a lot more options.

You can invest in real estate, direct and passive, like syndications or debt funds. Now, a self-directed 401K is a great place to invest in a real estate debt fund because the debt fund profit is taxed at your marginal tax rate, which kind of blows when you're at a high tax bracket, right? But if you do it inside of a self-directed 401(k), or even better, inside of a Roth IRA, then those returns are tax sheltered until you take it out.

And so, where do you open a self-directed 401(k)? Again, there are many, many, many options. I personally opened mine up with a company called eQRP. Now, eQRP is the brand name. It's not an actual type of a plan in terms of being identified in the IRS code.

However, QRP stands for qualified retirement plan, and so the eQRP is a specific type of qualified retirement plan and it is basically a self-directed 401(k).

Now, I chose the eQRP for a few reasons. I chose the eQRP because I did want the ability to self-direct the funds and invest in syndications, et cetera. I also wanted checkbook control. I wanted to eliminate the middle man.

Now, if you have a 401K or even a Roth IRA, et cetera, you kind of know that it's not super-easy to get the money out or do transactions. You have to go through a middle man. But with a self-directed 401(k) that has checkbook control, I literally have a checkbook and, if I want to take money out or invest in something, I can literally write a check. Now, for the most part, I don't really write checks. I just do an ACH transfer because that's just easier.

Another unique thing about the eQRP is that it has more protection than a regular solo 401(k) because they have an LLC wrapped around the account. So, I've had the eQRP for about a year now and, so far, I've used it to invest in one syndication fund, and I've also been able to take out money through the CARES Act via a distribution to use to invest in direct real estate.

A self-directed 401(k) is a great way to start investing in passive real estate since you regularly can't do that with a regular employer 401(k) plan. We'll link to all the things we talked about in this episode in the show notes, including how to learn more about the special eQRP.

Okay, so now you know all about a 401(k) plan and you know the sort of general rules and also the types of options you have, including self-directed 401(k) plans. If you want to learn more about your specific employer plan, then like I said earlier, ask HR for a copy of the SPD, or summery plan description, and then you can skim it to see what's available for your plan.

I've had many of my students in Money for Women Physicians find out that they can do things like a mega backdoor Roth IRA, or that they can make Roth contributions instead of pre-tax. And so, it's just really important to understand your plan so you can take full advantage of what it has to offer.

Okay, I'll see you next week, everyone.

Hey, if you're a woman physician who is ready to practice medicine on your terms, then you've got to check out my program Money for Women Physicians. It's part course and part coaching and 100% guaranteed to put more money in your pocket. Go to wealthymommd.com/money to learn more.