Retirement Planning Insights

March 2023

Tenon Financial Happenings

- Tenon Financial is growing!

Retirement Planning Happenings

- After-tax "basis" in IRAs

Tenon Financial Happenings

An introduction to Tenon Financial's new advisor

I'm super excited to announce there will now be a second advisor at Tenon Financial. Please join me in giving a warm welcome to Michelle Wu!

Michelle and I first met (virtually) on LinkedIn a few months ago. She started her own advisory practice in early-2022 and reached out to me to chat about my experiences in starting Tenon Financial.

I wasn't necessarily looking to hire or grow at the time. However, the more we talked, the more I realized she was the exact type of person I would want to hire if/when I were to hire someone.

After our initial conversation, we talked a few more times about what working together might look like. She then sat in on a few of my end-of-year client meetings to get a feel for the type of clients I work with and the type of planning I do. Finally, we met in-person at the end of December to discuss things some more. We ultimately decided it made a lot of sense for us to work together, so here we are!

Michelle and I have similar backgrounds; roughly 20 years of experience in corporate and institutional banking and investments, as well as undergraduate and graduate degrees in finance. Though I have to admit her educational pedigree is much more impressive than mine; I went to University of Delaware and Rutgers whereas she went to NYU and Columbia.

Also, our reasons for leaving the corporate world to start our own advisory businesses are very similar; to do something more fulfilling and meaningful with our professional lives while having more flexibility and control over how our professional and personal lives dovetail together.

Michelle is a Chartered Financial Analyst (or "CFA," which is the most prestigious investment-focused designation in the industry), a CERTIFIED FINANCIAL PLANNER™ ("CFP®") and is days away from becoming a Retirement Income Certified Professional® ("RICP®").

And as you can tell from her picture, she likes the outdoors!

Michelle will be a second advisor at Tenon Financial. I'll continue being the advisor for the clients I currently work with, and I still have no plans of taking on new relationships myself. We, as a firm, will be taking on new clients in the near-term, where

Michelle will be the advisor on all such new relationships.

She and I will be a cohesive team where we'll work closely together behind the scenes, bounce ideas and questions off each other, help cover one another when we're out and time-sensitive things come up and need to be addressed, etc.

Her focus will be the same as mine and Tenon Financial as a whole: ongoing tax-efficient financial planning and investment management for those in or near retirement, all for a flat annual fee.

I will continue to work out of Tenon Financial's corporate headquarters in Metuchen, NJ. Michelle will work out of her current location, just north of Boston. The expectation is she and I will continue to operate Tenon Financial as a virtual advisory practice; where client relationships are conducted mainly through Zooms, e-mail and/or telephone. However, the intention is we'll slowly make the travel rounds across the country to eventually meet clients face-to-face at some point.

If you're interested in potentially working with Michelle and would like to find out more about Tenon Financial's service and fees, check out **https://tenonfinancial.com/services-and-fees**.

We haven't yet ironed out the exact timeline or process for how and when we'll start having formal introductory calls with people who are interested in working together.

I suspect it will take a month or two of training and acclimating before Michelle and I feel it's the right time to begin setting up intro calls for new relationships.

While I don't especially like the notion of having a "waitlist," I think that is what we're going to have to do. For the benefit of new clients and Tenon Financial alike, the plan as of now is to ensure new relationships are added at a manageable pace.

With that said, if you'd like to have an introductory call to see if working with Tenon Financial might be a mutually good fit, please send an email to **hello@tenonfinancial.com**.

We'll keep track of everyone who reaches out. Then, when we start setting up the formal introductory calls, we'll coordinate the scheduling with everyone.

Thank you in advance for your consideration; Michelle and I greatly appreciate it!

Separately, unrelated to Tenon Financial, I wanted to make you aware of another advisor I recently had the pleasure of crossing paths with, who offers a unique service to a very specific segment of folks.

Alan Caldwell, CFP® is the owner of **On Track to Retire** through which he provides retirement planning and investment advisory services. However, whereas most advisors require management of clients' investments and generally have an investable asset minimum, Alan does NOT directly manage investments and he has income and asset MAXIMUMS (not minimums).

Alan's mission is to provide financial planning and investment advice (without directly managing investments) for a reasonable fee to an underserved set of people; single people with a maximum annual income of $130k and maximum investable assets of $200k, and/or married couples with a maximum combined annual income of $200k and maximum combined investable assets of $300k.

He provides an ongoing financial planning & investment advisory service for $950 per year. Separately, he also offers a pure hourly service at a rate of $120 per hour.

This is Alan's "encore" career after a 24-year career at Ford Motor Company in financial management. Four years ago, he started On Track to Retire out of a passion to provide cost-effective financial planning & investment management services to those who are underserved yet could very much benefit from such services.

If you're interested in learning more about Alan and his services, check out **On Track to Retire**.

I should mention I have no incentive to mention Alan or his company. I receive no referral or finder fees and I'm in no way compensated for making mention of him or On Track to Retire. I simply want to help spread the word about a service I think many have been looking for but haven't thus far been able to find.

That's a wrap for this month's newsletter. Thanks as always for reading!

-Andy

Retirement Planning Happenings

Understanding after-tax "basis" in IRAs and Form 8606

An Individual Retirement Arrangement (or "IRA") is a type of investment account designed to help people save and invest for retirement.

The Internal Revenue Service ("IRS") grants IRAs a special "qualified" tax status that allows deferral of taxation on money contributed to, and investment growth that occurs within, IRAs. Generally, IRAs are only taxed when money is distributed from them. Specifically, distributions are taxed as ordinary income in the years they occur.

Additionally, "converting" money from a traditional IRA to a Roth IRA is essentially another form of distribution. As such, Roth conversions are similarly taxed in the year they occur.

Contributions to IRAs can reduce a person's tax obligation in the year of the contribution as the IRS often allows the contribution to be deducted from that year's taxable income. For example, if someone has $100,000 of gross income for the year but makes a deductible $6,500 contribution to an IRA, that person's gross income is then reduced to $93,500 (which means their taxable income is reduced as well).

Considering the money that goes into an IRA is often tax deductible, and considering the gains within an IRA are tax-deferred, it's said that money inside an IRA is "pre-tax," in that it has not yet been taxed.

When an IRA contains entirely pre-tax money, the tax implications of taking distributions (or doing Roth conversions) are easy; every dollar that comes out of the IRA is fully taxable as ordinary income in the year it comes out.

However, it's possible for IRAs to have some already-taxed money in them; IRAs aren't required to be purely pre-tax money. Already-taxed (aka "after-tax") money inside an IRA is formally called "basis" in IRS lingo.

You get basis inside your IRA when you contribute money to it and are not able to deduct the contribution (or you choose not to). Long story short, the IRS places income-based limits on taxpayers' ability to deduct their IRA contributions. For 2023 and 2023, you can find the IRS summary of those limits **here**.

Having basis in your IRA isn't necessarily a problem. The good news is since that basis was already taxed in the first place (i.e. you weren't able to get a tax deduction for it when you contributed it), you won't be taxed on it again when you eventually distribute it or convert it to a Roth IRA.

However, whenever doing a distribution or Roth conversion from your IRA, you unfortunately can't pick and choose whether you take out the pre-tax money or the basis. Every dollar that comes out will have to be prorated such that some of it will be a tax-free removal of your basis and the rest will be a fully taxable removal of your pre-tax money.

Think about this proration concept like putting cream into coffee. Assume you have a cup of black of coffee in front of you. Consider that black coffee an IRA that has purely pre-tax money in it. Next assume you pour some cream into the cup. Consider the cream basis, or an after-tax contribution to that IRA. Now, stir the coffee.

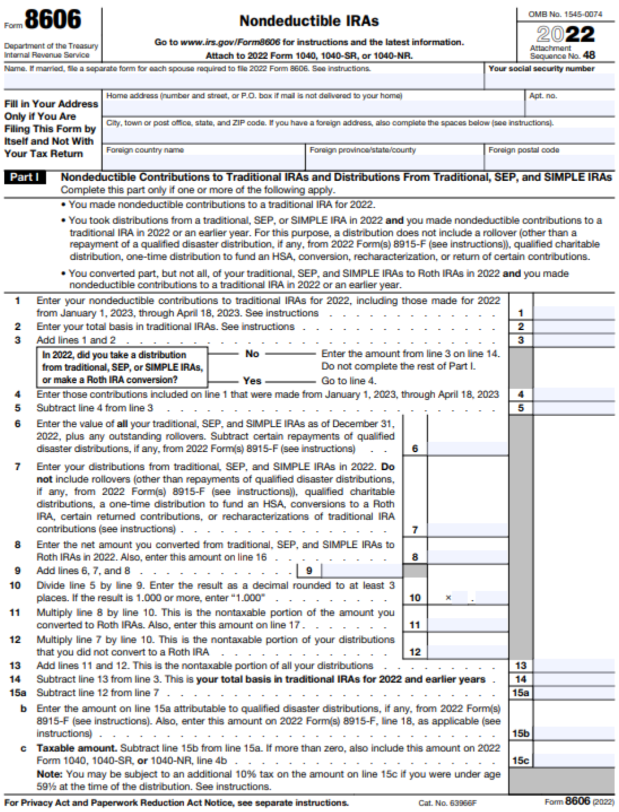
After stirring, what you have is a mocha-colored homogenous mix. Every sip you take will be a mix of coffee and cream. In other words, you can't sip or skim out just the coffee or just the cream; the two are inextricably mixed such that every sip will be a prorated portion of mostly coffee, but with a bit of cream.

Proration of IRA distributions or Roth conversions work the same way. For example, assume you have an IRA where the only thing in it is $95 of pre-tax money. Then assume you put in $5k of contributions where you aren't able to take a deduction. You just added $5 of after-tax basis to your IRA.

At this point, you have an IRA worth $100 in total. 95% of it is pre-tax money and 5% of it is already-taxed basis. Therefore, due to proration, every dollar you take out (via distribution or Roth conversion) will be treated as 95% pre-tax money and 5% basis. In other words, 95% of every dollar distributed or converted will be taxable; 5% will be tax-free.

There is more to it than this (specifically, the proration calculation only looks at your IRA balance(s) as of December 31st of the year of the distribution or conversion, and it looks at the balances of ALL of your IRAs aggregated together), but this is the gist of how IRA proration works.

The proration calculation is done via **Form 8606**, which is an additional form you have to include in your tax return for every year you have (or had) basis in any of your IRAs.



Form **8606**
Department of the Treasury
Internal Revenue Service

Nondeductible IRAs

Go to *www.irs.gov/Form8606* for instructions and the latest information.
Attach to 2022 Form 1040, 1040-SR, or 1040-NR.

OMB No. 1545-0074
2022
Attachment Sequence No. **48**

Name. If married, file a separate form for each spouse required to file 2022 Form 8606. See instructions. | **Your social security number**

Fill in Your Address Only if You Are Filing This Form by Itself and Not With Your Tax Return
Home address (number and street, or P.O. box if mail is not delivered to your home) | Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete the spaces below (see instructions).
Foreign country name | Foreign province/state/county | Foreign postal code

Part I **Nondeductible Contributions to Traditional IRAs and Distributions From Traditional, SEP, and SIMPLE IRAs**
Complete this part only if one or more of the following apply.

- You made nondeductible contributions to a traditional IRA for 2022.
- You took distributions from a traditional, SEP, or SIMPLE IRA in 2022 **and** you made nondeductible contributions to a traditional IRA in 2022 or an earlier year. For this purpose, a distribution does not include a rollover (other than a repayment of a qualified disaster distribution, if any, from 2022 Form(s) 8915-F (see instructions)), qualified charitable distribution, one-time distribution to fund an HSA, conversion, recharacterization, or return of certain contributions.
- You converted part, but not all, of your traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2022 **and** you made nondeductible contributions to a traditional IRA in 2022 or an earlier year.

1 Enter your nondeductible contributions to traditional IRAs for 2022, including those made for 2022 from January 1, 2023, through April 18, 2023. See instructions . . . 1
2 Enter your total basis in traditional IRAs. See instructions . . . 2
3 Add lines 1 and 2 . . . 3

In 2022, did you take a distribution from traditional, SEP, or SIMPLE IRAs, or make a Roth IRA conversion?
No — Enter the amount from line 3 on line 14. Do not complete the rest of Part I.
Yes — Go to line 4.

4 Enter those contributions included on line 1 that were made from January 1, 2023, through April 18, 2023 4
5 Subtract line 4 from line 3 . . . 5
6 Enter the value of **all** your traditional, SEP, and SIMPLE IRAs as of December 31, 2022, plus any outstanding rollovers. Subtract certain repayments of qualified disaster distributions, if any, from 2022 Form(s) 8915-F (see instructions) . . 6
7 Enter your distributions from traditional, SEP, and SIMPLE IRAs in 2022. **Do not** include rollovers (other than repayments of qualified disaster distributions, if any, from 2022 Form(s) 8915-F (see instructions)), qualified charitable distributions, a one-time distribution to fund an HSA, conversions to a Roth IRA, certain returned contributions, or recharacterizations of traditional IRA contributions (see instructions) . . . 7
8 Enter the net amount you converted from traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2022. Also, enter this amount on line 16 . . . 8
9 Add lines 6, 7, and 8 . . . 9
10 Divide line 5 by line 9. Enter the result as a decimal rounded to at least 3 places. If the result is 1.000 or more, enter "1.000" . . . 10 × .
11 Multiply line 8 by line 10. This is the nontaxable portion of the amount you converted to Roth IRAs. Also, enter this amount on line 17 . . . 11
12 Multiply line 7 by line 10. This is the nontaxable portion of your distributions that you did not convert to a Roth IRA . . . 12
13 Add lines 11 and 12. This is the nontaxable portion of all your distributions . . . 13
14 Subtract line 13 from line 3. This is **your total basis in traditional IRAs for 2022 and earlier years** . 14
15a Subtract line 12 from line 7 . . . 15a
b Enter the amount on line 15a attributable to qualified disaster distributions, if any, from 2022 Form(s) 8915-F (see instructions). Also, enter this amount on 2022 Form(s) 8915-F, line 18, as applicable (see instructions) . . . 15b
c **Taxable amount.** Subtract line 15b from line 15a. If more than zero, also include this amount on 2022 Form 1040, 1040-SR, **or** 1040-NR, line 4b . . . 15c
Note: You may be subject to an additional 10% tax on the amount on line 15c if you were under age 59½ at the time of the distribution. See instructions.

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 63966F Form **8606** (2022)

There are two pages and a lot of lines to Form 8606, so it looks kind of intimidated. However, if you walk through the form line-by-line, it's actually fairly straightforward to follow and understand.

A full walkthrough of Form 8606 is beyond the scope of this newsletter, but I thought it was worth at least making you aware of its existence and why it's important.

There are a handful of times in which you are required to fill out and include Form 8606 with your tax return. The full instructions to Form 8606 are detailed here.

But in a nutshell, the most common instances when it's necessary to fill out and include Form 8606 with your tax return are for any years in which you:

- made a non-deductible contribution to an IRA
- received distributions, or did conversions from, an IRA that contained basis
- did a Roth conversion from a traditional IRA to a Roth IRA
- received distributions from a Roth IRA

While understanding and tracking basis in your IRAs may not be fun, it's important to do as it's very much for your benefit. Basis is money you already paid tax on. If you don't accurately track and report it throughout the years, you won't know how much already-taxed money is in your IRA. And then whenever you eventually distribute or convert money out of your IRA, you will potentially be taxed again on the basis if you didn't properly account for it.

For what it's worth, I suspect LOTS of people don't know about and/or don't track their IRA basis. Which means they're eventually taxed twice on the basis. Not that it makes it okay, but it's probably a lot more common than you think. Nonetheless, you should always try to avoid paying Uncle Sam more than you have to!