My Money Is Worth More Than Your Money

[Editor's Note: This post is republished from WCI Network partner, Physician on FIRE.]

No, Loonie Doc, I'm not talking about your loonie Canadian dollar. Nor am I referring to the measly seventy cents or so that the New Zealand and Australian dollars are now worth (in 2018). This article has nothing to do with exchange rates. Although, friends, it is true that my money is worth more than yours.

Today's post is focused on the value of the American dollar in various retirement accounts. While I have seen a few very detail-oriented people adjust their net worth based on where their money is held, most of us – myself included – just add up the value of all the accounts to arrive at the total. Is that the best approach?

When a Dollar is Not a Dollar

If you've been earning and investing for a while you most likely have money in a variety of account types. Some of those dollars are inherently worth more than others, depending on the current and future tax treatment. Let's take a look at each of those dollars, from the most to least valuable.

Roth Dollars

Roth dollars are the most valuable dollars you can have. If they were a day of the week, they'd be Saturday. You've already paid tax on them, and they will continue to grow tax-free until you use them. These dollars have a value of $1.00. The Roth dollars also benefit from being sheltered from required minimum distributions (RMDs).

While it may not be ideal to make large Roth investments when you are in a high-income tax bracket, particularly if you anticipate a lower tax bracket in retirement, Roth dollars are sure great to have. If nothing else, contribute to a backdoor Roth for yourself and your spouse, if you've got one.

I made one small Roth conversion as a resident, a **Mega Roth conversion** as an attending, and have made backdoor Roth contributions for several years.

30% of our dollars are Roth dollars.

HSA Dollars

Dollars in a Health Savings Account (HSA) are the next best thing. They're like Sunday; it's still the weekend, but not as enticing as Saturday. When used for healthcare costs, the dollars in an HSA act just like Roth dollars.

Even better, you received a tax deduction when you put those dollars in the account. In the year that you contribute, you could say these dollars are *better* than Roth dollars, but after you've received that deduction, **the dollars remaining are at best equal to Roth**, and at worst equal to tax-deferred dollars.

There a couple ways to use your HSA dollars to cover healthcare expenses. One tactic is to use the account to pay for healthcare expenses when they are incurred. A second option is to save receipts, allow your HSA account to grow tax-free for years, then take a large reimbursement for the sum of the receipts after collecting them for years or decades.

The latter approach, saving receipts, has the potential to work out in your favor. You receive the benefit of tax-free growth of dollars that are not withdrawn when the bill arrives. I've begun to implement this strategy, and I'm not convinced the record keeping is worth the small benefit. I'll probably continue to save receipts until we pack up for **[our next adventure]**, and then cash in.

[Post-publication edit: I've cashed in and now choose to pay as we go. It's a tiny portion of my portfolio and saving and tracking receipts is something I found to be cumbersome, but I do understand the benefit of doing it the other way.

*I don't pay directly from our HSA, though. I first put our healthcare expenses on a rewards credit card and then reimburse myself from the HSA. I think **getting free travel** is a bigger benefit than avoiding a bit of tax drag on this small portion of my money.]*

If you end up with more HSA dollars than you can use for healthcare (not bloody likely), you can use the account like a traditional IRA at age 65. The money can be withdrawn penalty-free for any reason, but you will pay income tax if it not used to pay for healthcare expenses. Note that HSA money *cannot* pay for health insurance premiums, but can cover out-of-pocket costs and a lot of other expenses, like orthodontics and eyeglasses.

Flex Savings Account (FSA) dollars can be viewed like short-term HSA dollars, but typically must be used up by the end of the calendar year.

1% of our dollars are HSA dollars.

0% of our dollars are in Swedish krona

Taxable Dollars

"Taxable" sounds bad and expensive, just as "spinal" anesthesia sounds barbaric and scary. The truth is far from the implication from the off-putting word in both cases. Dollars in a taxable account are great dollars to have, and a spinal anesthetic, given below the level of the spinal cord, is often the safest and least invasive anesthetic option.

Taxable dollars are like Friday – part weekday, part weekend. You've already paid taxes on these dollars once, and the worst you'll do is pay some tax on the growth of these dollars. At best, "taxable" dollars can be treated the same as Roth dollars.

How are taxable dollars taxed? If they earn interest in a savings account, the interest is taxed as ordinary income. If you sell a stock or mutual fund that has grown in value, you may owe some taxes on the gains. The same is true for dividends. Gains on equities held at least a year are treated more favorably, as are qualified dividends (as opposed to ordinary, non-qualified dividends).

The more gains you have, the lower the potential value of your taxable dollars. An equity purchased for $100 and worth $100 is currently worth more to you than an equity purchased for $10 and now worth $100. There are **methods to avoid taxes on those gains**, but some are not pretty (death) and some could be eliminated with a change in the tax code.

How can taxable dollars be as good as Roth dollars? A few conditions have to be met, but it is possible.

First, you must have a taxable income that keeps you in the 0%

long term capital gains / qualified dividend tax bracket, which is about $77,000 for a couple in 2018 – a feat **easily achieved by an early retiree**.

Second, the investment must not spin off ordinary dividends or short-term capital gains. Passive index funds are good choices to meet these criteria. Growth stocks tend to pay fewer dividends, and Berkshire Hathaway famously pays none. Finally, your state of residence must treat gains the same way the federal government does. Not all of them do.

52% of our dollars are taxable dollars.

Tax Deferred Dollars

The final category contains your least valuable dollars. Monday dollars. While you have every reason to put as much as you can into tax deferred accounts when you earn a physician's salary, the dollars won't be worth as much as those above when it comes to retirement.

These dollars have not yet been taxed, but when accessed in retirement, you can bet your bottom dollar that they will be. These dollars can be held in a variety of numbered and acronymed accounts, each of which behaves a bit differently, but they all have one thing in common: income tax will apply.*

Unfortunately, many retirees will have most or nearly all of their dollars in tax deferred accounts. This isn't an inherently bad problem, particularly if the balances are sufficiently large, but if you're relying solely on tax deferred dollars to fund your retirement, your dollars won't go as far as any of the other dollars we've discussed. If your total tax in retirement is 15% to 25%, your tax deferred dollar is worth 75 to 85 cents.

17% of our dollars are tax-deferred dollars.

Other Dollars

I've ignored other dollars thus far because I've already accounted for 100% of our retirement dollars. Other dollars would include pensions, which is a complicated topic recently covered by the Financial Samurai.

He frequently discusses real estate, too; we do not own investment real estate, but there are ways to own real estate or real estate funds in all of the account types listed above. We currently have a handful of investments in **crowdfunded real estate** in our taxable account. You can also hold real estate investments in a self-directed IRA.

Annuities can also be held inside and outside of retirement accounts. Cash value life insurance is something I have stayed away from and probably doesn't deserve my attention (or yours).

Social Security is a benefit we Americans who have worked our 40 quarters can expect to collect at some point. I'm nearly 30 years away from collecting if the rules remain constant over those three decades. I have no idea how to value this benefit with so much time remaining. I expect we will receive a benefit and will treat it like an added bonus when the day finally comes.

Are My Dollars Worth More Than Your Dollars?

bad dog

Probably. With more than 80% of my retirement dollars residing in post-tax accounts, I'm in pretty good shape. If the situation were inverted, and more than 80% of my retirement dollars were living in tax-deferred accounts, those dollars simply wouldn't go as far in retirement. The latter is a common situation. Certainly, some of you will have an even higher percentage in Roth and taxable accounts. **You win!** Someone will always have a higher income, a nicer home, a more ideal asset location ration, or a better behaved dog. Actually, the vast majority of you probably have a better-behaved dog, if you have a dog.

So what?

I don't think we need to go to any great length to devised a formula or conversion factor for the different types of dollars we have. There are just too many variables. Even if the tax laws stay forever unchanged – they won't – our circumstances will change. I could pay between 0% and 40% on the dollars I withdraw from tax-deferred accounts depending on what happens in coming years. Income can change, deductions will graduate and leave the nest, even **gasp** [filing status] can change.

I do think it's worthwhile to consider where your money is, and understand the relative value of your different dollars. Sometimes, I think we should shoot for a **specific dollar amount** before making drastic changes in our work/life balance.

When I stop and think about our **25x (or 36x = financial freedom**), I realize that the absolute number isn’t all that important, anyway. So **now we’re shooting for a specific date**.

What are you aiming for? Do you discount tax-deferred or other dollars when calculating your retirement assets or net worth? I’d love to hear your thoughts.

*Strategies exist to make Roth conversions while avoiding federal income tax. You must have low expenses and/or a substantial amount of other dollars to spend in order to employ this strategy, and will only be able to convert a relatively small amount annually, but it is possible.