DISCOVER THE POTENTIAL OF

# *Mega Roth IRA's*

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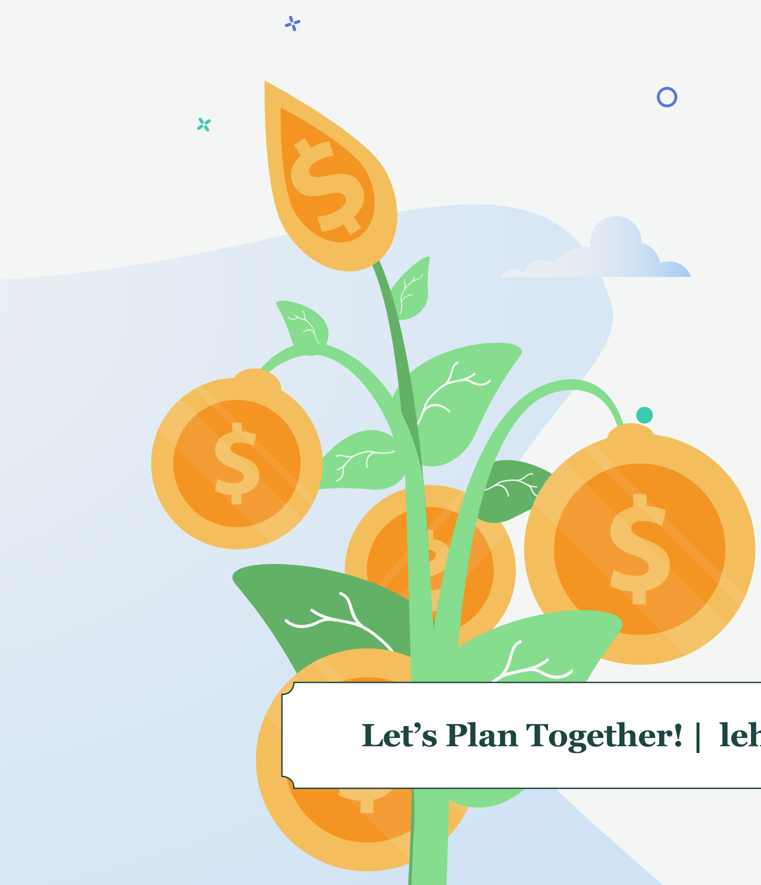
# Roth IRAs: A Tantalizing Option

For most high-income earners, Roth IRAs are a tantalizing option. The ability to grow investments indefinitely in a tax-free environment and then to have access to those funds later in life when the distributions will also be tax-free is an exciting prospect.

Unfortunately, most high earners can't fund a Roth IRA because of income limits set by the IRS. Further, the conversion of Traditional IRA assets is generally ill-advised because of the additional income tax liability created by the conversion.

There can be one minor work-around for high earners in the form of a "back door" Roth IRA. This only works for someone who has no other Traditional IRA assets. In this situation, the worker can fund a non-deductible Traditional IRA with the full amount of $6,000 (under age 50) or $7,000 (if over). There are no income limits to doing this. Then, immediately after, the owner converts the Traditional IRA to a Roth IRA. Because there are no taxable dollars in the account, the conversion is tax-free.

One caveat is that the owner cannot have any other pre-tax Traditional IRA assets. If they do, the IRS will assume that the conversion is pro-rata across all IRA assets and therefore a portion of the conversion will be income taxable, thus incurring additional income tax and undoing most of the value gained by having a Roth in the first place.



**So, while this approach can be a small advantage, the Mega Roth IRA option offers far greater potential.**

For certain fortunate employees, they can use their company's 401K plan as a way to put up to $37,500 into a Roth IRA each year. The option is available only to employees who have a 401K plan that offers an "after tax" contribution option.

It's important to note that an "after tax" option is not the same as a Roth 401K option. While both versions use "after tax" money as a funding source, only the "after tax" contribution offers the ability to optimize retirement savings.

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# The IRA Strategy

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## The strategy works this way: the high-income earner first fully funds the employee contribution part of the 401K thus achieving a maximal tax deduction in 2021 on either $19,500 (if under age 50) or $26,000 (if over).

If the employee receives an employer match, add that amount to the amount contributed to the plan by the employee. Keeping in mind that the absolute maximum amount allowed to be contributed for 2021 is capped at $58,000 (if under 50) and $63,500 (if over), subtract the sum of employee and employer contributions from these absolute maximums.

The resulting amount is what can be put into the "after tax" portion of the plan and can then be used as the Mega Roth IRA contribution.

As an aside, while the Roth 401K sounds like it will achieve the same result as a Mega Roth because it too is funded with after tax money and will be tax-free for life, it will not. The Roth 401K contribution counts toward the maximum an employee can contribute each year. Therefore, every dollar contributed to the Roth portion of the 401K nullifies the tax deduction that is available to contributions made to the Traditional portion of the 401K. To achieve maximum benefit, the employee will want to use ALL of their contribution limit to be recorded as pre-tax contributions.

## A Mega Roth Example

Assume we have a 55-year-old wanting to maximize savings for retirement.

Step 1 is to defer $26,000 to the employee portion of the 401k. Assume that the employer matched dollar-for-dollar up to 6% of the employee's salary; in this case, let's assume $200,000 of salary. That's an extra $12,000.

So, total contribution to the tax-deductible portion of the plan is $26,000 plus $12,000 or $38,000. Now, subtract that from the $63,500 maximum and you get $25,500 of excess that can contributed to the "after tax" part of the plan.

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# Where the Magic Happens

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Here's where the magic happens. In company plans where the "after tax" option exists, the employee can then immediately remove the funds from the plan by "converting" the after tax portion to a Roth IRA. So long as there are no earnings on the funds in the "after tax" account, there is no income tax on this conversion.

**The employee has now just funded a Roth IRA with $25,500. A "mega" contribution! In a case where there is no employer match, the Roth IRA deposit can be up to $37,500!**

In cases where an "after tax" account already exists for an employee, the conversion CAN be done, but there will be income tax due. Since the "after tax" account grows tax-deferred, any amount converted at this point will be pro-rated as a combination of pre-tax and post-tax money. While this approach can still be beneficial, the conversion strategy works optimally if there is NO tax-deferred money in the account.


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