The Mega Back-Door Roth Strategy You Should Be Using

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“I make too much money to contribute to a ROTH retirement account.”

Many working individuals believe they are ineligible for ROTH accounts. What if I told you there are strategies to deposit funds into a ROTH every year regardless of your income? It’s true. Many investors and professional advisors are not well versed in how to utilize the tremendous benefits of ROTH retirement accounts.

Today I’ll let you in on the mega back-door roth strategy you will want to steal to maximize your designated funds for retirement, and go over how it all works. Let’s start at the beginning.

Retirement Account Basics

Regular retirement accounts, IRA, SEP, 401k, 403b and Profit Sharing Pension plans all grow tax deferred. This means you do not pay taxes on the earnings in these retirement accounts until the funds are withdrawn, usually in retirement. In contrast, ROTH retirement accounts do not pay taxes on their earnings even when the funds are withdrawn in retirement. Money you contribute to a Roth truly becomes tax-free.

Chances are you have a 401k plan at work. You know you can put part of your salary in a retirement account before you pay tax on it, and that money grows tax-deferred. Your company usually matches a portion of what you put into the account as well. Since the money you put into these accounts do not incur any tax until you take it out, it's a great way to save for retirement as your money grows more quickly than it would in a traditional investment account.

In addition, many plans also allow for Roth contributions, where the money is taxed before it goes into the 401k, but it then grows tax-free (assuming you meet several requirements). This may be a great strategy depending on your situation but many savers are reluctant to give up the tax deduction from the normal pre-tax contributions.

What Can You Contribute to a 401k?

Everyone wants to know how much they can contribute to a 401k. A simple Google search will tell you that the IRS does limit what you can put into these accounts. In 2020, **the maximum you can contribute** to a 401k plan is $19,500 (if you are over 50 you can add an additional $6,500 for a total of $26,000 per year). However, this is where most people's understanding of their 401k plan ends.

If your knowledge ends here, know that you aren't alone. There are so many subtle nuances in the different types of 401k plans and various advantages and drawbacks of each. This is why a customized financial plan is crucial; an advisor can help look at your overall situation with the specific type of plan you have, and make more informed decisions for you to efficiently plan for the future.

Enter the Mega Backdoor Roth Strategy

If you regularly max out those traditional 401k limits, you'll want to pay attention here. What most people may not know is that the actual 2020 IRS limit for the total amount of Employee and Employer contributions is 100% of your income or $57,000 whichever is less (or $63,500 if you're over age 50.)

Most people contribute the maximum deferral of $19,500 in each year, their company puts in an additional $5,000-10,000, and that's it. For high earners, this usually results in excess money going into a savings account where it sits in cash and doesn't grow, or into brokerage account each month where it's at least growing, but that growth is subject to taxation, eating into the overall return. **Financial planning** is all about efficiency and making sure you are taking advantage of everything you can to maximize the growth of your money. So, after you've maxed your 401k contribution, where should you contribute next?

Most high earners contribute the maximum pre-tax contribution of $19,500 and stop there, even though the IRS allows you to put up to $57,000! This is a huge benefit that few people take advantage of simply because they were unaware. What if you could contribute an additional $20,000 to $30,000 per year and have those funds grow tax free? Would this be of benefit to you? Not all 401k plans allow these types of contributions but we can help you to determine if your plan has this option.

Even if your 401k plan does not have the appropriate features to allow for these additional deposits, there is one additional strategy to allow for annual ROTH IRA deposits up to $14,000 per year for a married couple. Are you a business owner? Consider setting up your solo plan to allow for these additional benefits.

Remember, both the ROTH 401k strategy and the ROTH IRA strategy are available **regardless of your income**.

If you are a high earner, and find yourself in a position of uncertainty around what accounts you should be utilizing for your savings, you should **consult a financial professional** who is familiar with how to execute this strategy. Everyone should **have a plan**, you should know where to save and how to invest that money relative to the tax implications of the account type. Very few people take the time to understand and maximize this aspect of investing (known as asset location) and focus too much on what they should be invested in. These are the strategies that make a substantial difference on your future.