STIFEL | Executive Wealth Consulting Group

CONSIDER TAKING ADVANTAGE OF THIS ROTH IRA STRATEGY WHILE STILL AVAILABLE

One of the mechanisms for high-income workers to contribute to a Roth IRA may be eliminated by the spending bill, which is currently under debate in Congress.

Roth IRAs have distinct advantages over other types of retirement savings accounts. Contributions grow tax-free, and earnings can be withdrawn tax-free in retirement if certain conditions are met. Roth IRAs are also not subject to the required minimum distributions (RMDs) that must be taken from traditional IRAs and employer-sponsored plans beginning at age 72.

Under current law, individuals with a modified adjusted gross income above $140,000, or $208,000 for a married couple filing a joint return, can't contribute directly to a Roth IRA. But for years, savvy high-income earners have been taking advantage of a strategy referred to as a "backdoor" Roth IRA – by doing so, they are able to circumvent income limitations. The technique involves making a nondeductible contribution to a traditional IRA, then converting those dollars to the Roth IRA with no additional taxes due.

Some employer-sponsored plans even facilitated "mega-backdoor" contributions, allowing participants to make large after-tax contributions to a 401(k) plan and then convert to a Roth IRA or Roth 401(k) to grow tax-free.

The bill summary released by the House Ways and Means Committee indicates that conversions of after-tax funds from a traditional IRA or employer-sponsored plan to a Roth IRA may be prohibited after December 31, 2021 – closing the back door on investors.

While the final provisions of the legislation remain unclear, high-income earners can still take advantage of the backdoor Roth strategy for 2021, and may wish to consult with their financial and tax advisors prior to the end of the year.

In addition, investors interested in accumulating tax-free retirement savings might consider making direct Roth 401(k) contributions if their employer offers one, since there are no income limitations preventing plan participants from doing so.

Health savings accounts (HSAs) are another potentially tax-free retirement savings vehicle that may still be available as Roth IRA savings become more restrictive. HSAs offer triple tax advantages, since contributions are tax-deductible, growth is tax-free, and withdrawals can be tax-free if used to pay for qualified medical expenses. Though participation is limited to those who are covered by an HSA-eligible, high-deductible health plan, there are no income limitations to prevent higher earners from contributing.

While the specifics of the bill are still under negotiation and may be modified from the Ways and Means Committee summary before coming to a vote, time is growing short for investors to consult with their tax and financial advisors to determine which savings strategies to implement before new restrictions may take effect.

CONTACT

Executive Wealth Consulting Group

Tom Awadalla, CFP®, Senior Vice President/Investments
Tom Lieser, CFP®, Managing Director/Investments
Leigh Gage, CFP®, Senior Vice President/Investments

(513) 904-6500 | www.ewc-stifel.com

221 East Fourth Street, Suite 2800 | Cincinnati, Ohio 45202

Stifel does not provide legal or tax advice. You should consult with your legal and tax advisors regarding your particular situation.