Baker Avenue
Wealth Management

Create Mega Value Using Your 401(k): How to Put Up to $72,500 per Year Into Retirement

Here's What You Need to Know About the Mega Backdoor Roth Contribution Strategy

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What You Need to Know About the Mega Backdoor Roth Contribution Strategy

Many of us are familiar with the benefits of saving for retirement using 401(k) and IRA contributions to build that retirement nest egg - but if you think it stops at $22,500 into your 401(k) and $6,500 into your IRA, then you may be in for a pleasant surprise.

Below we examine how to turbo-charge your retirement savings using IRS-approved strategies, which are widely available to, but under-utilized by, millions of people saving for retirement.

The Basics: 401(k) and IRA Contributions

In 2023, you can contribute up to $22,500 on a pre-tax (i.e., tax-deductible) basis into your 401(k) and another $6,500 into either a Roth or Traditional IRA. If you are age 50 or older, you can contribute an additional $7,500 into your 401(k) and an additional $1,000 into your IRA. Employers often provide you with a match on a portion of your 401(k) contributions. However, there are limitations:

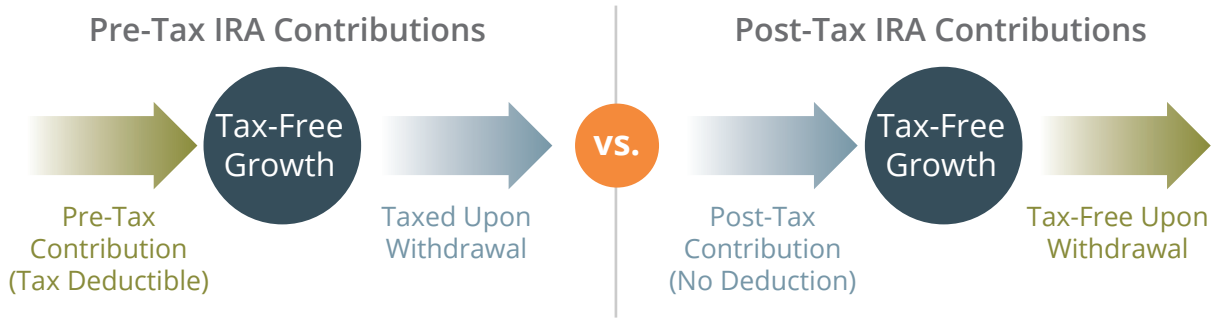
- You cannot contribute directly to a Roth IRA where your Adjusted Gross Income (AGI) exceeds $153,000 (Single) or $228,000 (MFJ) in 2023.
- You will not get a tax deduction for your Traditional IRA contributions where you participate in a company plan, such as a 401(k), and your AGI exceeds $83,000 (Single) or $136,000 (MFJ).
- If your spouse participates in a company plan, and you do not, you won't get a deduction for a Traditional IRA contribution where joint AGI exceeds $228,000.

Roth Accounts – R is for Rolls-Royce

Roth accounts are often viewed as the Rolls-Royce of retirement accounts because they provide not only tax-free accumulation and compounding over time, but they are also tax-free upon withdrawal in retirement. Add in the fact that the IRS will never require you to take a Required Minimum Distribution (RMD) on a Roth account, and you have a very powerful "tax-free forever" vehicle to build wealth.

The limitation with Roth accounts is that they are not easy to get funded with substantial amounts of cash due to the $6,500 per year direct contribution limit and the prohibition on direct contributions where income exceeds $153,000 (Single) and $228,000 (MFJ). However, there are strategies to circumvent these restrictions. The two best known strategies are:

1. Making post-tax contributions to a Traditional IRA and then immediately converting these contributions to a Roth IRA account without tax consequences – this strategy is often referred to as the "Backdoor Roth Contribution" technique (not to be confused with a "**Mega** Backdoor Roth Contribution"). It is a good strategy, but it only gets $6,500 per year into your Roth - $7,500 if you are over 50. It may also provide only limited benefit because an IRA-to-IRA conversion (Traditional to Roth) will also be subject to the IRA aggregation rules, which restrict your ability to isolate post-tax contributions into a Roth account.



2. Converting an existing Traditional IRA to a Roth IRA – there is no limit on the amount you can convert, but it will generate a hefty tax bill at your top marginal tax bracket on the amount converted.

There is, however, a third and much more powerful strategy for funding your Roth account without the annual $6,500 limitation or the need to subject any converted amount to your top marginal tax rate. It is known as the Mega Backdoor Roth Contribution technique.

How Does a Mega Backdoor Roth Contribution Work?

This powerful, but rarely utilized, benefit is only available as part of your employer 401(k). It allows employees to first make very large post-tax contributions into the 401(k) plan and then convert these after-tax 401(k) contributions into a Roth account. Once inside the Roth account, the contributions will benefit from tax-free growth and, even more crucially, completely "tax-free forever" access in retirement. This is in contrast to regular (pre-tax) 401(k) contributions and earnings, which are always taxable in retirement.

The Mega Backdoor Contribution strategy side-steps the Roth IRA income limit for direct contributions, the $6,500 per annum contribution limit, and even the current year tax hit on the conversion amount.

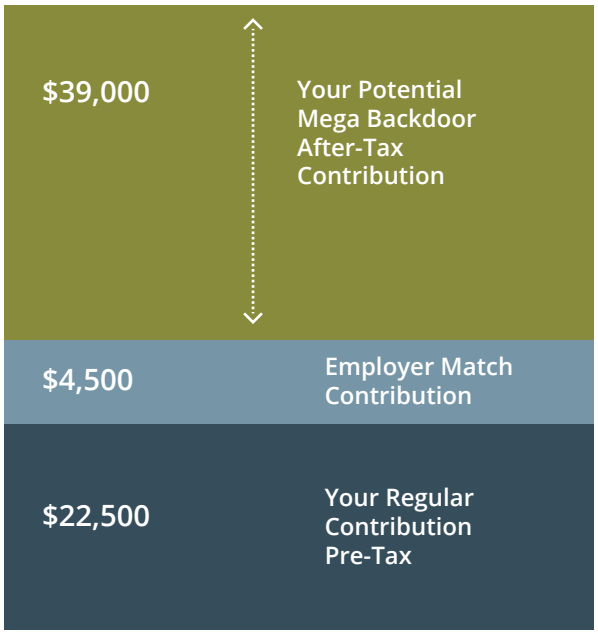
The Mega Backdoor Roth Contribution allows you to fill the gap between your regular contributions and the overall 401(k) contribution limit using after-tax dollars.

Here Is How It Works:

If your 401(k) plan allows it, and most of them do, you can contribute $22,500 on a pre-tax (tax-deductible) basis. That's a good start, but you can also contribute up to $43,500 on a post-tax basis (if you are over 50, the numbers would be $30,000 and $43,500 every year). Note that the overall contribution limit needs to include any employer matching contributions to arrive at the maximum allowed post-tax contribution and the plan may also have specific plan limits which can be less than the IRS limits.

If nothing else were to happen to those post-tax contributions, the earnings associated with them would benefit from tax-deferred growth within the 401(k) plan until you started taking distributions - at which point they would be taxable. The contributions themselves would be tax-free when you started to take distributions. But because the post-tax contribution limits are twice as large as the regular pre-tax contribution limits, this strategy presents a unique opportunity to turbo-charge your retirement savings and reach financial security in retirement years ahead of a regular pre-tax savings strategy.

IRS 401(k) Contribution Limits - 2023



$66,000 Annually

But Things Can Get Even Better!

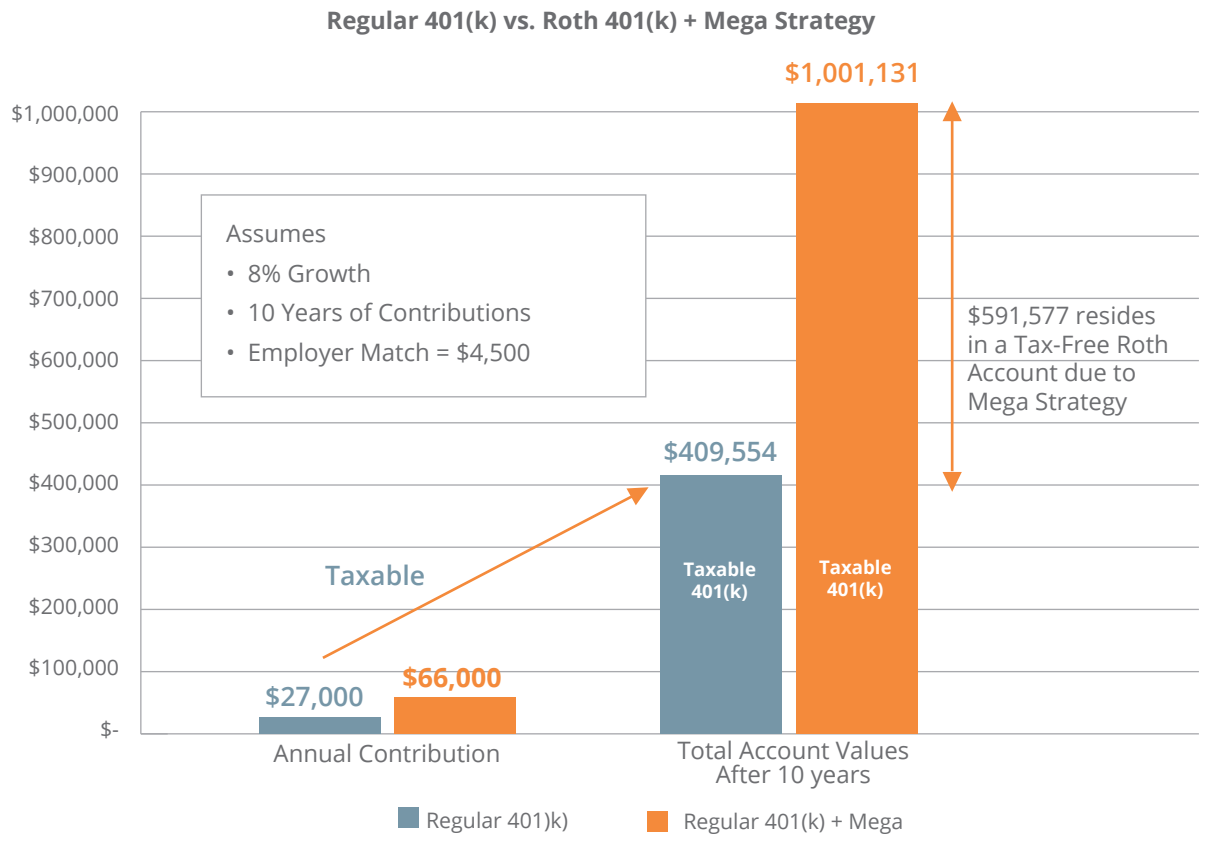
The Mega Backdoor Roth Contribution can deliver not only "tax-free forever" on your post-tax 401(k) contributions, but also "tax-free forever" on the earnings associated with those contributions – over time this can provide another huge boost to your retirement goals. The key is to get the post-tax contributions out of the regular 401(k) account and into a Roth IRA (or Roth 401(k) account) as quickly as possible after making the actual contributions. How is this achieved?

Many 401(k) plans anticipate employees harvesting their post-tax contributions into a Roth account every year and will facilitate these conversions from the regular 401(k) account to the Roth account by permitting either an "In-Plan" rollover to a Roth 401(k) or, more commonly, an "In-Service" withdrawal from the 401(k), while still an employee, to fund a Roth IRA. Because the 401(k) plan administrators keep separate accounts for your post-tax contributions, the rollover/conversion of post-tax contributions to the Roth account can often be done with minimal tax. Once in the Roth account, the funds will be "tax-free forever."

Where an "In-Plan" rollover or "In-Service" withdrawal are not available because the plan rules prohibit them, plan participants can still use a rollover at retirement, or on leaving the company, to send all their post-tax contributions to a Roth IRA account and send the pre-tax contributions and earnings to a Traditional (Rollover) IRA. Both these steps can be executed without any current taxation. This is slightly less optimal than an "In-Plan" or "In-Service" rollover, but this option still provides a huge boost to your retirement security.

The Benefits of the Mega Backdoor Roth contribution strategy can be illustrated by comparing:

- A regular 401(k) savings strategy (blue bar) versus
- A regular 401(k) savings strategy with the Mega Strategy added (orange bar)



The annual contributions for the regular 401(k) would be $27,000 ($22,500 employee and $4,500 employer match). Over 10 years, the account would grow to be worth $409,554 – which would be fully taxable in retirement.

The annual contributions for the regular 401(k) plus Mega strategy would be $66,000 ($22,500 employee, $4,500 employer match and the post-tax Mega Contribution of $39,000). Over 10 years, the account would grow to $1,001,131 – comfortably more than double the regular 401(k) account, but now $591,577 of the account is residing in a tax-free forever Roth account as well.

Age 50 and Over

if you are age 50 and over, the annual contributions for the regular 401(k) would be $34,500 ($30,000 employee and $4,500 employer match). Over 10 years, the account would grow to be worth $523,318 – which would be fully taxable in retirement.

The annual contributions for the regular 401(k) plus Mega would be $73,500 ($30,000 employee, $4,500 employer match and the post-tax Mega Contribution of $39,000). Over 10 years, the accounts would grow to $1,114,896 with $591,578 residing in a “tax-free forever” Roth account.

So Which Companies Provide the Mega Backdoor Roth Option?

Here is just a sample of those companies that facilitate the Mega Backdoor Roth Strategy for 2023.

- Akamai
- Amazon
- Apple
- Asana
- AstraZeneca
- AT&T
- Autodesk
- Blend
- Boeing
- Carta
- Cisco
- Coupa Software
- Coupang
- Coursera
- Cruise
- Dell Technologies
- DocuSign
- Envestnet
- Exelon
- Facebook
- Fannie Mae
- GitHub
- Google
- HBO
- Humana
- IBM
- Intel
- Intuit
- John Hancock
- Johnson & Johnson
- L'Oreal
- Labcorp
- LinkedIn
- Mastercard
- McKinsey
- Microsoft
- NBCUniversal
- Netflix
- Nevro
- Optiver
- Oracle
- Palantir
- Palo Alto Networks
- PayPal
- Pitney Bowes
- Puppet
- Qualcomm
- Qualtrics
- QuantumBlack
- Raymond James
- Roblox
- Roku
- Salesforce
- Samsung
- Sandia National Labs
- ServiceNow
- SmartNews
- Snap
- Spectrum
- Splunk
- Square
- Squarespace
- Stripe
- Target
- Tenable
- Teradata
- The Clorox Company
- The Trade Desk
- Thomas Reuters
- Title365
- Two Sigma
- Uber
- UiPath
- VMware
- Waymo
- Wells Fargo
- Workday
- Xander
- Yahoo
- Zillow
- Zoom
- Zynga

If you see your company in the list, we can help you implement the Mega strategy. If you don't see your company, we can advise if your company does or doesn't offer the strategy – our list is by no means definitive.

Note that the exact features for 401(k) plans can be very plan-specific – we can help you review the plan documents to see if the Mega strategy makes sense for your circumstances.

Key Takeaways

- The Mega Backdoor Roth Strategy can provide tax-advantaged retirement accumulation greater than all the other tax-advantaged savings plans combined.
- It uses established 401(k) plans and carries no risk of challenge from the IRS.
- Because every 401(k) plan will have different rules, the plan documents must be thoroughly reviewed in order to maximize the Mega Backdoor Roth benefits.
- You might be sitting on a retirement savings goldmine with your 401(k) and not even realize it. BakerAvenue can review your 401(k) documents, advise on optimal contribution levels, and help you implement your Mega strategy every step of the way.

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