

Maximizing the Power of a Roth IRA

Seasoned advisors will tell any client that utilizing tax-advantaged accounts is a vital way to put money to work; Roth accounts chief among them. A Roth allows clients to grow their money in an after-tax pot, which means the funds can be pulled out later with significant tax savings.

But while a normal Roth is an evergreen tax-advantaged vehicle for most any investor, in some circumstances, its earning power can be amplified even further.

Supersize the Roth

Certain high-income households may have access to a mega backdoor Roth conversion through their retirement plans. These conversions involve employees contributing funds into their 401(k)s as after-tax contributions, which are then converted to a Roth IRA.

A person with a traditional Roth 401(k) can contribute as much as \$23,000 of his or her salary into the account for 2024. However, a mega backdoor Roth can push that amount up to \$69,000, as of this year. An individual over 50 years old can go even further, with a cap of \$76,500 for 2024.

There are several eligibility requirements for a mega backdoor Roth. First, an individual's 401(k) provider must allow for a Roth in general. Then, it must also allow for in-service rollovers to a Roth IRA with after-tax dollars.

According to Fidelity, only about 10% of retirement plans at the financial institution permit the mega backdoor Roth, but the number has been climbing in recent years.

Taking It To the Next Level

If an individual can afford to save aggressively, there's yet another step to truly maximize the power of Roth accounts. In addition to Roth 401(k)s, an individual could also open a Roth IRA, which would allow them to contribute another \$7,000 or \$8,000 per year to an investment vehicle with comparable tax rules.

By using these two strategies in tandem, an individual under 50 could save \$76,000 in tax-advantaged accounts this year, while those over 50 could stash away a whopping \$84,500.

There are several considerations to ponder before taking the mega backdoor Roth route, including lifestyle, income, and goals. But for those with immense savings capacity, the mega backdoor Roth can save households a considerable amount in taxes, while maxing out retirement contributions.

If you are unsure if a mega backdoor Roth is available for you, consider consulting with a financial advisor to fully understand all savings options on the table — and to select the best one for your unique circumstances.