

WEALTH WISDOM

MONTHLY FINANCIAL INSIGHTS

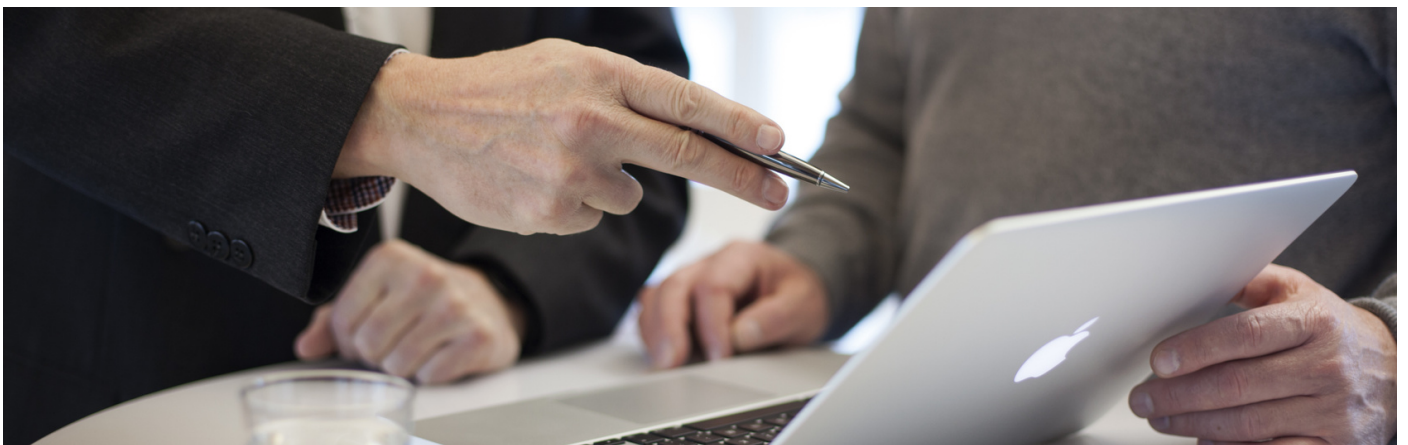


Welcome

Welcome to "NEIRG Wealth Wisdom: Monthly Financial Insights," your go-to source for insightful and educational content on various financial topics. Designed for the informed investor, our goal is to empower you with clear and concise knowledge, helping you stay ahead in the complex financial world.

A GUIDE TO ROTH ACCOUNTS FOR THE HIGH-NET-WORTH INVESTOR

In this article, we will explore two powerful retirement planning strategies: Roth conversions and Backdoor Roth IRAs. While Roth accounts were initially introduced to help mass market investors save in a tax-preferred manner, you will see that they have become incredibly powerful tools for the high-net-worth too.



What is a Roth?

Established in 1997 under the Taxpayer Relief Act, Roth IRA's offer a unique approach to retirement savings. Unlike Traditional IRAs, contributions to Roth IRAs are taxed upfront, but withdrawals are tax-free. This distinctive structure allows funds to grow and compound without incurring future tax liabilities.

	Traditional IRA	Roth IRA
Contributions	Deducted from current year income (assuming qualifications are met)	No deduction
Compounding within Account	Tax-free	Tax-Free
Withdrawals	Taxed as ordinary income tax rates	Tax-Free

Originally, Roth IRAs aimed to incentivize lower-income investors to pay the taxes on their contributions in their current brackets, allowing for tax-free withdrawals in retirement. They were not intended for high-net-worth individuals in higher tax brackets, as these individuals typically benefit more from tax deferral through pre-tax accounts. In fact, those above a specific income threshold could not, and still cannot, directly contribute to Roth IRAs.

CONTRIBUTION LIMITS FOR 2023

Income Limit for Contribution	Maximum Contribution (Under 50)	Maximum Contribution (Over 50)
\$153,000 (single) \$228,000 (married filing jointly)	\$6,500	\$7,500

While some individuals have employer sponsored retirement plans, such as 401K and 403B plans, that allow for Roth contributions (these plans do not have income limits), most affluent families do not have a direct way to utilize these advantageous accounts. For these individuals, the only way to invest in Roth accounts is through Backdoor Roth IRAs and Roth Conversions.

Backdoor Roth IRA

The Backdoor Roth IRA strategy allows high-net-worth investors to contribute to a Roth IRA indirectly, regardless of their income level. For affluent families, Roth accounts help create tax diversification in retirement which allows those families to effectively manage their tax bracket in retirement.

How This Works

1. **Establish a Roth IRA:** If the individual does not already have a Roth IRA, they will need to establish one.
2. **Non-Deductible Traditional IRA Contribution:** The individual makes a non-deductible contribution to a Traditional IRA. While this contribution will not provide immediate tax benefits, it sets the stage for the backdoor conversion.
3. **Conversion to Roth IRA:** Next, a conversion is performed by moving the funds from the Traditional IRA to the Roth IRA. Since the taxes have already been paid on the contribution, this conversion is generally tax-exempt.
4. **Contribution Accomplished:** The contribution has been converted to Roth dollars and will continue compounding tax-free.

An Important Note: *This strategy is incredibly powerful, but it is not appropriate for investors who already have Traditional IRAs with pre-tax dollars in them. The pre-tax dollars effectively eliminate the ability to complete a “non-taxable” conversion described above. **Please contact your wealth advisor at [NEIRG](#) before undertaking this strategy on your own.***

Contribution

Non Deductible
IRA

Conversion

Roth IRA

Roth Conversions

An added benefit of Roth IRAs is found in multigenerational planning. When most children inherit an IRA from their parents, they must withdraw the funds within 10 years of their parent's passing. Each withdrawal can create a substantial tax liability for the child who is typically in their peak-earning (and, thus, highest tax bracket) years. This typically results in the child paying significantly higher taxes than their deceased parent would have paid prior to their death.

If a child inherits a Roth IRA, however, they will usually pay no income taxes when withdrawing from the inherited account. As a result, it can be incredibly advantageous for affluent families in retirement to eliminate pre-tax dollars in favor of Roth accounts over time.

Converting dollars from Traditional IRAs to Roth IRAs is the foundational premise behind a Backdoor Roth IRA. Additionally, this strategy of "converting" funds can also be utilized by families with substantial pre-tax assets in retirement too.

How This Works

1. **Establish a Roth IRA:** If the individual does not already have a Roth IRA, they will need to establish one.
2. **Determine Conversion:** With the help of an advisor or tax professional, the individual(s) determine the amount of funds to convert from their pre-tax account to their new Roth account.
3. **Pay Taxes:** The individual(s) pay ordinary income taxes on the amount of funds being converted.
4. **Conversion Accomplished:** The converted dollars move to the Roth IRA and will continue compounding tax-free.

This strategy capitalizes on a retiree's lower tax bracket, allowing them to pay ordinary income taxes as they transfer funds into accounts that are more favorable for their heirs. If designed appropriately, it can save a substantial amount in taxes over the account's lifecycle. Because of the sensitivity of various tax brackets, this strategy needs to be thoughtfully planned each year to create tax alpha.

Please contact your wealth advisor at [NEIRG](http://www.neirg.com) before undertaking this strategy on your own.

Wealthy families with a goal of passing the most after-tax dollars to their heirs can use Roth Conversions in retirement to maximize their heirs net inheritance.