5 Overlooked Retirement Strategies

by Rochester Wealth Strategies

Health Savings Account

Many employers offer HSAs to assist in paying for medical expenses; however, few employees take full advantage of the long-term benefits. Unlike most retirement plans where you must choose between a deduction today or tax-free withdrawals later in life, an HSA offers the best of both worlds; it allows for deductible contributions and tax-free withdrawals if used for qualified medical costs. In addition, you do not have to wait until 59 ½ to use the funds and there are no required distributions after age 72.

One strategy to utilizing an HSA is to hold off on using the account to pay for immediate medical costs. What makes this account so valuable is that it offers another way to grow investment assets on a potentially tax-free basis. Hence, the more money you leave in the account early on, the more you will benefit from its purpose in retirement. It is also one of the best plans out there to self-insure against the rising costs of long-term care.

Contribution limits for 2021 are $3,600 for individuals and $7,200 for families (individuals over age 55 can save an additional $1,000 per year). There are also no income restrictions. The easiest way to determine whether this may be an option for you is to call your healthcare provider and ask if your plan is HSA eligible.

Spousal IRA

When it comes to a non-working spouse, the IRS has made available an option to contribute money into a retirement account for them. As long as the household income is under $198,000 (2021 limit) and the non-working spouse was not covered by an employer plan at any point throughout the year, he or she may make a full deductible contribution to a Traditional IRA. The contribution limit for 2021 is $6,000 (or $7,000 for individuals over age 50). Due to the number of variables, it is useful when both your financial advisor and tax professional collaborate together.

Cash Balance Plans

If you are self-employed and maintain an income above $290,000, it may be time to consider a retirement plan called a Cash Balance Plan. These plans are used by businesses looking to maximize their deductions and obtain greater retirement funding for owners, partners, and key employees. When combined with a 401k and profit-sharing plan, the overall deduction could be upwards of $300,000.

A Cash Balance Plan is a Defined Benefit Plan with characteristics similar to a Defined Contribution Plan. Contributions are made by the employer based on a pre-defined formula. However, unlike the common 401(k) plan, deduction limits are based on actuarial funding rather than a fixed dollar limitation.

The demographics of the company will ultimately dictate how much can be tucked away. Although the plan usually favors an employer that is much older than his or her employees, it can also benefit employers who have much greater income than their employees. The plan tends to be more ideal for business owners with fewer employees. This would also include doctors, attorneys, and highly compensated professionals with small to mid-size practices. It can even be a great option for the younger entrepreneur who is looking to put a large amount away so that they can retire earlier than the norm. When incorporating this plan, your advisor will coordinate with an actuary to ensure that all requirements are met.

Backdoor Roth IRA and Mega Backdoor Roth

A Backdoor Roth IRA may allow individuals to fund a Roth IRA even if they are over the income thresholds. The process implies making a non-deductible contribution to a Traditional IRA and then immediately converting the money to a Roth IRA; allowing for tax-free growth and withdrawals in retirement. Please note that if you have any current money in a Traditional IRA, this strategy may become very complicated and some of the conversion dollars could trigger taxes.

Perhaps the most intricate strategy is one called the Mega Backdoor Roth. For this concept to work, your employer plan must allow for "after-tax" contributions (different from Roth) and in-service distributions or in-plan transfers to the Roth bucket. Since the total amount that both an employee and employer can contribute to a qualified plan is $57,000, there is often times a shortage from maxing this out each year; this is where the "after-tax" contribution comes in. If the total amount that you put in is $26,000 and your employer match / profit sharing is $4,000, this may leave $27,000 for which you may be able to contribute. It is important to note that we do not want to keep money in the "after-tax" bucket; instead, we simply want to use it as a passthrough to get the money in either the Roth 401(k) or rolled over to a Roth IRA. It goes without question that this concept should also be discussed with your advisor and tax professional.

Roth Conversions and In-Plan Roth Conversion

Roth conversions have been a popular topic. This usually entails moving a portion of your Traditional IRA to a Roth IRA in order to take advantage of today's historically low brackets. In other words, pay the taxes today while in a lower tax bracket and benefit from tax-free withdrawals later on. This is also enticing if one believes they will be in a higher tax bracket in the future or if they prefer the freedom of choosing when to take distributions as oppose to being required to at the age of 72 (in the case of a traditional plan). And for those who have recently lost some or all of their income due to COVID-19; this may create a rare opportunity.

Recent legislation allows employer plans to create an in-plan conversion feature. Similar to Traditional IRA to Roth IRA, you may now have the option to do this within your 401(k) as well. It is always important to understand the current tax implications versus the future benefits.

These were simply a few of the many ways one can optimize their retirement. While these methods can be useful, they are not designed for everyone. Consult with a trusted advisor to ensure that these options are right for you.

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