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WEALTH MANAGEMENT

Mega Backdoor Roth: The Retirement Game Changer for Microsoft Employees

If there's one strategy that Microsoft employees should be aware of to maximize benefits and accelerate their path to financial independence, it's the Mega Backdoor Roth. This powerful tool can significantly enhance your retirement savings by offering meaningful tax advantages and investment flexibility. For many Microsoft professionals, correctly utilizing the Mega Backdoor Roth could be the key to reaching work optionality in your 50's.

Understanding the Value of the Roth

The Mega Backdoor Roth's effectiveness begins with understanding the value of the Roth IRA and 401k. Contributions to your Roth, as opposed to Traditional IRAs or 401ks, are made with after-tax dollars. This means both your contributions and their growth are tax-free when withdrawn. For example, a $30,000 contribution to a Roth IRA is a full $30,000, compared to the same amount in a Traditional IRA or 401k, which could be reduced to $20,000 or more when considering future taxes. **This is why contributions to your Roth just count more.**

This strategy is particularly beneficial when using growth investments in your Roth, where future growth is tax free. **The Roth also provides great flexibility when planning for an early retirement.** For instance, withdrawing from your tax-free Roth can help keep your taxable income and health insurance premiums low before Medicare starts at age 65.

The Mechanics of the Mega Backdoor Roth at Microsoft

In 2024, Microsoft employees can contribute up to $23,000 to their 401k (traditional or Roth), with an additional $7,500 for those 50 or above. Microsoft's 50% match on the first $23,000 further augments your savings. Additionally, Microsoft allows after-tax contributions of $34,500, **raising the total possible 2024 401k contribution to a striking $76,500!**

For many, a balanced approach of contributing to both Traditional and Roth accounts is advisable. For example, you can contribute up to $30,500 to your Traditional 401k for the upfront tax deduction, and then an additional $34,500 after-tax, which may then be converted to your Roth, enabling tax-free growth. This combines receiving up-front tax savings while also building up your Roth accounts.

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Case Study: The Impact of Consistent Contributions

Consider a 50-year-old Microsoft employee who maximizes their 401k contributions, including the Mega Backdoor Roth, over the next five years with a goal of achieving financial independence by age 55. Over the next five years, their total personal contributions could exceed $345,000, factoring in potential increases in contribution limits. Assuming a steady annual return of 7%[1], combined with personal and Microsoft's employer contributions, this could lead to an impressive increase of approximately $500,000 in their 401k during this period.

Implementing the Mega Backdoor Roth

The Mega Backdoor Roth strategy is indeed a game-changer for retirement planning. Its ability to significantly boost your retirement nest egg in a tax-efficient manner is unparalleled. The idea of contributing up to $65,000 annually to maximize the Mega Backdoor Roth can be formidable, therefore it is important to come up with a personalized strategy of how to best incorporate into your own financial plan. For example, one practical method is to treat your RSU Stock Vests as if they were cash bonuses, channeling those dollars into your Mega Backdoor Roth contributions to receive these tax and diversification benefits.

Our team of financial planners specialize in working with Microsoft Professionals to create a personalized road map to financial independence. **We invite you to book a strategy session with our team today to review how the Mega Backdoor Roth and other key strategies fit in to your plan!**

[1] *Case study return for illustrative purposes only and not a promise of future performance.*

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