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Here Are 2 Ways People Have Large Roth IRA Accounts

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Since 2009, I have typically given at least 40 talks per year and thousands have attended my financial seminars. Many have seen me for a consultation on their taxes, investments, and retirement planning and I've noticed that no more than 2% have more than $30,000 in a Roth IRA account. The main reason is that Americans love getting the immediate tax deduction when they contribute to a traditional IRA or 401(k) account. The earnings are tax-deferred, but then all withdrawals (with the bulk taken during retirement) are taxed as ordinary income. This is only fair because traditional IRA or 401(k) contributions come from either wage earnings from a job or profits from one's business.

There are only two ways to have large amounts in a Roth IRA account. One designates most annual contributions as Roth instead of traditional. This means that one does not get an immediate tax deduction in the year of contribution. However, if one waits until age 59.5 and has had any Roth IRA account for at least 5 years, one can withdraw funds in the future and there are NO taxes on one's earnings.

The second way is to convert existing traditional retirement accounts (typically IRA or 401(k), but also eligible are the 403(b) plans for non-profit employees and the 457 thrift savings plan for government employees) to a Roth IRA. Example: one has $250,000 in a traditional 401(k) account and does a complete Roth IRA conversion in 2020. This creates $250,000 of extra taxable income and most folks just can't stomach paying the large tax bill. What kinds of folks actually have large Roth IRA accounts?

Farmers: consider their farm a multi-generational legacy and want their kids and grandkids to inherit the farm and continue working the land. Example: In 2010, I met Bill and Susan, married farmers from a small Iowa town, who attended a seminar I gave in Mesa. They converted their entire $510,000 traditional IRA to a Roth IRA. I offered them the option of converting a third ($170,000) per year over 3 years to keep the tax rate down, but they did the entire $510,000 Roth IRA conversion in 2010 and paid $175,000 in extra income tax with other savings. The Roth IRA would generate over $2 million in future tax-free income for their four kids. Their hope is that this $2 million will allow the kids to stay in the small Iowa town and continue to work the farm. This also allowed them to stop paying $110,000 per year of annual premiums on two different $1 million death benefit whole life insurance policies which was their original strategy to leave the kids $2 million. Mary loved having an extra $110,000 of annual income she could spend.

Those who want to leave a legacy to kids, grandkids, and charity: In 2015, a single client did a $400,000 Roth IRA conversion and it cost him $150,000 of income tax, which he paid with savings in order to have the full $400,000 inside the Roth IRA. He then invested in real estate deals where the expected rate of return would double his money every five years (about a 15% compounded annual return). In 20 years, the expected value of his Roth IRA would be $6,400,000. The entire $6,000,000 of earnings is tax-free. In 20 years, if the entire amount is shifted from growth-oriented real estate to cash-flow real estate including lending programs, he expects an average 10% cash flow. This $640,000 of annual income would be available to kids, grandkids, and various charities. What is lower, paying tax today on $400,000 of income OR on $6 million of earnings in the future?

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Dr. Harold Wong earned his Ph.D. in Economics at the University of California/Berkeley and has appeared on over 400 TV/Radio programs.