Episode 153 - Roth At Any Income

Episode Transcription

"Like the guy from How I Met Your Mother, Ted. It's a future Ted problem, not a today Ted problem. Today Ted gets the tax deduction. Later, Ted's going to have to pay tax on all those distributions.

Paul Adams: Hello and welcome to Your Business Your Wealth. My name is Paul Adams, I'm co-host of this podcast, CEO and Founder of Sound Financial Group. And I'm joined, as always, by the illustrious Cory Shepherd. Cory, are you as excited today as I am?

Cory Shepherd: I am, I am indeed. I'm excited to be back from a couple weeks away from the show out of range of WiFi, in fact, the whole days where I didn't even turn my cellphone on.

Paul Adams: Nice!

Cory Shepherd: It was amazing. Oh, I am the President of Sound Financial Group, by the way, if we're using titles this morning. I guess we are.

Paul Adams: Well, there could be a new listener who's like, "Who are these people and why would I listen to them?"

Cory Shepherd: Right, right. Well, and we're so excited about being back, and so excited about the topic, in fact, that we don't have a this weekend planning article just 'cause we have way too much to talk about. And Paul, I know you are really excited about this one today, so I will let you tell everyone what we're gonna be addressing.

Paul Adams: It's Roth IRA at any income. You see, one of the big things that happens, we meet someone new. It is amazing how often a new potential client will be going through our application process, etcetera. And they make three, four, $500,000 a year, even a quarter million dollars a year, and they have no idea that they could be doing a Roth IRA. Everybody's told 'em, "You can't do a Roth IRA." They google Roth IRA income limits, and it's also not a part of the regular communication out in the marketplace about how to do what we're gonna talk about today called a backdoor Roth IRA. And stay 'til the end of the episode because oftentimes, people are gonna wonder, "Well, why in the world don't I hear about this, guys? This seems so amazing!" Well, the reason that you don't hear about it is because there's some real interest against everybody doing a Roth IRA, and it's not just the IRS.

Cory Shepherd: So I think good place to start would be just getting clear for everyone on what the contribution and deduction limits actually mean 'cause first thing people tell us is, "I make too much money to use a Roth IRA." And that's only partly true.

Paul Adams: Indeed, indeed. So Jordan, if you can cut to my screen here, we're just gonna walk you through a little bit of the income limits of IRAs and Roth IRAs, and why people get tripped up, thinking that they can't do it. So to start off with we just have a regular, traditional IRA. This is an IRA you set up in your name, it's the IRA that's existed for decades, and you have no income limits. You can make as much money as you want and put money into an IRA. The income limits are based upon two things. One is, do you have a 401k? Because the income limits are not about contribution in an IRA, that's a big misnomer; it's about the deduction of the contributions to an IRA. So that traditional IRA is non-deductible if either spouse has an employer-sponsored retirement plan, and the household makes over 74,000 if you're single or 123,000 if you're married. Now, Cory, will you just talk about the phase-outs for a second?

Cory Shepherd: So starting at 103,000 for a married couple, you can't deduct all of your contributions to the IRA... But you can deduct some, and then by the time you hit that 123, you can't deduct any of it. Now, I get it, I know why, 'cause the person... If it was just 123, and the person who made 124 was cranky 'cause like, "Oh! $1,000, and I could have deducted. Now, I can't." So they set up this phase-out range but it's only 20,000 and it's a deduction on a $6,000 contribution. So the total net impact, one way or the other, it's not like it's the hugest thing in the world that it creates all this needless complexity of, "Oh, I gotta keep track of this phase-out range." I think it's one of the reasons why the IRS is considered a little bit inefficient. We have all this cost of administering the tax code and why people push for simplification. This is one of those things.

"For many, many entrepreneurs, you are not as likely to retire in a lower tax rate as the person that's a high income earning executive."

Paul Adams: Exactly. And the one big thing to remember is that there is this phase-out that occurs if neither spouse has a 401k. If one spouse has a 401k, you're subject to these phase-outs on your deductibility of the IRA. Now, the funny...

Cory Shepherd: Now, the other side of it is that if neither of the spouse has a retirement plan at work, then you don't need to worry about the income levels for the purposes of deduction.

Paul Adams: Exactly right. That employer-sponsored retirement plan is key, not just 401k. There's several types of employer-sponsored retirement plans. All of them, if either spouse has one, will knock you out of the deductibility at any income, and you'll be subject to these phase-outs. That is traditional IRA. Now, if you are subject to the phase-outs, let's say you make $300,000 a year, you have a 401k, something we see a lot, for some reason, it tends to be around people who work in technology and highly analytical spaces. I would contest that it's because they understand the power of the math of compounding without taxation each year. So we notice a bunch of people will make after-tax IRA contributions when they make over a certain amount of income. And how that works is you have a basis that's the amount, you don't have to pay taxes on again. You make your contribution every single year, and then when you take your distributions, you pay your tax on the growth. Pretty simple. Here's the trouble, and we're gonna talk about this again in a few minutes: It's your responsibility as the taxpayer to track that basis.

Paul Adams: So if you make a $5000 a year contribution, make my math easy here, I'm doing this off the top my head. For 20 years, you have made $100,000 contribution. If it's worth half a million dollars, then you have 400,000 of gain, and 100,000 of basis. So that when you take distributions, you don't have to pay tax on the $100,000. And there's something called the pro-rata tax rule we'll talk about as we wrap up this episode, but here's the key: It's your responsibility as the tax payer to track that basis. So if you're making contributions at age 45 and maybe you don't take your first IRA distribution 'til 70, you've had to keep those records for 25 plus years. I have a hard time keeping hold of a pair of running shoes for a year-and-a-half, I don't think I'm gonna be able to track tax records for 25 years with a level of efficacy I would want to take those contributions back out tax-free. So let's transition to Roth IRA. Roth IRA has a phase-out similar to traditional IRAs in how it phases, except the limits are a little bit higher. But now, once you're over the phase-out, you can't...

"Put your money into an IRA first, and then immediately convert it to Roth and then you have a Roth IRA. That's exactly how it works, there's no major mystery to it."

Cory Shepherd: And why wouldn't they make them the same stinking numbers? Why?

Paul Adams: Amen!

Paul Adams: They just need to make them higher, because feelings I don't know why.

[chuckle]

Paul Adams: The Roth IRA phases out from 122 to 137, if you're single, and the phase-out is 193 to 203, if you're married. So for the most part the clients that reach out to us and apply to become clients, we think most of our listeners, just out of hand don't qualify to put money into a Roth IRA. And here's the trouble even if you're close, one of the problems that can happen is you make your Roth IRA contribution earlier in the year, and then your business is unexpectedly more profitable, you're having a break out year. Or if you're an employee and you get a bonus, uh-oh, 'cause it's all sources of income, your regular wages plus your K1 distribution through your business. But here is the part that gets fun, which is the ability to convert, Roth IRA to Roth from taxable to non-taxable. We just have to pay the taxes, one time. Now, you could do this all or in part. You could say, I have $100000 in IRA, I'm gonna convert it all this year. Cory what happens to them, tax-wise, if they just convert all of an IRA to Roth in a single year?

Cory Shepherd: That 100000 in your IRA filters right into the tax bracket that your last dollar that you earned in your paycheck went and potentially bubbles over into the next one. So you do have to be careful and be aware of where you are on those tax bracket levels and know it's not the end of the world if you bubbled over to the next one but you do wanna do the math to make sure that it's still a valuable transaction for you by paying the extra tax at that higher level.

Paul Adams: Exactly right, that is key in the realization in the difference between your marginal tax rate, and your effective you might get your tax returns back from your CPA and it says that you paid on average 23%. But that includes your lowest brackets averaged

"One little technique, if you're a business owner, and this is key, you should make sure that you are controlling the investment structure."

with your highest brackets. When you do an IRA to Roth conversion, it's gonna be at that last highest bracket, which might be 30 some percent for you including if you're in like California, New York, New Jersey or many, many other states with a regular state income tax also you're gonna have that tax as well on the conversion. We don't get to escape it, unless you move out of the state. So...

Cory Shepherd: Now, Paul can I just... Now that I'm the ranting one today. If folks are a little confused this is where the confusion comes from, because they say, "Oh I knew that there was this income limit for me, putting money into a Roth but I can just change any of my money into Roth at any time still? Wait, I thought... " Yes, it's a situation that I think only politicians could create, that is a little wackadoodle and it'll get even more wackadoodle when we talk about backdoor Roth in a moment.

Paul Adams: I don't know if you could do this really quick, Cory, and we can come back to it, but would you, just 'cause I'd love to get the actual number, I know it's out there on the web. Could you just look up while, we convert to our next section here to tell me how much Mitt Romney and Mark Zuckerberg, have in the Roth IRAs. 'Cause there was some kind of disclosure they had to make to the SEC, that disclose this and it's amazing. And why did they have this, 'cause they did one of these IRA to Roth conversions, some time ago with some of the privately held securities that they had and the regular publicly traded holdings.

Cory Shepherd: It's estimated that Mr. Romney has between 20.7 million and 101.6 million in an IRA account and that's pre-tax.

Paul Adams: But there's another one out there for his Roth, I thought, and Zuckerberg's Roth.

Cory Shepherd: And their Roth, oh, let me make a check.

Paul Adams: Because what I think you almost see is that there is huge amounts of capital to be made outside of the regular IRS income tax system with the use of a Roth IRA. It's easy to miss because many people don't wanna deal with the temporary pain if you will, of paying tax today and we do much, like you've heard us talk about what's the guy from How I Met Your Mother?

Cory Shepherd: Ted.

Paul Adams: Ted. It's a future Ted problem, not a today Ted problem, today, Ted gets the tax deduction, later Ted's gonna have to pay tax on all those distributions because for our clients, for most of you listening to this podcast for many, many entrepreneurs you are not as likely to retire in a lower tax rate as the person that's a high income earning executive, because you'll have the sale of your business, you'll no longer have all the

"IRA's are considered one of the stickiest assets for these asset management firms."

deductions you run through your business today, you won't have your 401K IRA deductible contributions happening anymore and there you'll be taking distributions all at regular income tax rates, and that's if the IRS doesn't increase taxes due to all the spending that's occurred, anything on either of those guys?

Cory Shepherd: I haven't found Zuckerberg. I have found an article about Dustin Moskovitz who is another... Oh no, Max Levchin, who started Yelp, he's got how much 95 million, in a Roth IRA.

Paul Adams: Yeah, that's perfect. No required minimum distributions, totally tax-free on distribution and while it's subject to whatever "death tax" may occur, there's no income tax when it passes to heirs. It is an exceptional tool that is highly underused but that even by Cory's example, some of the wealthiest people out there use and now we'll have to do more searching and Googling we'll put in the show notes if we find those articles to Mitt Romney and Zuckerberg's Roth IRAs.

Paul Adams: So let's look at what happens to be able to pull off the backdoor Roth IRA, you see with a regular IRA conversion, it's pretty simple, we've just talked about it. All you have to do is take your traditional IRA put it in a conversion, it stacks on top of your regular income taxes, done deal, now it's tax free in the Roth IRA going forward forever, no required minimum distributions at age 70 and a half, which on a traditional IRA has up to a 50% tax on what you didn't take, that you were supposed to take. And tax free to heirs outside the estate tax system. We talked about that. [13:34] ____ miss any of it.

Cory Shepherd: We should also put an exclamation point for folks that when you're doing that conversion, you're gonna wanna have the cash in some other pot of money to pay the taxes.

Paul Adams: Oh yes, say more about that.

Cory Shepherd: Because... Well, so the IRS is very benevolent and will allows you to create this conversion opportunity. But, if you're under 59 and a half they won't even let you take the money out of the IRA to pay them without charging you the additional 10% early withdrawal penalty. So, if you're converting a, let's just make numbers easy, a $100,000 IRA all in one fell swoop and you're at 30% tax rate, then you need 30 grand in a savings account, in some other investment account you can cash out for your tax bill come the next April because it can't net out of that account unless you wanna pay that 10% penalty.

Paul Adams: I was gonna say, yeah. Then you'd take out the 30,000 from your IRA, then you better have $3,000 in savings to pay the extra penalty, which is typically the breaking point, we won't recommend that people do that. But now let's talk about the backdoor Roth IRA and how it can be executed. You see, for many clients you have a bunch of

"The financial industry has taught people to make enormous contributions to these pre–tax accounts, to do so in a way that may even drive them into a higher tax rate into their old age, creating that shadow that you can't outrun."

money inside your company retirement plan. Most of our clients are business owners, they control their retirement plans, so they can put a lot of their 401k based money there. We also have some of these clients, you could be one listening, that has a solo-preneur type business, meaning we have clients that make over seven figures a year, they have one staff, no staff or a contracted virtual assistant and super low overhead.

Paul Adams: Or maybe you have a unique business, just you and your spouse in a consulting role. You may be able to ensconce your money into a solo 401k. If you have anything that has your money outside of IRAs so that you don't have any pre-tax IRAs, that's what this is gonna apply to, I just wanna be super clear. To do what I'm about to say you need to have at least one spouse that has no deductible IRAs or you've already gone through the procedure we just discussed to be able to convert the pre-tax IRA to Roth so there's nothing left in pre-tax IRAs. Now, this is not per household like the 401k rule is around contributions, this is on a per spouse basis. So, all you need is one spouse with no IRAs and you can do what I'm about to say.

Paul Adams: So, you have an unlimited opportunity to contribute to an IRA but what we can do is choose if we want it to be deductible or non-deductible. In this case, even if we qualify to deduct part of it, we're gonna choose to make it non-deductible, that's $6,000 per spouse per year if you're under the age of 50, 7,000 per spouse per year in 2019 if you're over the age of 50. Now, there's no income limit to contribute to that IRA, we're going to leave it non-deductible. Now, think about this for a moment if you're listening, just picture it in your head. You have $6,000 you just put into an IRA, it's non-deductible, which means if we took it out in a qualified distribution you're either converting it to Roth or if we were over age 59 and a half and just decided to take it out there's no taxes on it because we put it in after-tax, that's part of the basis, we're just not waiting to let it grow to earn any taxable earnings. We put it directly into the IRA, immediately convert it to Roth, and we could do that every single year.

Cory Shepherd: No matter our income level.

Paul Adams: No matter our income level. And I gotta tell you that even as I re-say it this way where I know I'm talking to many of you who've never heard this before, that it can sound really strange. Like, "Wait a second, you mean all I have to do is put my money into an IRA first and then immediately convert it to Roth and I have a Roth IRA just like as if I had contributed to Roth?" Yes, that is exactly what we mean. That is exactly how it works, there's no major mystery to it. All they're gonna do is that the rule is on December 31st of the year you did this backdoor Roth IRA, they look to see is do you have any other IRAs on the books? Because if you do have any other IRAs on the books it's gonna introduce something called the pro-rata tax rule that we would ideally like to avoid for most of you. But the key is we just gave you the keys to the kingdom to be able to contribute for, say, two spouses, both of whom either have their money in 401k's or solo 401k's or some employer-based plan.

“If the New York Times published an article tomorrow that all these doctors had been creating a problem... the scandal would be unthinkable. But this is exactly what’s happening when firms aren’t talking about the ability to do this, [they] aren’t offering people the chance to do a backdoor if they could.”

Paul Adams: They could be contributing as much as either 12 or if both spouses are over the age of 50, $14,000 every year into a tax-exempt environment where they're not gonna be subject to required minimum distributions and where they can withdraw the money tax-free. Now, something we didn't talk about very often but does come up periodically is people talk about asset location, we talk about that often, short-term, mid-term or long-term money. And then, there's asset allocation, that's one everybody talks about like, "Oh, how's your asset money allocated?" In fact, that's what most advisors only talk about so we want asset location, asset allocation, and asset taxation. Because then if taxes get out of whack in our old age we have the ability to use this as a reserve to distribute money from it a way that is highly predictable and tax-free to manage our taxes more effectively upon distribution.

Cory Shepherd: If I could re-rant one more time before we go to commercial, it's like people might be asking, "Well, why is there even an income limit in the first place if I can still get the money in, it's just creating more work and not really creating any more benefit?" The pro-rata rule might be one of the reasons why they did it this way, to force some of the more wealthy folk to churn through some of that money, we'll talk about it a little bit later, but it's a question that's somewhat unanswerable... I haven't seen an answer yet, why do we complexify everybody's life? I just made up a word. George Bush hasn't been around for a while so I had to...

Paul Adams: I like that.

Cory Shepherd: Yeah. So with that, I think it's a good time to go to commercial from Sound Financial Group and take a moment to hear a little bit more about how you can engage deeper with us at SFG and at Your Business, Your Wealth, and we'll be back with some of these pitfalls of the backdoor Roth in just a moment.

[music]

Paul Adams: Hey everybody, I had to interrupt our show for just a moment to share with you something new. We've designed a new White Paper that we think is gonna add you value in the way that you think about money. It's Three of the Biggest Mistakes We See People Make and Six Ways to Fix Them. Now, for some of you, you might not want the White Paper, you might be ready to have a conversation with us, and that is okay. You can email us at info@sfgwa.com, that's info@sfgwa.com. Find us on the web at yourbusinessyourwealth.com, and any time on any of our social media platforms, send us a message and we can get you this White Paper. But in the meanwhile, if you want to just skip over the White Paper, have a philosophy conversation with us, we're happy to do that with you, just let us know "Philosophy Conversation" in the subject line. And if you want this White Paper, just put "White Paper" in there, and we'll immediately get out to you this White Paper on The Three Biggest Mistakes That We See People Make, and the

Six Things That You Can Do to Fix Them. And now back to our show.

Paul Adams: Welcome back to Your Business, Your Wealth. We are going to jump right into what are the pitfalls of the backdoor Roth IRA. They are a plenty and they can hurt. Jordan, we won't need to go to my screen right away, but we will in just a moment. So here is the first piece, is the problem comes up, if you try to do a backdoor Roth IRA, and this is per spouse, remember, not per household, per spouse, if you have an IRA, Simple IRA, those both qualify simple IRAs don't count as an employer-sponsored plan the same way for 401Ks defined benefits, money purchase plans, all that stuff would qualify as, okay? So, it's Simple IRA or IRA. If it's got an IRA in it, it's gonna count.

Paul Adams: Now, if those contributions were made pre-tax, you are going to have to pay some portion of the taxation on the entire account on a pro-rata basis. So to cover this, what we're gonna do is go to the blog of a gentleman named Michael Kitces called "Nerd's Eye View" was its original name and he's done since re-branded it to kitces.com, but he does most of his writing for financial advisors. So he's not always the easiest to understand for a regular consumer, but he does a really great job and thank you Michael Kitces for doing such a wonderful job of graphics every time you're posting something so it really makes sense to people.

Paul Adams: So here is where, as an example, somebody tried to do a backdoor Roth IRA and what could go wrong. He was, he is just illustrating it here. We have a $67,000 IRA and it's all been funded pre-tax either in contributions to an IRA, or they contributed to an employer-based plan and converted it over. Then they made a $5000 after-tax non-deductible IRA contribution. That means that of all of their money that they have, 6.94% is after tax. So now we make a distribution. A distribution could be made like you're at over age 50 and half, and you're thinking it's distribution in your old age, that could be a distribution, but it's also kind of as a distribution when you move an IRA to a Roth. So, if this same person with $67,000 pre-tax and $5,000 after tax, giving them an IRA worth a total of $72,000, where to say, I'm going to try to do a backdoor Roth with this $5,000.

Paul Adams: What's going to happen is that only $347 of the $5,000 conversion to a Roth IRA is going to be tax-free because the inverse of the 6.94% effectively 73.06%, 93.06% that's what I get for doing math in my head live on the show, is going to be taxable. So the backdoor Roth IRA being able to do this without any income tax consequences, meaning you made the IRA contribution after-tax, made the Roth conversion immediately after does not work if we have other IRAS it invokes this pro-rata tax rule. And here's our bigger problem: Remember, earlier I mentioned to you that you could be responsible, are responsible for keeping track of your basis when you've made non-deductible IRA contributions. Now, Cory and I've watched over the years finding people that have accumulated say over five or six or 10 years a bunch of pre-tax, post-tax contributions mixed with pre-tax contributions to an IRA. Some were rolled over from 401K, some were contributed, here's the major problem with that, is that now you have to track that basis. And in this case you created basis but you have to also do the math of, "Oh, well, there is $5000 that was after tax, we used 347 of it for the pro-rata tax rule, that leaves us with $4,653 of basis that I can use later when I take the distribution. You can get a sense of how painful this could be.

Cory Shepherd: I think there's only one person that I've met who actually had all the records, that's our very own Jeff Miller, and it still took him just ages to go put it all together to be usable.

Paul Adams: Oh, my goodness.

Cory Shepherd: So, best-case scenario is you're gonna spend a bunch of Saturdays [chuckle] coming up with everything.

Paul Adams: Best case scenario. And that was contributions he'd done over the prior 10 years and I think Jeff has said as much publicly if he had not met us, odds are he wouldn't have known that, his records would have been too old, there would have been no way to track it down. By the way, if you're making distributions when you're in your mid-70s, do you think that is how you wanna spend your weekends? Is trying to figure out how many non-deductible contributions you made to an IRA 30 years ago? Oh, so with that, this is the problem with the pro-rata tax rule, we try to avoid it at nearly any cost and it's okay to not be able to do this. It's just that, if you do qualify to do the backdoor Roth IRA, you should do it every chance that you get because the compounding capacity is amazing. I'm gonna just pull up a very quick time value money calculator to give you guys a sense of it. I don't need to run two of them, I'm only gonna run one but I wanna give you a sense of how big of a deal this is.

Paul Adams: If somebody has the ability to do $6000 a year to an IRA for 30 years and they get an 8% rate of return, over that period of time. That would be a total of $734,000. And if we could do it for both spouses, again, the IRA contributions increase a little bit every year. Although, for the sake of this conversation we're just saying $6000 a year per spouse for 30 years running, that's almost 1.5 million dollars. It could be in an IRA. But if it's in a traditional IRA, how much of that belongs to you? 65%? Because that tax liability moves with you through time. Unlike a mortgage that gets slowly paid off over time. It's much more like a shadow that you cannot outrun that tax liability. And the only difference is, how you behaved on the front end, and whether or not you could do a backdoor Roth IRA. Because then, it's the exact same number of 1.468 million. Except, it's tax-free. That's the power of doing this. It's super small on the front end, it's super big on the back end. Alright, I think we're done with my computer screen, Jordan.

Cory Shepherd: And this basis tracking forever issue becomes not an issue if you have no IRA balances or if you've converted all of your IRA balances to Roth IRA. Which you may want to do anyway if you have a large 401K deferred tax balance. Anyway, that's where most people started saving and investing. Then you may wanna balance out your tax channels anyway and be in a strategy of IRA to Roth contributions. So you can get yourself out of it. Once they're converted then you don't need to track that basis anymore.

Paul Adams: We work to do a tax review with our clients every year around November, at least November, maybe earlier so that we have some lead time before the calendar year ends. And here's why, let's say, in your business, you're having a rough year this year. You did some major re-investment, you hired that new key executive that you had to pay a quarter million dollars a year so that you could spend more time with your family. Anything that created a significant draw down on your income. Perhaps you set up a captive insurance company or a unique defined benefit plan that has your income a lot lower than most of the years. To Cory's point. That might be a great year to trigger an IRA to Roth conversion, because you have this extra latitude. We even do it sometimes for our retirees in a year where maybe they make a large charitable contribution it can make sense to convert a chunk of IRA to Roth that year. And one little technique that Cory and I run into periodically...

Cory Shepherd: So clever. So sneaky.

Paul Adams: Yeah. If you're a business owner and this is key, you should make sure that you are controlling the investment structure in the 401K you're gonna do this with. Too often, we won't have our executives do this because there isn't enough control over the plans 401K, to control the way their money is invested properly. But if you control the 401K and we can make sure you have solid investment options, that are academically allocated, globally-diversified, and low cost, then you can hide your IRAs in your own 401K. Or if you're one of our solo-preneurs, you could do that inside of a solo K, leaving only the IRAs that you just created that have basis because it was non-deductible and then you can do the back door, Roth IRA. It's a little bit of a step process. I would not like... What is it like? Do not do stunts. Do not perform without adult supervision or without professional supervision. This was done on a stunt course by professional drivers, do not do that one like solo by Googling. That can be highly complex. In fact, several of these things maybe should not be operations, not to be executed by Google.

Cory Shepherd: So, Paul, that we promised them at the beginning that we'd get to talk a little bit about the answer to, "Why in the world haven't I heard about this before?".

Paul Adams: I know.

Cory Shepherd: It maybe what a lot of people are thinking.

Paul Adams: And by the way, it hurts mine and Cory's heart every time we know somebody didn't know about this. And we have some of the biggest, most prestigious wealth management firms out there who've have had clients that they have lost to Sound Financial Group. Or I should say we have had clients that were clients of them who have gained through their new relationship with Sound Financial Group. For this reason is just simply being able to say, "You know those people", I don't wanna name any company names, but they would rhyme with things like "more than", "trust", and Darrell Lynch, private client group, things like that.

Cory Shepherd: Yeah. Right.

Paul Adams: So when they're at those, firms those firms are concentrating so much on the asset allocation. And asset performance, they're not looking at some of the broader view. And when I sit down with somebody and say, "Why did they, for the last 10 years, not bring up the backdoor Roth IRA? You would have qualified this entire time". And they go, "What do you mean?". And sometimes, the difference by the time we meet them could have been hundreds of thousands of dollars they could have had in Roth IRA by the time they get to us. So why is it Cory, that they don't tell all their clients, all the time, about this opportunity?

Cory Shepherd: So a big part is that it's a major disincentive for the advisor. Meaning a client might think, "Well, I'm putting the non-deductible contribution in and then that all of it's going over". So the advisors managing the same amount, except, you've gotta pay that taxes from somewhere else. And on that 100,000 dollar account, that 30 grand in taxes that was in savings was gonna get contributed to their investment account. Maybe it was in a brokerage account that the advisor is managing that goes to the IRS, doesn't stay with a firm. So there's a major disincentive for big box financial retailers and the E-tailer firms teach advisors how to do this.

Paul Adams: [32:48] ____ advisors don't teach it, the no load companies don't teach it. Look at all the... This is not so complex. Yes, a banner ad on Facebook, could communicate this like those all... Why don't they? Well, in part, 'cause of what Cory just said.

Cory Shepherd: It's also double the paperwork for a $6000 contribution. And.

[overlapping conversation]

Paul Adams: For every client.

Cory Shepherd: Everyone, yeah.

Paul Adams: Every client. And to what Cory just said on 100,000 so if you have $1 million IRA, it's less likely your advisor is gonna wanna do the math with you. Because the advisor and the brokerage house, they work for will make 30% less post-conversion. 'Cause you'll move the million dollars from IRA to Roth but then on the other accounts you have with them, they're not in retirement accounts, you'll have to take $350,000 out, that's a lot less money for the advisor to manage and it almost guarantees that your money will be less sticky. So stickiness is something that's taught by these large financial institutions that your money is less likely to move from either one brokerage house, to another. Or to actually be withdrawn. And IRAs are considered one of the stickiest assets for these asset management firms. Because of two reasons: One, if it's a retirement account... Whatever statistic why you're less likely to move it from one institution to another. But second is that when you take the money out, the institution doesn't need to punish you. Because Cory, who's gonna punish the client for taking the money out?

Cory Shepherd: The IRS?

Paul Adams: Yep. And they have guns.

[laughter]

Cory Shepherd: They do that's true.

Paul Adams: So when they say, "Hey we're gonna take this money, you next year don't wanna take as much out of your IRA. You'll consider taking it out of elsewhere. And the brokerage house, is getting to manage both the IRS's money and your money. We've talked about this before, but I cannot stress it enough. If you're on a 35% tax rate, and you have $1 million invested only 650,000 is yours, 350,000 belongs to the IRS and here you are doing things like listening to this show, so you can do better with your money. But you've got a partner, with 35% in that retirement account and that partner is benefiting from all the work you do to be better with your money. That doesn't mean you should never do a retirement account. It's just us looking in and telling the truth about what's actually there, what's available and how much is yours? So...

Cory Shepherd: And gosh... Required minimum distributions, we've talked about in the past, I know you've heard from us, but the IRS literally knows how objectionable it is to people to take money out of these accounts later in retirement, so they force us to through required minimum distributions. Starting at 70 and a half. So here's a question: If the IRS knows you're not gonna wanna and they're gonna make you then when do you think you'd rather do it at their timing down the road, or maybe as soon as possible? That's the question that we float.

Paul Adams: Cory... And that if you don't take distribution it's your taxes plus an extra 50% of what you didn't take.

Cory Shepherd: Of what you would have taken. Yeah.

Paul Adams: It's one of the most draconian like punishments the IRS has for us. It's bad... Now here's why the institution also love it. We talked about stickiness of assets, but financial institutions, attorneys, all kinds of folks will teach things like stretch IRA provisions. So if you have a really, really big IRA. Well, you don't want your children to pay taxes on this all in one shot. And then what they... The quiet part that they don't say out loud is and we don't wanna lose all the assets that would be managed 'cause your heirs have to take out 35% of it to pay taxes all in one year. That part, they don't say, but they will say, "Well stretch this out slowly, pay the taxes over time, look how much wealth can be created for the next generation, but we're still not escaping that embedded tax. Think of it this way. The financial industry has taught people to make enormous contributions to these pre-tax accounts. To do so in a way that may even drive them into a higher tax rate in their old age, creating that shadow that you can't outrun. And I think Cory put it best pre-call. Well, you give the quote... I think you deserve to say this one, it's so good.

Cory Shepherd: It's just the way it occurred to me was, if the New York Times published an article tomorrow that all these doctors had been creating a problem that they were then making money off of by selling the pill to treat the symptom, but never actually doing away with the problem that they created. The scandal would be unthinkable in that case, but this is exactly what's happening when year after year firms aren't talking about the ability they just do this, aren't offering people the chance to do backdoor do solo k, if they could like... This is huge, yet it doesn't get talked about, which is why we were so jazzed about this episode at the beginning.

Paul Adams: I'm glad you guys could hang with us through that. We know we went a bit analytical. If you haven't had a chance, watch for this also on YouTube, be sure to like it and you could share it. If you're like, "Do I qualify for this?" And you want to... You know, kinda nudge your CPA or nudge your current advisor, send him this episode. Or reach out to us directly. We've given you through the commercial and at the end of the episode how to do that, but always know you're welcome to reach out to info@sfgwa.com. I cannot tell you how much we appreciate your reviews on iTunes. It really helps not just us, but it helps all the people that are inevitably gonna find one of these episodes. Because you took the time to care enough to write a review, give us an honest rating and put other people in a position where they might get a chance to hear a show like this one and your review, your sharing of this episode might mean the difference, no kidding to the tune of hundreds of thousands of dollars of additional taxes in retirement, all because you took the time to pay it forward with a short review or take this episode, hit that little three dots next to it and text it to a friend saying, "You've got to hear this." Let's talk a little bit about our giveaway this week. Cory what do people get if they send us a screen shot, of said review.

Paul Adams: You have a choice of Sound Financial Advice from Paul Adams, Cape Not Required from Cory Shepherd or Clockwork from Michael Michalowicz. And again, an honest review does not have to be of any particular flavor. We just would appreciate you giving your feedback and send us the screenshot to info@sfgwa.com and let us know which of those books, you'd like. Send us your address, and we'll get that out to you in the mail. And we've got a great review, today. That was made recently, just a couple of weeks ago by Joel. And Joel says Cory and Paul do a tremendous job breaking down complicated financial concepts and offering useful tips.

Paul Adams: I agree with him.

Cory Shepherd: I just listened...

[laughter]

Paul Adams: He didn't say anything about the good looks, but maybe he's only listening on the podcast.

Cory Shepherd: Yep. I just listened to the episode 149 about 529 plans, my wife and I have a 10 month old daughter, and we're preparing to set up a 529 plan but we've decided against it based on the information Cory and Paul laid out, that single episode likely saved our household, a lot of financial heartache. Joel thank you so much for letting everybody know what you got from the podcast.

Paul Adams: And I can't help it. Of course, I read this before Cory, but I'm like a little choked up, because one of our listeners may have just forwarded this episode. It might have been somebody who requested one of our free White Papers from before in a prior podcast. Got in his email, ran across it randomly on Facebook. But they were able to make a very different choice in life, that gives them more agency and autonomy with their money, beyond what the financial institutions look to deliver to people which is the delivery of a product to answer something that people want and they do it for all sorts of stuff. And most of the products are not designed to be owned, they're designed to be sold. And things like 529 plans, things like... I think another episode we're gonna have to go through the list of the tools that are really good for advisors to sell. Like meaning the narrative sounds good, but they're really terrible to own for several decades in a row.

Paul Adams: And let our listeners have some taste of that. So Joel thank you for taking the time for your future to be able to be a listener of the podcast, and thank you to all of you who make that review who text this episode to one friend, because it has the ability to make a profound difference for them and ultimately it'll make a profound difference to you, the better people are thinking about money. To your right and left as you go through life with them, the better you're likely to do. And Cory and I from the bottom of our hearts, hope that this podcast, much like that podcast was to Joel on the 529 plans has been a contribution to you being able to design and build a good life.

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