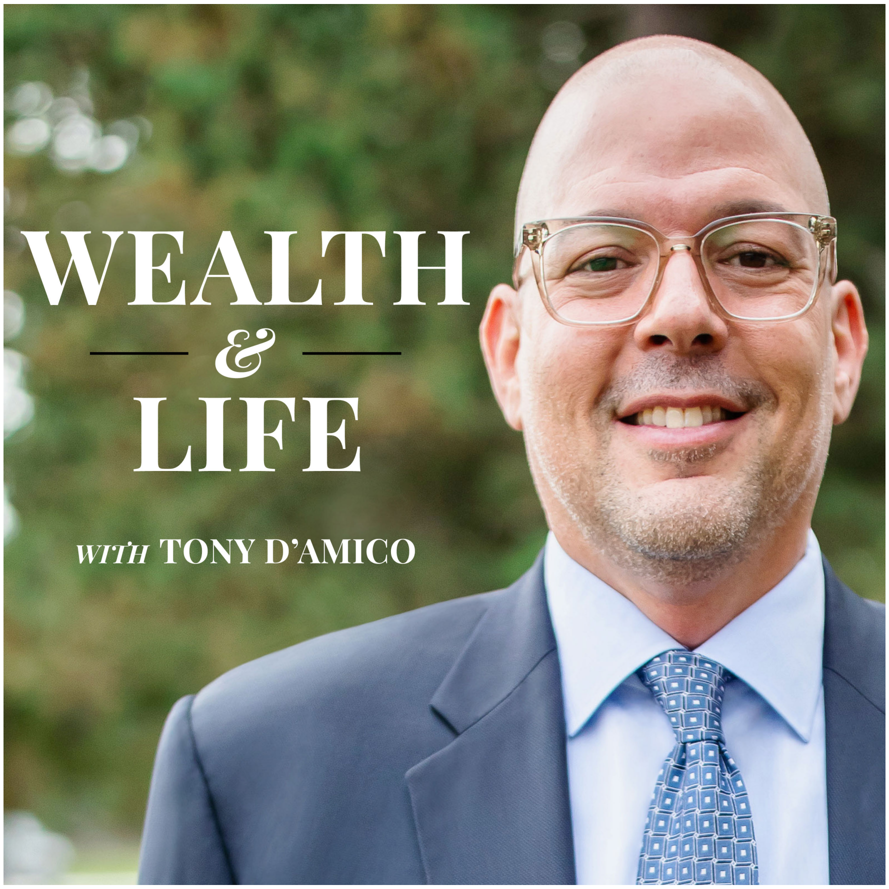
Ep #17: The Power of After-Tax Contributions Into Your Retirement Plan for Alexion and Cleveland Clinic Employees with Marissa Beyer



Full Episode Transcript

With Your Host

Tony D'Amico

***Wealth and Life* with Tony D'Amico**

Ep #17: The Power of After-Tax Contributions Into Your Retirement Plan for Alexion and Cleveland Clinic Employees with Marissa Beyer

Welcome to *Wealth and Life*, where you'll learn with financial planner, consultant, speaker, and business owner, Tony D'Amico. You'll hear stories from successful business owners and individuals about how they navigated the inevitable challenges that arose as they achieved each new level of success, and you'll get insights and strategies from leading wealth planning professionals on how to achieve your next level of success. Now here's your host, Tony D'Amico.

Tony D'Amico: Hi, everyone. Welcome to this episode of *Wealth and Life*. And today we have Marissa Beyer, who has been a certified financial planner for a little over 10 years and has been providing financial planning for over 15 years. Marissa also is a lead wealth advisor at Fidato Wealth, and she is the past president and current chair of the board for the Financial Planning Association, the chapter in Northeast Ohio.

So Marissa, welcome to the podcast. Look forward to really talking about an important strategy that we do for some of our clients and you sharing your wealth of expertise on the topic. So today we're going to talk about making after-tax contributions to a 401k, what that strategy is, why someone would do that, and who benefits from it. So Marissa, please share with our listeners what is that strategy, and perhaps who do you see that takes advantage of that strategy.

Marissa Beyer: Sure, Tony. So that's a great question. So as advisors, we're always trying to set our clients up for success. And one of the things that we hope to do while they're working is to have them save into different buckets of money. So pre-tax, after-tax, and then also make Roth contributions, which would be able to grow tax-free. A lot of our clients, they earn good incomes, and therefore, due to those incomes, they don't have the ability to make direct Roth IRA contributions.

So right now, for individuals that make over about $200,000 of modified adjusted gross income, they're not even allowed to make a Roth IRA contribution and take advantage of that tax-free growth in those types of accounts. So what we do is we really look to maximize benefits available within existing client retirement plans, such as 401ks, 403bs. And one of the things that we found increasingly over the last few years is while a lot of our clients do a great job of taking advantage of those pre-tax contributions, which again, allows you to get those current tax benefits and save you money on your income tax returns, over the past few years, a lot more plans are now allowing for after-tax contributions.

So really what this means is once the client would contribute, in this case, the maximum amount for the year, which is 19,500, if they so choose and their plan allows, they would have the ability to create or to contribute additional money above that $19,500 up to what would be the IRS limit for the year. In this case, the IRS limit this year is 58,000. But they could put the money in after tax. So they're paying current tax rates, but then that money goes into a little bit of a separate bucket in the 401k.

And the nice thing about this is once they retire, those after-tax contributions can be rolled into a Roth IRA. So for those individuals, again, that don't have the direct ability to make our Roth contribution, it's a way to start saving money indirectly into an account that eventually will be able to go to a Roth. And the even cooler part about using this versus a Roth is depending on what a client's saving ability is, they can contribute much more money after-tax than you can with a direct Roth IRA contribution, which for 2021 is only 6,000 compared to a much larger amount if they have the ability to do so within the after-tax contribution of their retirement plan.

Tony D'Amico: That's awesome. And we just recently had a scenario like this that we can talk about, but as Marissa mentioned, when we're working with... we call them a high wage earner, it could be a professional, could be a doctor, somebody in mid- to upper-level management, and they're already maxing out their 401k on a pre-tax basis. So yeah. Marissa, let's maybe talk about a recent scenario that we discovered and what that scenario was like. So it was a couple, let's say in their mid-40s. Making really good income. Maybe talk about how they were saving and then we can talk about how we adjusted their savings moving forward. And most importantly, I'll spend a little bit of time on talking about that benefit to them.

Marissa Beyer: Sure. So these are clients that we just started working with again, mid- to late-40s, really looking to retire early. And one of their focuses was really taking advantage of the benefits that they had through work. They were both contributing the maximum to their pretax 401ks and were both receiving a nice match from their existing employer. And currently through their incomes as well as bonuses, they were saving a large amount of that into a non-qualified joint account, which had built up quite substantially over the years. Now because the account had built up, every year, they were paying interest in dividends as well as capital gains when some of the individual mutual funds and stocks had appreciated and they sold them. So one of the first things we found out and they confirm with each of their plans is that both plans were eligible for after-tax contributions.

And so one of the first things we did was we looked to see what they were saving on a calendar basis and to the joint account. And then we showed them to say, "Instead of taking these monies and putting them into the joint account where you're going to be taxed every year on those interests in dividends as well as capital gains, why don't we divert the money instead into the after-tax contributions in your 401ks?" That money then will be able to be rolled over into that Roth IRA. And because they were in their mid-40s, they had about 15 years until they were hoping to retire. So it was a nice amount of time where the amount of money that they were contributing to the joint account, which was pretty substantial, about $50,000 a year, a little more than that, between the two of them, they were able to instead divert into their 401ks after tax and really take advantage of the full amount that they could.

In this case, they're both set up to maximize to that annual IRS limit that can go into their plans. Again, this is between their pre-tax contributions, the employer match, and then after-tax contributions. And that amount is 58,000. But really what we saw is over those 15 years, by putting that money into the 401k after-tax, the amount of money that they would be able to put into their Roth IRAs when they retired, and again, roll that money out, was about 850,000.

Tony D'Amico: That's pretty powerful, right? So they were saving right at about 60,000 a year was going into the joint account. They wanted to save. They had the ability to save. They were already maxing out their contribution limit, the 19,500 to go into the pre-tax. And basically we said, "Okay, instead of putting that 60,000 between the both of them into a joint account, let's put it into your after-tax account." Right? And like you said, because they have about 15 years to go, if they continue with that savings pace and little adjustments for increased spending, now they're going to save about $850,000. Right? As you mentioned, that would now be... I mean, I think that's really so powerful. That 850,000 that they would have saved, it will grow tax-free, right? It will not be subject to capital gains tax, which currently that capital gains tax is... The maximum is 20%. But that could change potentially in the future.

So if we think about that, Marissa, that's 850,000 that they'll have money that they can take out income tax-free because it will be in a Roth, but also too, the Roth grows tax-free. In this scenario, let's say that they're 45 and they're going to retire at 60. So if they're 60 and they've saved 850,000 into a Roth that would have otherwise been in a jointly-owned account, like I mentioned, and now it's in a Roth. And let's say today when a couple reaches 65, there's a 47% chance that one of them will live to 90. Right? So that's quite a bit of time, right? So that's 25 years. But let's just say 20 years goes by. So they're 60. They have 850,000 in contributions that they've made that could be a Roth. And if you do the math... And we also have to account for the impact of this on their plan.

And I think this is really important for our listeners as we want to really have you understand the long-term impact of these seemingly little decisions. But if you have 850,000 that can grow tax-free, in this case, let's say when they're 60, if we just assume a hypothetical 7% return per year, in 20 years, provided that there's no distributions, the balance would be $3.3 million in 20 years, which now that two points... So that's a growth of $2.45 million. Right? But the amazing part is there now that growth that they experienced, whatever that number would end up being is not subject to capital gains tax—

Marissa Beyer: Or interest in dividends.

Tony D'Amico: Yes. Or income tax, right? It's not subject to taxation. So if they would have had that same growth of 2.45 million and it was subject to, let's say a 20% capital gains tax, that would be a tax bill over their lifetime of $490,000. So about a half million dollars. So definitely tax-free compounding is obviously the best kind of compounding. It really changed the trajectory of their financial plan. But I guess, Marissa, how else would you maybe, I don't know, describe the benefit to them, or I guess maybe encourage our listeners to think about how they would benefit from this strategy?

Marissa Beyer: Sure. So one of the things that we learned when we were helping set them up, because again, there is definitely some math involved. You do need to make sure you're taking into consideration your contributions, which is the easy part. But you have to take into consideration your employer match. And so you always have to make sure we're under that magic number of 58,000. So as we were doing those computations, and then they were going online to their respective 401ks, in this case, the husband, his plan is at Fidelity. And as he was updating his contributions online to add those after tax, he was actually made aware of a provision within his existing 401k plan... again, the custodian was Fidelity... that they had this option where if you wanted to enroll, which we eventually did, have him enroll. So right after the after-tax contributions are made. And again, they're payroll-deducted... so it's not like the clients have to send a check anywhere... payroll deducted, that he had the ability through the plan at Fidelity to immediately convert that money into a Roth.

So this was huge because one of the things that typically would happen even with making these after-tax contributions, which are a great benefit, is while the contribution itself is after-tax, the growth on it, because it's in the 401k, is pre-tax. So in most instances, you can separate the contribution, but the growth attributable to that contribution remains a pre-tax asset within the core 401k. Because of his plan at Fidelity, his 401k plan offered this additional conversion option, or immediately after he makes these after-tax contributions, they were able to be contributed to Roth. So in his case, the money was going in after-tax, and then immediately following the contribution was actually being converted.

So because of this amazing advantage, his money is actually going to grow completely tax-free, and it basically turned into a separate part of his IRA and became a Roth. So all of his growth from here on out because of this availability within the plan is actually going to be even more financially beneficial than those numbers that Tony shared with us earlier. And again, this is just the benefit that we found out about in working through this process. And it's one of the reasons as benefits change or as plans change that we constantly encourage clients to keep us posted because employers are always trying to attract new employees and provide benefits. And this is something too, in this case as employer, they're not paying extra for it, the plan's custody at Fidelity, and they're able to provide this, and it's a benefit that most people aren't aware of.

But by doing a little bit of research to really see what the full available options are, we unintentionally basically stumbled on what we refer to as a game-changer for them. And this is going to be a huge benefit to them and something that they were very appreciative of as we continue to just turn over every rock, as we do throughout the process, but making sure that we're leaving no stone unturned.

Tony D'Amico: Yeah. That's awesome. So basically instead of that 850,000 that they're contributing along the way, instead of having to wait for them to retire where the IRS has provided guidance in 2014, that as we're talking about, the after-tax contributions can be directly rolled into an IRA, right? Not the growth on that after-tax, but in this scenario, then Fidelity brought up this option that they have for this particular 401k plan, this particular company, where again, they're offering to convert that to a Roth as they make after-tax contribution so it can begin to grow tax-free even sooner, which is rare, right? We don't run into many custodians or 401k plans that offer that. So it's also important to note that not all 401k plans, not all companies allow after-tax contributions. Some do, and some don't.

I think Marissa, the other thing that came to mind here is obviously that's definitely a hidden gem. And we found that actually for the Alexion 401k, and they're in the process of being bought out by AstraZeneca. So we'll see how that impacts. But that's an important strategy for Alexion employees. And we have other employers that offer after-tax contributions. So Cleveland Clinic offers after-tax contributions, and there's other really large corporations that we work with that offer those after-tax contributions. And for our listeners, we'll list those companies out in our show notes. So that could be front of mind, because a really helpful and important strategy to take advantage.

I think it's important to note too the IRS did provide guidance on this, very specific guidance. And in my opinion, I think that has minimized some of the legislative risk of this strategy. So prior to 2014, when they came out with this guidance, people were doing this because it was interpreted that they could, or maybe were just maybe doing it unintentionally. So I think the guidance from the IRS in 2014 that does state that you can take the after-tax funds and move them to a Roth is very helpful.

But there's always chance, right Marissa, that laws could change. I mean, perhaps Congress takes a look at this and they deem it to be a loophole, right? There's always that possibility, which is even more impressive that the Alexion 401k through Fidelity, Fidelity has that feature that they brought up to us and our mutual client that they can immediately convert it to a Roth. So good stuff there. Yeah. I guess really, I think the next question that I have, Marissa, is I guess the other thought that I have about this scenario for this particular client and something that I encourage our listeners to make sure that they're getting from their current advisor, is just that importance of taking a holistic view of everything.

And it's not just... They were with this particular client that joined our firm recently. They have done a phenomenal job saving, have done such a good job. And they were with one of the... I'll just say one of the big bank firms, right? And the important piece here is that too, for someone to have their full financial plan evaluated, and really look at all issues, not just what accounts that we directly manage for them, but also other outside assets that they have, their 401ks, are a huge asset. And really I would say that comprehensive approach, but that fiduciary approach. So Marissa, do you want to talk a little bit about that? Because I really think that was the game-changer for them. I'll let you talk about it, even though I would love to talk about this as well.

Marissa Beyer: Sure, Toni. So I think that's a great point. We are fiduciaries. We are doing and making recommendations in our client's best interest. So getting back to us making the recommendation to have them divert the money into the after-tax, most advisors, in particular, those that aren't fiduciaries, would gladly say, "Well, that 50, 60,000 that you're saving, let's keep depositing it into that non-qualified account where they could get a direct higher percentage of contribution," or if they were using mutual funds that had commissions and loans, that they'd be getting large upfront commissions because that would be in their best interest. They wouldn't take the additional step to one, look at the financial plan and see what would be best for the client, and then two, tell them to say, "You know what? The savings, as Tony mentioned, is great, but why don't we do something that's more productive and more..." we use the word intentional and purposeful, "... with your money. And let's take this and divert that 50, $60,000 a year into those after-tax contributions because maybe they're not getting a percentage of the 401k, or maybe they're not managing it."

So to that advisor who's not a fiduciary, they don't want the client to put the money in the 401k because they're not receiving any financial benefit. When we make recommendations, we're thinking about obviously the client's best interest because it's what we want to do as advisors and what we've pledged to do as fiduciaries and as certified financial planners. And it's what Tony and I signed up to do. We didn't want to sell. We don't want to be in the business of selling to people. We're in the business of long-term relationships and doing what's right for our clients. And in the end, if we're doing what's best for them, then we both win. And that's just how we view it.

But I think it's a great point. I think it's one that is overlooked, and a lot of times, people don't really understand what it means to be a fiduciary. So if you're someone that has worked with an advisor for a long time, and you're not sure if they are, ask them the question. It's a very straightforward question and they should be able to give you a very black and white answer if they are or if they are not a fiduciary on your behalf.

Tony D'Amico: Yeah. No. That's awesome stuff. And that's one thing I'll just share with our listeners. Again, for those of you that may work with a different advisor that's listening is to ensure that you get the level of care because I think the game-changer for this particular couple was that we'd looked at the whole picture. One of the comments that you made, it's like, "Wow. They had a lot of planning needs. We had two or three pages listed of planning priorities for the next couple of years. And this was one of the most pivotal ones." But it's really taking a look at all those other issues, their other benefits, maximizing their disability insurance because they need that. Right? Looking at risk protection, tax planning, estate planning, and really taking that integrated approach.

So investment management is very important, and we do manage, at the end of March, 277 million of assets for our clients. And that's very important. But there's a lot of, I guess you can call it alpha or benefit or value, and also doing tax planning, which is really a key need for a lot of our clients, which is important because sometimes, I guess the beauty of wealth management is its focus on how do you add value in consideration of that person's goals? Sometimes, some years it's investment management, some years it's tax planning, some years it's both, but you never want to just rely upon the portfolio to grow for you. It's not just the growth, but it's also what you keep after taxes.

So Marissa, I think this has been a great conversation. Most importantly, hopefully it's been very helpful for our listeners. But I guess Marissa, as we conclude today's podcast, this show is about achieving success where the intersection of wealth and life occurs. And people have different definition of what it means to be wealthy. And even people have different definitions of what it means to be, I guess, successful. You've had a great career for the past over 15 years and are doing a lot to advance the profession. But I guess as you look at the intersection of wealth and life for you today, what does success look like for you moving forward?

Marissa Beyer: Sure. So I guess I didn't know that I always wanted to be an advisor. I was one of those people that went to college and was undecided. And my sophomore year, I took one of those tasks like, "Okay, what do you think you want to do?" And it led me down a path. And then I ended up meeting a finance professor who was actually a CFP, and he became my mentor and I just really liked. Then they had a financial service degree at the college that I went to. Because I always knew I wanted to help people and make a difference. I just wasn't sure up until that point what it meant. So my sophomore year, I got into the financial planning degree, and just I loved it immediately. I knew I wouldn't have to go to school forever like a doctor and I wouldn't have to stick needles in anyone, which was a huge plus, but I also knew that I could be in a profession to really make an impactful difference and be a part of someone's lives.

I've had the benefit of creating so many amazing relationships over the years, and you become an extended family to some of these clients. A lot of times when there's major life events, after a spouse or a parent, we're the third or fourth phone call because they want us to know what's going on and they want to make sure that they're doing the right thing. So to me, success is coming to work every day and being able to make a positive difference and then still keep a balance with having my own family at home and making sure that I'm taking care of my family at work, and then my my family at home and providing great opportunities for them.

So it's been a great fit. Since I started, I've been very fortunate that I've never had to sell anything. I've always worked for what I would call smaller, registered investment advisor, fiduciary type firms. And I can look back and say I'm extremely proud of all the work that I've done and helped all these people over the years. So it's been fantastic.

Tony D'Amico: That's awesome. Well, great. Well, thanks for sharing your expertise today and all—

Marissa Beyer: Thanks for asking.

Tony D'Amico: Yeah. All of your contributions to Fidato and your clients there. So awesome. Well, thanks, Marissa.

Marissa Beyer: Thanks, Tony.

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