

Episode 5 – On the Lord of the Roths

This document provides resources for educators looking for ways to incorporate current events into their curriculum. Each podcast episode is approximately 20 minutes long and available on all major podcast outlets for free. This document provides multiple choice and true/false questions to test for high-level comprehension of podcast topics as well as opportunities for either short-answer/essay-style questions or discussion questions to delve further into topics. Email taxnerds@gmail.com for an answer key.

In this episode, we discuss the Pro Publica article "Lord of the Roths." This article details how Peter Theil, a billionaire founder of Pay Pal, managed to take a retirement account worth less than $2,000 and turn it into $5B over the course of 20 years. Today we unpack the differences between Roth IRAs and traditional retirement accounts, highlight some Roth-related tax loopholes, and discuss some equity issues than can arise when using tax breaks to subsidize retirement planning.

Multiple Choice and T/F Questions

1. What is an IRA?
    a. A defined benefit pension plan
    b. A tax-sheltered investment account
    c. A regular investment account

2. According to the podcast, which of the following are features of a Roth IRA? Select all that apply.
    a. Taxpayers contribute pre-tax dollars to Roth IRAs
    b. Taxpayers take distributions from Roth IRAs tax free
    c. Roth IRAs are better for individuals who expect higher future tax rates
    d. There is no limit on how much money an individual can contribute to a Roth IRA each year
    e. There are no required minimum distributions

3. Traditional IRA accounts allow the taxpayer to claim a deduction for the amount of funds contributed in the year they are contributed.
    a. True
    b. False

4. Which of the following steps is ***not*** part of a back-door Roth?

a. Make a non-deductible contribution to a traditional IRA.
b. Convert the funds from a traditional IRA to a Roth IRA.
c. Claim a deduction for the amount of funds contributed.
d. Set up both a traditional and a Roth IRA account.

5. Which limitation of traditional Roth IRAs do “back-door” Roth IRAs help taxpayers avoid?
    a. The tax rate limitation
    b. The annual income limitation
    c. The itemized deduction limitation
    d. The capital loss limitation

6. Employer-sponsored retirement accounts like a 401(k) can be offered in traditional or Roth form
    a. True
    b. False

7. Both traditional and Roth IRAs allow for tax-free accumulation of wealth (i.e., both shelter dividend and interest income from taxation).
    a. True
    b. False

8. According to the podcast, putting growth stocks into a traditional IRA might be tax-disadvantaged because:
    a. Stock held in a traditional IRA has a lower basis
    b. Capital gains are taxed annually in a traditional IRA
    c. This strategy converts capital gains (that would normally be taxed at preferential rates) into ordinary income upon withdrawal.

9. Which of the following activities does the IRS consider an abusive transaction?
    a. Back door IRAs
    b. Stuffing assets with artificially low valuations into Roth IRAs
    c. Offering employer-sponsored plans in Roth form
    d. Transferring Roth IRAs upon death

10. Which of the following is/are true according to the podcast?
    a. In 2019, median household had retirement savings of $65,000
    b. In 2019, the average amount of retirement savings was more than $65,000
    c. The distribution of retirement savings in the U.S. is skewed toward higher-wealth individuals.
    d. The distribution of retirement savings is relatively equal across income brackets in the U.S.

11. A natural experiment in Denmark concluded that high-wealth individuals retirement savings is not sensitive to tax subsidies; high-wealth individuals will save the same amount with or without a tax subsidy.

This document was prepared by Lisa De Simone and Bridget Stomberg, Associate Professors, for instructional purposes — to serve as the basis for assessments or classroom discussions.

a. True
b. False

12. One of the primary legislative objectives of a Roth IRA is to subsidize retirement savings for lower-wealth individuals.
    a. True
    b. False

13. According to the podcast, what are some reasons that high-wealth individuals can save more for retirement?
    a. They have a greater ability to save money
    b. They have greater access to tax and investment advisors
    c. They have greater access to "exotic" or high-yield investment opportunities
    d. All of the above are true

Short answer/essay or Discussion Question Ideas

1. Do you think your tax rate will be higher when you retire than it is during your first year after graduating? What about 15 years after you graduate? Why?
2. What was the original motivation for why the U.S. should have Roth types of accounts? Has the availability of Roth types of accounts "fixed" the problem they were created to solve?
3. Should founders and employees be able to use funds contributed to a retirement account to invest in their firm's stock? Why or why not?
4. Should retirement accounts be subsidized by the tax code? Why or why not?
5. Explain in your own words why Congress and the IRS are sometimes willing to look the other way regarding back-door Roth IRAs.

Data Analytics/Visualization

1. Using this or other data, create infographics that highlight retirement savings in the U.S. based on age.
2. Using data from the IRS' Statistics of Income, show the composition of net wealth by type in 2016. How much wealth is from retirement assets?

Case

Peter, the founder of a fintech company, receives a pre-tax bonus of $2,000. As a responsible adult wanting to save for his future financial health, Peter plans to use the bonus to buy a growth stock with an expected annual pre-tax return of 8%. The stock he has chosen does not pay dividends and he does not expect that it will pay dividends over a 20-year investment horizon. He expects that his marginal tax rates for the entire 20-year horizon will be as follows:

Long-term capital gains tax rate	20%
Ordinary tax rate	37%

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His company's CFO told him there were four potential ways he could invest his bonus in the growth stock he has selected: (1) in a traditional IRA using deductible contributions, (2) in a Roth IRA, (3) in a regular brokerage account, or (4) in a traditional IRA using non-deductible contributions. However, she didn't know which would be the best option for Peter given his personal facts and circumstances. Peter heard you were taking this class and asks you to help him evaluate how he could most efficiently invest his bonus in the growth stock he has selected. Assume that he is not limited by any restrictions.

1. List the four savings vehicles above in the order that maximizes Peter's after-tax returns to the growth stock. Be prepared to show the class how you arrive at your list, using numerical support. Which ONE of the four options do you recommend he use, and why?
2. Are you surprised by the order of the list? Why or why not?
3. How would the order between the Traditional IRA and the Roth IRA change if:
    - Ordinary tax rates fell from 37% to 25% by year 20?
    - Long-term capital gains rates fell from 20% to 10% by year 20?
4. Are there any non-tax issues that you should make sure Peter considers before using any of the four savings vehicles?
5. What if instead the stock Peter chose pays significant dividends but is not anticipated to appreciate much in value? Which of the four savings vehicles do you recommend he hold this stock in? Why?

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