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## Secrets to Building Wealth at **Microsoft**

## Your Financial Situation is Different

For many people, compensation is straightforward. You earn a salary, subtract 401(k) contributions and taxes, leaving your take-home pay.

$$\text{Salary} - 401(k) - \text{Taxes} = \text{Take-Home Pay}$$

But at Microsoft, this equation gets a whole lot more complicated.

You start with a Salary, Bonus and RSU income, then subtract Pre-Tax 401(k), After-Tax 401(k), ESPP, Deferred Compensation, and Taxes before getting to your take-home pay.

The equation becomes:

$$\text{Salary} + \text{Bonus} + \text{RSUs} - \text{Pre-Tax 401(k)} - \text{After-Tax 401(k)} - \text{ESPP} - \text{Deferred Comp} - \text{Taxes} = \text{Way More Variable \& Complicated Take-Home Pay}$$

After maximizing all the benefits you're eligible for, you're left with less take-home pay than your salary suggests.

**As a result, Microsoft employees often wonder:**

- What benefits should I use to maximize my wealth?
- How do I optimize my financial strategy to reduce taxes?
- And I have a lot going on; what am I missing?

This guide will walk through five ways to leverage your Microsoft benefits to build wealth.



## Sell RSUs as They Vest

RSUs make up a significant percentage of your annual compensation at Microsoft—anywhere from the high teens for a level-59 Software Engineer to as much as 40% at level 67.

### Key RSU Points

- **RSUs get taxed as income when they vest. Holding shares will not reduce your tax.**
- It's vital to periodically manage your company stock to prevent concentration and income/career risks.
- If you are an executive or insider, follow company and SEC guidelines when buying/selling company stock and avoid wash sales.

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*Think about it this way: If your company gave you a cash bonus, would you turn around and use it to buy your company stock?*

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This might be counterintuitive advice, especially for long-time Microsoft employees that have benefited from the stock's strong performance. But diversifying your company stock is a more reliable way to build wealth and reduce your substantial financial risk already tied to your company and industry.

### Consider the following:

- Four out of every ten stocks have a negative total return.<sup>1</sup>
- Nearly 40% of all stocks have suffered a permanent 70% loss of value.<sup>2</sup>
- Four of five stocks underperform a diversified stock index.<sup>3</sup>



Since holding onto your RSU shares doesn't change your tax bill, the most consistent way to boost your returns and grow your wealth is a disciplined plan to sell RSUs as they vest and reinvest the proceeds into a diversified portfolio.

### RSU Wealth Building Tips

- **Do** Plan for your RSU taxes and potentially develop a strategy to reduce your overall tax bill.
- **Do** Determine when to sell your RSU shares and manage your company stock to prevent concentration and income/career risks.
- **Don't** fall prey to inertia. Instead, think of your RSUs as a cash bonus with upside, and don't simply hold onto the shares because it's easier than diversifying.

<sup>1</sup> "The Capitalism Distribution" – Longboard Capital Management

<sup>2</sup> "The Agony and the Ecstasy: The Risk and Rewards of a Concentrated Stock Position" – J.P. Morgan

<sup>3</sup> "How Many Stocks Beat the Indexes" – Morningstar



## Manage Taxes with the Microsoft DCP

The Microsoft DCP allows you to defer income today, reduce taxes, and boost your savings. The longer the tax deferral, the greater the value. Deferring taxes over a 10-year distribution schedule has value, but deferring taxes for 20 years (allowing your money to grow pre-tax) creates much higher value. The caveat here is that the money in a deferred compensation plan is an unsecured liability of your employer. So you risk your company not being around to make good on its deferred compensation obligations in 10 or 20 years.

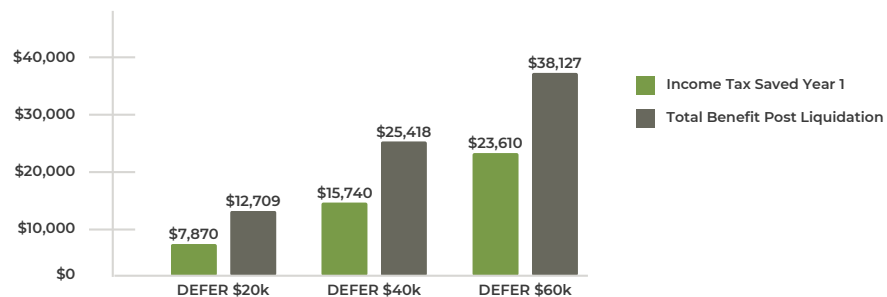
### Key DCP Points

- DCP reduces your taxable income and tax bill today.
- Your deferred income is invested and shielded from taxes until it's distributed.
- The DCP at Microsoft is an unsecured liability of the company. As a result, you become a creditor of your employer in the unlikely event of bankruptcy.

*The DCP is a powerful tool to manage your taxes, cash flow, and savings each year.*

### Consider the following example:

- Income deferred for 15 years
- The tax rate now is 39.35% vs. 30% at distribution
- Pre & post-tax investment returns via Vanguard Target date funds



Deferring \$20,000 of income now saves nearly \$8k off your current year's tax bill and almost \$13k in taxes over 15 years—double and triple these amounts for \$40k and \$60k, respectively.

### DCP Wealth Building Tips

- Each year analyze how much to defer into the DCP, for how long, and how to invest the funds.
- Use the DCP to offset otherwise high-income and tax years.
- Don't ignore creative solutions to offset the risk in your Microsoft DCP if it's too large a percentage of your investable assets.

## Boost Savings (& Reduce Taxes) with the Mega Backdoor Roth 401(k)

The Mega Backdoor Roth 401(k) is a relatively new benefit and gaining popularity among tech companies, where high salaries limit contributions to a Roth account.

For many people, the conventional Roth isn't an option, with a \$228,000 income cap for those filing jointly (and \$153,000 for single filers). Additionally, a traditional Roth allows only \$6,500 per year (in 2023).

Enter the Mega Backdoor Roth 401K.

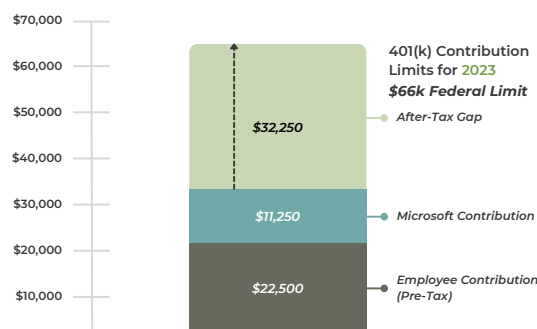
### Key Points

- The Mega Roth 401(k) allows you to contribute to a Roth account even if you're over the income threshold for a traditional Roth.
- Money in a Roth 401(k) grows tax-deferred and is tax-free at distribution.
- However, contributions are made after-tax, so there is no tax break in the year of the contribution.

*The Mega Backdoor Roth at Microsoft allows you to increase your tax-advantaged savings—even for those over the income limits for a Roth IRA.*

Consider the following example:

- In 2023, you can contribute **\$22,500** pre-tax to your 401(k)
- Microsoft will match 50% and contribute another **\$11,250**
- But, the IRS total contribution limit for a 401(k) in 2023 is **\$66,000**
- The **\$32,250** gap can be made as an after tax-contribution



Consider the significant advantages of Mega Backdoor Roth: It increases your savings into a tax-advantaged account, you can realize both tax-deferred growth while the money is invested, plus when you retire, the money you withdraw will also become to be tax-free.

### Mega Roth 401(k)s Wealth Building Tips

- Create a cash flow model to plan how to fund this account.
- For those eligible for DCP, analyze which plan to participate in.
- Don't ignore this benefit because it's new and complex. Every year you wait is a missed year of contributions and tax-free growth.

## 4 Using RSUs to Maximize Tax-Advantaged Savings (401k, Roth, DCP)

If you sell RSUs as they vest (secret #1), you now have a chance to redeploy this cash to fund tax-advantaged savings and potentially reduce your tax bill.

Key points to consider:

- You can't control the timing of your RSU income.
- However, you can use RSU income to fund other savings.
- And, by funding an account with a tax advantage, you potentially reduce current and future taxes.

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*Coordinating your RSU income into your savings plan can be one of the best ways to boost your savings and reduce your taxable income*

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Consider the example:

- Jill, a Microsoft employee, has \$100k of RSUs vesting this year
- This vesting will increase her taxable income by \$100k
- Instead of paying the taxing and holding the stock, she could fund her Microsoft DCP by deferring \$100k of salary and boost savings and decrease taxes in the current year.



### Wealth Building Tips When Funding via RSUs

- Consider other uses for your RSU income as it vests (emergency funds, debt, home improvements, etc.).
- Identify additional savings opportunities.
- Assess using additional from RSUs to fund DCP, Mega Roth 401(k), or other tax-advantaged accounts.

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## Reduce Taxes with Multi-Year Tax Planning

Due to RSU vesting, signing or retention bonus, DCP payout, or other income, it's typical for Microsoft employees to have years where their income is significantly higher than other years.

While that's a good thing, it does cause an increase in your tax bill.

Key points to consider:

- **It's worth modeling income over a multi-year time frame.**
- **This will allow you to look for tax opportunities strategically.**
- **Lumping deductions in high-tax years is a productive way to reduce taxes.**

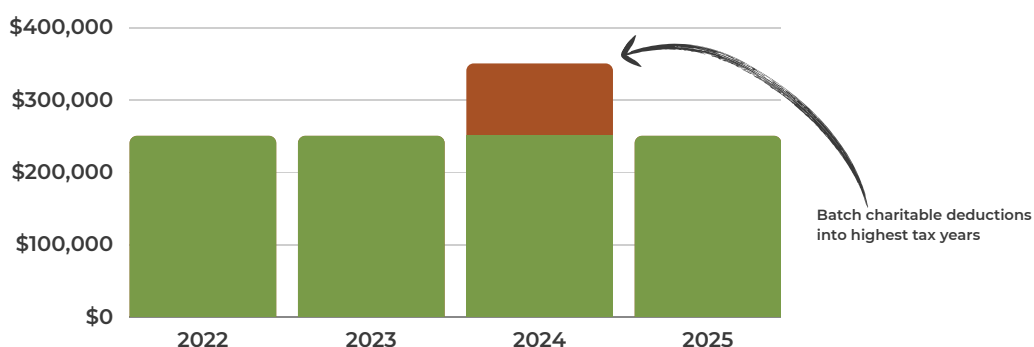
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*Performing multi-year income planning can help you identify high tax years and look for ways to reduce your overall tax burden.*

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**Consider the example:**

- John, a Microsoft employee, has income of \$250k in most years but, due to special bonuses and RSU vesting, will have taxable income of \$350k in 2024.
- John typically gifts \$10k to charity each year but cannot itemize these deductions as the standard deduction is greater than itemized deductions for him.
- By pre-funding five years of charitable deduction in 2024 into a Donor Advised Fund (DAF), John can get a \$50k tax deduction in 2024 to reduce his tax bill.



## Wealth Building Tips With Multi-Year Income Planning

- Maintain and update your cash flow plan each year.
- Identify high-income years.
- Assess strategies you can use (like DAFs) to reduce your tax bill in these years.

## Want Personalized Help?

At Cordant, we work with our Microsoft clients to reduce their taxes, optimize their compensation, and build a financial strategy to achieve their goals.

If you'd like a personalized review of how to apply the strategies covered in this white paper to your situation, we'd love to start a conversation with you.

### Sign Up For Your Free Financial Assessment

A 3-step process to help tech employees evaluate our services and make an informed decision about working together.

You'll get the following:

- Equity Comp Assessment
- Tax & Investment Analysis
- Personalized Action Plan

We look forward to talking with you!



[Schedule Your Assessment](#)