



Backdoor Roth IRAs

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Backdoor Roth IRAs

What is a “Backdoor Roth IRA”?

An IRA, or Individual Retirement Account, allows for annual tax deductible contributions up to certain limits. That limit is \$7,000 (2025) and, if age 50 or older, an additional \$1,000 catch up contribution, bringing the total to \$8,000.¹ There are however, limits on deductible IRA contributions if one is a member of an employer sponsored retirement plan (401(k), SEP, SIMPLE, Cash Balance plan, etc.) and has Modified Adjusted Gross Income (MAGI) in excess of \$143,000 married filing jointly or \$87,000 single or head of household.²

If one’s MAGI prevents deductible IRA contributions, there is the option of the *non-deductible IRA*.³ Here is where the Backdoor Roth IRA concept begins.

A "Backdoor Roth IRA" is a strategy for high-income earners to contribute to Roth IRAs indirectly, bypassing the income limitations that prevent direct contributions. It involves making non-deductible contributions to a traditional IRA, and then converting those funds to a Roth IRA. This permits one to take advantage of the tax-free growth and income tax-free withdrawals of Roth IRAs, even when one’s income exceeds the direct contribution limits.

Here's how the Backdoor Roth IRA works:

1. Open an IRA account and Make a Non-Deductible Traditional IRA Contribution:

Individuals make a contribution to a traditional IRA, understanding that the contribution won't be tax-deductible.

2. Convert the non-deductible Traditional IRA to Roth IRA:

The funds in the non-deductible Traditional IRA are then converted to a Roth IRA. There is no taxable event as the IRA account was funded with after-tax dollars.

3. Tax Implications:

While there are no income limits on Roth conversions, the conversion can trigger a tax liability on the earnings within the traditional IRA. In other words, from the time of the contribution to the Traditional non-deductible IRA and the time the Traditional non-deductible IRA is converted to the Roth IRA, any earnings on the account will be taxable at the time of conversion. That's a good reason to create and fund the account one day and convert the account the following day!

4. Advantages:

This strategy allows high income earners to contribute to a Roth IRA and enjoy tax-free growth and tax-free future

withdrawals. And, in many jurisdictions, IRA accounts are protected from the claim of judgment creditors! ⁴

Important Considerations:

Taxable Conversion:

The conversion from a traditional IRA to a Roth IRA is a taxable event, meaning you'll owe taxes on the amount converted.

When converting a non-deductible IRA to a Roth IRA, only the earnings on the non-deductible IRA account are taxable as income.

Nonetheless, many have other existing IRA accounts which may be converted to Roth status. These accounts, when converted to Roth status, will create a taxable event.

Pro-Rata Rule:

If you have a mix of deductible and non-deductible contributions in your traditional IRA, the conversion may be taxed based on the proportion of earnings to contributions.

Five-Year Rule:

To avoid penalties, you generally need to wait at least five years from the conversion date before making tax-free withdrawals. ⁵

Mega Backdoor Roth:

Some 401(k) plans offer a similar strategy called a "Mega Backdoor Roth," allowing for larger after-tax contributions that can be converted to Roth 401(k)s.

¹<https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits>

²<https://www.irs.gov/retirement-plans/plan-participant-employee/2024-ira-contribution-and-deduction-limits-effect-of-modified-agi-on-deductible-contributions-if-you-are-covered-by-a-retirement-plan-at-work>

³<https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits#:~:text=You%20can%20contribute,a%20certain%20level.>

⁴ <https://www.experian.com/blogs/ask-experian/are-retirement-accounts-protected-from-lawsuits/>

⁵[https://www.irs.gov/publications/p590b#en_US_2024_publink100089627:~:text=A%20qualified%20distribution%20is,a%20%2410%2C000%20lifetime%20limit\).](https://www.irs.gov/publications/p590b#en_US_2024_publink100089627:~:text=A%20qualified%20distribution%20is,a%20%2410%2C000%20lifetime%20limit.)

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