Asset Strategy

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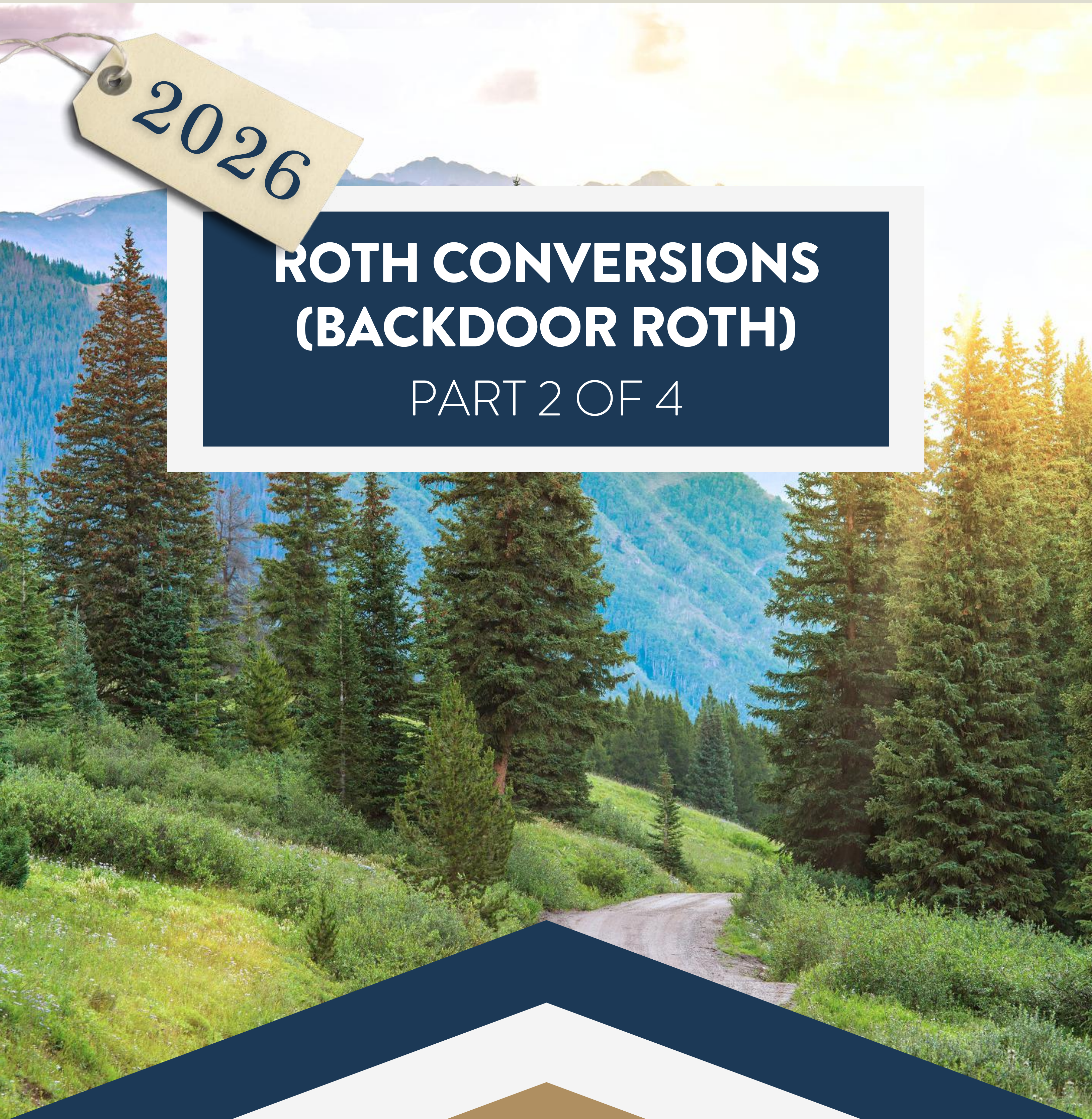

ROTH CONVERSIONS (BACKDOOR ROTH)

PART 2 OF 4

What is a Backdoor Roth IRA?

A Backdoor Roth IRA is not an official type of retirement account, but a strategy. While high-income earners are restricted from making direct Roth IRA contributions, there are no income limits on Roth conversions, which makes this strategy possible.

A Backdoor Roth IRA is a legally permitted IRS strategy when executed correctly. When you move money from a Traditional IRA to a Roth IRA, you have to pay taxes on any assets that have not already been taxed. This includes the principal, earnings, and appreciation.

Overview

- High earners can convert a Traditional IRA to a Roth IRA by using a Backdoor Roth IRA.
- You can convert an entire IRA to a Roth IRA or contribute to an IRA and roll it over using this method.
- A Backdoor Roth is a legal method that allows high earners to access Roth IRA benefits despite income limits on direct contributions.
- A Backdoor Roth may incur higher taxes when it’s created, but it will bring tax savings of a Roth account in the future.
- The Backdoor Roth IRA strategy is also useful for a person who anticipates having funds leftover in their Traditional IRA, because they can pass the money on to their heirs in a Roth IRA.

How to Create a Backdoor Roth IRA

1)	**Contribute to a Traditional IRA**	Make a non-deductible Traditional IRA contribution, up to the annual IRS contribution limit, based on your age and eligibility.
2)	**Leave the Money in Cash**	Leave the contribution in cash, a money market fund, or a settlement fund prior to conversion.
3)	**Convert the Traditional IRA to a Roth IRA**	Convert the non-deductible Traditional IRA to a Roth IRA by transferring the funds into your Roth IRA, often shortly after the contribution is made, to reduce potential taxable growth.
4)	**Invest the Money**	Select an investment for the funds in your Roth IRA. If you already have a Roth IRA, the converted amount can typically be added to your existing account.
5)	**Beware of the Pro-Rata Rule**	Existing pre-tax balances in Traditional, SEP, SIMPLE, or rollover IRAs may cause a portion of your conversion to be taxable. In some cases, rolling these assets into an employer-sponsored retirement plan may help reduce this impact. The IRS considers the total value of all IRAs when applying the pro-rata rule, not just the account being converted.
6)	**Fill Out IRS Form 8606 Correctly**	Properly complete IRS Form 8606 when filing your tax return to report non-deductible contributions and Roth conversions. Failure to file this form correctly may result in double taxation of after-tax contributions and IRS penalties.

Tax Implications of a Backdoor Roth IRA

If you transfer or convert a Traditional IRA to a Roth IRA, you must pay taxes on any untaxed funds in the Traditional IRA. For example, if you contribute **$7,500** to a Traditional IRA, claim a deduction for that contribution on your tax return, and then convert the money to a Roth IRA, the full converted amount will be taxable as ordinary income. You will also owe taxes on any earnings generated between the time the contribution is made to the Traditional IRA and the time it is converted to a Roth IRA. [1.]

If you make after-tax, non-deductible contributions to a Traditional IRA, those contributions are not taxed again when converted to a Roth IRA. However, any earnings associated with those contributions are taxable at the time of conversion. [2.]

If most of your IRA contributions were deducted from income and your IRA has accumulated earnings or appreciated investments, then most of the amount converted to a Roth IRA will count as taxable income in the year of conversion. This can increase your taxable income and potentially move you into a higher tax bracket. However, you are not taxed twice on after-tax contributions because the IRS applies the pro-rata rule, which allocates taxable and non-taxable portions of the conversion based on the ratio of pre-tax and after-tax IRA funds.

Converted amounts in a Roth IRA are treated as conversions, not contributions. If you are under age 59½, you must wait five years from the date of conversion before accessing converted funds penalty-free. This rule is separate from regular Roth IRA contributions, which can be withdrawn tax-free and penalty-free at any time.

A Backdoor Roth IRA allows individuals to access Roth IRA benefits despite income limits on direct Roth IRA contributions.

For 2026:

- If you are single and your Modified Adjusted Gross Income (MAGI) is $168,000 or higher, you are ineligible to make a direct Roth IRA contribution.
- If you are married filing jointly and your Modified Adjusted Gross Income (MAGI) is $252,000 or higher, you are ineligible to make a direct Roth IRA contribution.
- These income limits do not apply when converting money from a Traditional IRA to a Roth IRA, which is what makes the Backdoor Roth strategy possible.

1. https://www.investopedia.com/terms/b/Backdoor-roth-ira.asp as of 12.29.2025
2. https://www.irs.gov/retirement-plans/rollovers-of-after-tax-contributions-in-retirement-plans as of 8.26.2025
3. https://www.irs.gov/retirement-plans/traditional-and-roth-iras as of 8.26.2024

What Are Some Benefits of a Backdoor Roth IRA?

Why would taxpayers choose to use a Backdoor Roth IRA strategy, given the additional steps involved? There are several valid reasons.

1)

Required Minimum Distributions (RMDs) are not applicable to Roth IRAs, thus account balances can grow tax-free for as long as the account holder is alive. You have the option to leave everything to your heirs or take out as much or as little as you choose, whenever you want.

2)

Backdoor Roth IRA strategies can result in significant tax savings over time because qualified Roth IRA distributions are generally tax-free, unlike distributions from Traditional IRAs.

3)

Backdoor Roth IRAs, like all Roth IRAs, require you to pay taxes on your converted pretax funds up front, and everything after that is tax-free. **This tax benefit is greatest if you believe that tax rates will rise in the future** or that your taxable income will be higher in the years following the establishment of your Backdoor Roth IRA than it is now... especially if you plan to withdraw after a distant retirement date.

Do You Pay Taxes Twice on a Backdoor Roth IRA?

When using a Backdoor Roth IRA strategy, non-deductible contributions are not taxed again when converted. However, any pre-tax contributions or earnings included in the conversion may be taxable. When executed correctly, the strategy avoids double taxation on after-tax contributions.

Is a Backdoor Roth a Good Idea?

If you earn too much to contribute to a Roth IRA or have determined that a Roth IRA is better for your retirement, the Backdoor Roth strategy may be advantageous.

The Takeaway

Consulting with an Asset Strategy financial advisor is crucial to ensure compliance with IRS regulations and to maximize the benefits of this retirement planning strategy.

Ultimately, when executed properly, a Backdoor Roth IRA can be a valuable tool in a comprehensive retirement plan.

Contact us today for a review of your finances to determine whether Roth IRA strategies align with your overall financial plan.

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