EXECUTIVE PROGRAM

# Backdoor Roths and Mega Backdoor Roths: What are they, how do they work, and why should I consider them?

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Many investors are taking advantage of Roth accounts today. They see the benefit of tax-free growth, future tax-free withdrawals, and the ability to avoid required minimum distributions (RMDs) among many enticing factors. Investors typically make regular contributions directly into their Roth IRAs to purchase assets for their future needs in retirement. But, if you're a high-income earner, you've hit the Roth contribution income limits and thought, "Now what?" Maybe you've heard whispers of workarounds, like the "backdoor" and "mega backdoor". It's time to explore these powerful (and perfectly legal) loopholes, how they work, and if they may be right for you.
First, a brief overview.

**Backdoor Roth IRA: The Classic Loophole.** This strategy lets high earners make non-deductible contributions to a Traditional IRA, then convert them to a Roth IRA. The IRS doesn't have income limits on conversions, just contributions, so this is a clean workaround.

**Mega Backdoor Roth: The Overachiever's Upgrade.** Available to employees with 401(k) plans that allow after-tax contributions and in-plan Roth conversions or in-service rollovers (if your plan doesn't offer this, it is worth seeing if it can be added). You can sock away tens of thousands extra per year, well beyond the regular Roth IRA or 401(k) limits, and convert them to a Roth account.
Let's Break It Down.

### Filing Status: Married vs. Single

The IRS phases out the ability to make Roth IRA contributions, fully eliminating your ability to make contributions if your modified adjusted gross income (MAGI) exceeds:

- $165,000 (single) or
- $246,000 (married filing jointly) for 2025

Backdoor Roths bypass these limits, but your MAGI still affects tax implications via the pro rata rule (more on that below). Filing jointly can help when it comes to MAGI, but if one spouse has significant pre-tax IRA funds, it can complicate the conversion.

Pro Tip: Backdoor Roths are filed individually, each spouse can contribute and convert $7,000 (or $8,000 if age 50+).

### How to Complete a Backdoor Roth (Step-by-Step)

1. **Open both a Traditional IRA and a Roth IRA.** Most custodians, such as Schwab, Fidelity, or Vanguard, support both.
2. **Contribute to your Traditional IRA.** Make contributions with non-deductible dollars (max $7,000 in 2025; $8,000 if 50+).
3. **Wait a few days** (optional) for the contribution to settle (fully deposit and process in your account).
4. **Convert the funds to your Roth IRA.** This direct transfer should be made all at once. And you should consider contacting your custodian's customer support to help facilitate the process the first time around.
5. **File IRS Form 8606.** Each individual must report the non-deductible contribution and Roth conversion annually to the IRS using Form 8606 when filing taxes (yes, even if you are filing jointly).

That's it. If you don't do this right, you owe no tax unless the pro rata rule impacts you.

The Pro Rata Rule: If you have any pre-tax money in any Traditional, SEP, or SIMPLE IRA, the IRS treats your conversion as a proportion of pre-tax and after-tax dollars, even if you only converted the after-tax part.

**Example:**
- $93,000 in pre-tax Traditional IRA
- $7,000 non-deductible contribution this year
- You convert $7,000

Only 7% of the conversion, $490, is tax-free, compared to your desired $7,000. You pay taxes on the rest.

**Solutions:**
- Roll pre-tax IRA funds into a current 401(k) (if allowed). The pro-rata rule does not apply 401k balances towards your pre-tax balances that would impact your backdoor Roth conversions.
- Use the mega backdoor instead (up next) if eligible

**Mega Backdoor Roth:** This is for 401(k) overachievers. In 2025, total 401(k) contributions (employee + employer + after-tax) can't exceed $70,000 ($77,500 if 50+).

**Here's how in 4 easy steps:**
1. Max your regular 401(k) contributions ($23,500 for 2025).
2. Your employer contributes, let's say, $7,000.
3. That leaves room for $39,000 of after-tax contributions.
4. Convert those after-tax funds to a Roth 401(k) (in-plan) or Roth IRA (in-service rollover) to your Roth IRA with a custodian of your choice, as we discussed earlier during the Backdoor Roth discussion.

**Not all 401(k)s allow this. You will need:**
- After-tax contributions
- Either an in-plan Roth conversion or an in-service rollover option

What about Taxes? The growth on after-tax dollars is taxable when converted, so time it right to minimize gains before conversion.

You are not an overachiever for no reason. You take learning personal finance topics to the next level and learn how these strategies work within the holistic context of your financial plan. So, let's take a second to review the benefits of these strategies and see if they align with your goals.

### Why Use Backdoor or Mega Backdoor Roths?

- Tax-free growth forever
- No RMDs on Roth IRAs (ever)
- More Roth space = more flexibility in retirement
- Income-tax diversification: gives you future options for strategic withdrawals
- Legacy benefits: tax-free wealth transfer

### What to Watch Out For

- **Form 8606**: File it every year you make a non-deductible contribution or do a conversion. And each individual must file the form even if filing jointly.
- **Double-check the pro rata rule**: Even $1 of pre-tax IRA money messes up the Backdoor.
- **Conversion timing**: Don't let after-tax money sit too long before converting. The faster, the better, to avoid any tax issues.
- **401(k) plan features**: Not all plans support the mega version.

### Which Is Right for You?

### Backdoor Roth Might Be Right If You:

- Have high income and no pre-tax IRA balances
- Want simple tax-free growth on a small contribution
- Desire the benefits that come with Roth IRAs, such as no RMDs and legacy benefits

### Mega Backdoor Roth Might Be Right If You:

- Have access to a 401(k) plan with the right features
- Want to contribute $20K to $40K+ extra per year to Roth
- Want to grow your Roth balance aggressively and tax-free

**Or... Use Both.** If you're eligible, you can do:

- A $7,000 Backdoor Roth IRA
- A $20K+ Mega Backdoor Roth via your 401(k)

## Final Thoughts

Backdoor Roths and Mega Backdoor Roths aren't just for the ultra wealthy with teams of attorneys combing through tax loopholes. They're smart moves for high earners looking to maximize tax-free retirement growth and do not have to be overly complex to implement. They take some paperwork, coordination, and awareness of your IRA balances and 401(k) plan rules, but the payoff is long-term flexibility and greater ability to be strategic now and later during your retirement.
In a world where future tax rates are anyone's guess, growing your Roth might be the most tax-savvy move you make today. Feel free to use the table below to reference some of our discussed topics quickly.

## Roth Strategy Comparison

| Strategy | Contribution Limit | Employer Plan Needed | Tax Forms | Pro Rata Risk | Annual Setup Time |
|---|---|---|---|---|---|
| Backdoor Roth IRA | $7,000/$8,000 | No | Form 8606 | Yes | Low |
| Mega Backdoor Roth | Up to $40,000+ | Yes (401k) | 1099-R (if rollover) | No (if only in 401k) | Moderate |