

About the “Backdoor Roth IRA”

Generally, the ability to contribute to a Roth IRA is limited to individuals who earn below a certain amount of Modified Adjusted Gross Income (MAGI). However, an opportunity to add money to a Roth IRA may exist for those individuals who are eligible to make a traditional IRA contribution. Below, we look more at this opportunity, commonly referred to as a “backdoor” Roth IRA.

Who should consider this opportunity?

Individuals who:

- Have earned income;
- Would like to fully contribute to a Roth IRA but are ineligible (e.g., single tax filers with more than \$125,000 in MAGI or joint tax filers with more than \$198,000 in MAGI for 2021);
- Do not need to access the funds during the next 5 years or are already at least age 59 ½; and
- Have little to no existing pre-tax IRA balances.

What is the “backdoor”?

It’s the process by which an individual who is ineligible to make a Roth IRA contribution is able to add funds to a Roth IRA. First, make a non-deductible contribution to a traditional IRA (do not claim a tax deduction for the contribution). Then, transfer the funds to a Roth IRA through a conversion.

What is a conversion?

A conversion is a transfer of funds into a Roth IRA from another type of tax-deferred account such as a traditional IRA. If you have no existing pre-tax funds in any IRA, there is no tax due on the conversion.

Are there any deadlines?

The deadline to make a 2021 non-deductible traditional IRA contribution is April 18, 2022. The conversion can be performed at any point after the contribution, but must be done by December 31 of any year in order to qualify as a conversion for that tax year.

You should consider performing the conversion as soon as possible after your contribution in order to avoid owing income tax on any earnings due to the conversion.

How do I complete a Roth IRA conversion?

Your IRA custodian will generally have a procedure in place. Clients with an Oppenheimer IRA should request the Roth IRA Conversion Request form.

What are the benefits of a Roth IRA?

- Tax-deferred growth
- Qualified distributions are tax-free
- Not subject to Required Minimum Distributions (RMDs); however, beneficiaries may be required to receive RMDs or distribute the account within 10 years

Additional Considerations

Although the ability to fund a Roth IRA through the backdoor can seem attractive, there are some situations that may cause individuals to think twice. If you have existing IRAs that contain pre-tax money, conversions to the Roth IRA are taxed on what is called a pro-rata basis meaning that you cannot convert solely your non-deductible IRA contribution. If you are covered by an employer-sponsored qualified retirement plan (such as a 401(k)) that will accept rollovers, you may wish to transfer your existing IRA assets to that plan first in order to start your non-deductible IRA contribution with a clean slate.

Note: In November 2021, the Build Back Better bill, which had provisions for eliminating the Backdoor Roth, was presented to Congress and was eventually knocked down in the Senate. While the Backdoor Roth is still available, as of this communication, please be aware that there is a chance that a revised version of the bill, which may include provisions for eliminating the Backdoor Roth, could be presented to Congress as early as this year. If the bill is passed, and whether the Backdoor Roth elimination provision remains in it, it is possible that the Backdoor Roth may be eliminated in the near future and as early as 2022.

For more information on Roth IRA conversions, ask your
Oppenheimer Financial Professional for our guide Roth IRAs and Conversions.

¹A distribution is considered “qualified” (and therefore is tax- and penalty-free) if it is made more than five years after your initial deposit to a Roth IRA and is made for one of the following reasons: (1) you are age 59 ½ or older; (2) due to a qualifying disability; (3) paid to your beneficiaries after your death; (4) the purchase of a first-time home (up to \$10,000 lifetime limit).