The Mega-Backdoor Roth

RETIREMENT PLANS

Are you looking for a strategy that will allow you to create more tax diversification in retirement and fund a Roth IRA with amounts in excess of your annual contributions? For 2025, Roth IRA contributions are limited to $7,000 ($8,000 if age 50 or older) and Roth qualified plan salary deferral contributions are limited to $23,500 ($31,000 if age 50-59 or 64+, $34,750 if age 60-63). If you're looking to sock away more Roth dollars over and above the Roth IRA and/or Roth qualified plan salary deferral limits, you may be able to do so by executing the mega-backdoor Roth strategy.

In order to be eligible for the mega-backdoor Roth, your employer-sponsored qualified plan must allow for after-tax contributions and in-service withdrawals or in-plan conversions. The strategy is a two-step approach:

1. Make an after-tax contribution to your qualified plan
2. Roll the after-tax contribution to a Roth IRA or convert the after-tax contribution to a Roth qualified plan

Benefits

- Tax-free growth; tax-free earnings after five years and age 59½
- Hedge against future tax rate hikes
- No income limits for after-tax contribution eligibility (unlike a Roth IRA)

Considerations

- Must be eligible for a qualified plan with after-tax contributions
- Following a conversion, Roth qualified plan assets may not be available until a triggering event occurs
- After-tax contributions by certain employees may force the qualified plan to fail actual contribution percentage (ACP) testing

Hypothetical Example (See Diagram)

401(k) Employee Contributions:

- $23,500 pre-tax salary deferrals
- $45,500 after-tax contributions

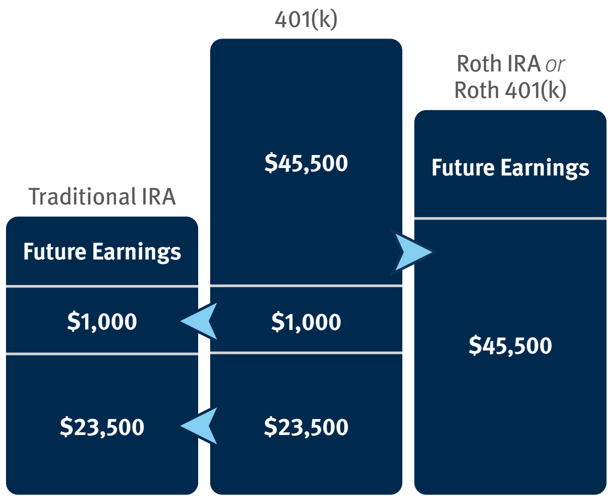
401(k) Employer Contribution:

- $1,000 match

Total between all employee and employer contributions cannot exceed $70,000 ($77,500 if age 50-59 or 64+, $81,250 if age 60-63) for 2025.

Roll after-tax contributions of $45,500 to a Roth IRA or convert to a Roth 401(k); future Roth earnings will be tax-free after five years and age 59½.

Upon a triggering event like separation from service, **roll pre-tax salary deferrals and employer contributions to a traditional IRA.**



If you're not utilizing the mega-backdoor Roth strategy, you may be missing out on an exceptional opportunity. As a plan sponsor, consider amending your plan document to allow for after-tax contributions. As a plan participant, reach out to your company's benefits specialist to discuss your after-tax contribution options.

Contact a Stifel Financial Advisor today to review your qualified plan funding options. It is always recommended that you seek the aid of a competent tax advisor or accountant to assist with tax advice and guidance.

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