



## Can I Do A Backdoor Roth IRA Conversion?

Mark Haser, CFP®, MBA

A backdoor Roth IRA conversion is a strategy for high-income earners to contribute to a Roth IRA on an annual basis, even if their income exceeds the annual limits for direct Roth IRA contributions. The process involves making a non-deductible (after-tax) contribution to a traditional IRA and then converting the funds to a Roth IRA. It is worth noting up front that this strategy only works well for individuals who do not have any existing IRA accounts. All IRA contributions, including non-deductible contributions, are limited to the IRS's annual limit of \$6,500 in 2023 (+\$1,000 for anyone over age 50).

Here is how a backdoor Roth IRA conversion works:

1. **Make a non-deductible contribution to a traditional IRA.** A non-deductible contribution means that you do not get a tax deduction for the contribution. There is no income limitation for this, unlike with making direct contributions to a Roth IRA.
2. **Convert the traditional IRA to a Roth IRA.** After making the non-deductible contribution to the traditional IRA, the account holder can convert the funds to a Roth IRA. The conversion will trigger taxes on any pre-tax funds in the traditional IRA based on the pro-rata rule explained below. If there are no other funds in the IRA, there should be little or no tax liability.

The pro-rata rule is a tax rule that determines how your IRA money is taxed upon withdrawal or conversion. It requires that the taxes owed on the conversion be based on the overall proportion of pre-tax and after-tax contributions in **all** the account holder's non-Roth IRAs. This means that if the account holder has pre-tax IRA funds, they will be subject to tax on a portion of the conversion. In other words, they do not get to choose which funds to convert. It's important to consider this rule when deciding whether to do a backdoor Roth IRA conversion.

### Pro-Rata Rule Example

If you have \$100,000 a traditional IRA, including \$10,000 in non-deductible (after-tax) contributions, your after-tax contributions represent 10% of your total IRA balance. If you convert \$10,000 from the traditional IRA to a Roth IRA, only 10% of the conversion (\$1,000) will be tax-free, and the remaining 90% (\$9,000) will be subject to income taxes. In other words, you cannot segregate and convert only the after-tax dollars. After this conversion, you would now have \$10,000 in your Roth IRA and \$90,000 left in your traditional IRA. Of that \$90,000 leftover, \$81,000 is pre-tax and \$9,000 is after-tax dollars.



## Who is the Backdoor Roth IRA Conversion Best Suited For?

A backdoor Roth IRA conversion is best suited for anyone who cannot directly contribute to a Roth IRA (because they are above the IRS income limitations) and does not have any existing non-Roth IRA accounts with pre-tax dollars in them. This includes all types of IRAs (e.g., traditional IRA, rollover IRA, SEP IRA, and SIMPLE IRA). If you are married, you can exclude IRAs that are in your spouse's name.

If you have an IRA with pre-tax dollars, one option would be to consider a "roll-in", which means to transfer your IRA into a 401(k). Doing so eliminates the pro-rata rule issue. Not all 401(k) plans accept "roll-ins", so you need to check with your plan administrator first.

### The Bottom Line

A backdoor Roth IRA conversion can be a useful strategy for high-income earners who want to take advantage of the tax-free growth and distributions offered by a Roth IRA. Qualified withdrawals from a Roth IRA are completely tax-free, and therefore act as a hedge in the event tax rates increase in the future. However, it's important to consider the pro-rata rule, which can make Roth conversions less attractive for individuals with significant pre-tax IRA balances.

**Artemis Financial Advisors**  
115 Newbury Street  
Suite 302  
Boston, MA 02116

DISCLAIMER: Artemis Financial Advisors is an SEC-registered advisory firm. The material in this document is prepared for our clients and other interested parties and contains the opinions of Artemis Financial Advisors. Nothing in this document should be construed or relied upon as legal or financial advice. All investments involve risk – including loss of principal. An investor should consult with an investment professional before making any investment decisions as not all recommendations will be suitable for all investors. Factual material is believed to be accurate, taken directly from public materials believed to be reliable.