Take-Away: A *backdoor* Roth IRA conversion is a popular estate planning strategy. However, there are plenty of rules, regulations and contribution limitations that must be compiled with to successfully complete the *backdoor* conversion.

Background: At its most basic level, a *backdoor* Roth IRA contribution consists of two-steps: (i) contribute to a traditional IRA with an after-tax contribution; and (ii) convert the traditional IRA balance to a Roth IRA. This retirement contribution strategy sounds simple until, that is, you confront the rules and limitations associated with IRA contributions and MAGI constraints associated with making a Roth IRA contribution.

IRA Income Restrictions: A traditional IRA contribution is limited to the lesser of 100% of an individual's eligible compensation for the year and the contribution limit in effect for the calendar year. For 2024, the contribution limit is $7,000, or if the individual is at least age 50 by the end of the calendar year, he/she may make an additional catch-up contribution of $1,000, for a total of $8,000 contribution in 2024.

Income Tax Deduction: An individual can claim a full income tax deduction for a traditional IRA contribution, but only if he/she is not an active participant in an employer-provided qualified plan and not married to someone who is a participant. The individual may also be able to claim an income tax deduction if they are an active participant in an employer-sponsored qualified plan, or they are married to someone who is, but only if their modified adjusted gross income (MAGI) is below a certain amount tied to their income tax filing status. Those MAGI limits for 2024 for tax deductions to a traditional IRA are as follows:

Single: If a single individual participates in an employer-sponsored qualified plan, and his/her MAGI is $77,000 or less, then he/she may make a 100% deductible contribution to their traditional IRA. If their MAGI is between $77,000 and $87,000, only part of their contribution will be deductible, and if their income exceeds $87,000 none of their contribution will be tax deductible.

Married, Filing Jointly, Contributor a Participant: For married couples, if the spouse who makes the IRA contribution is an active participant in an employer-sponsored qualified retirement plan, if their reported MAGI is $123,000 or less, the contribution to the traditional IRA is fully tax deductible. If the couple's reported MAGI is between $123,000 and $143,000, then only part of the contribution will be tax deductible. If the couple's MAGI is above $143,000, then none of the contribution will be tax deductible.

Married, Filing Jointly, Contributor Not a Participant, But Spouse Is: If the couple's MAGI is less than $230,000, the contribution to the traditional IRA is fully tax deductible. If the couple's reported MAGI is between $230,000 and $240,000, only a part of the contribution to the traditional IRA will be tax deductible, and if the MAGI exceeds $240,000, none of the contribution to the traditional IRA will be tax deductible.

Married, Filing Separate- Active Participant: If the individual's MAGI is less than $10,000, he/she will be able to claim a tax deduction for part of their contribution to the traditional IRA. If his/her income is above $10,000, none of the contribution to the traditional IRA will be tax deductible.

Comment: Treating a deductible contribution as nondeductible is not always ideal for a *backdoor* Roth IRA conversion. For example, if an IRA owner has only pretax amounts in his/her traditional IRA, claiming a deduction for the new contribution would avoid the *pro rata rule* application for distributions and conversions.

Roth MAGI Limits for Contributions: If an individual wishes to make a Roth

IRA contribution he/she may do so, but only if their modified adjusted gross income (MAGI) does not exceed certain amounts, which amount is based on their tax-filing status. A short summary of those MAGI rules follows.

> **Single:** If the individual is single, he/she may make a 100% contribution to a Roth IRA if their income is $146,000 or less in 2024. As their MAGI increases, their ability to make a Roth IRA contribution is phased-out, completely disappearing if their MAGI is $161,000 in 2024.
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> **Married, Filing Separately:** If this is the individual's filing status, and his/her MAGI is less than $10,000 he/she may make a partial contribution to a Roth IRA. If his/her MAGI is greater than $10,000, then he/she is not permitted to make any Roth IRA contribution in 2024.
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> **Married, Filing Jointly (or Filing as a Qualified Widow(er):** If this is the individual's tax filing status, a full (100%) Roth IRA contribution can be made if his/her MAGI is$230,000 or less. If his/her MAGI is greater than $230,000, their contribution limit is phased-out, where no Roth IRA contribution can be made if the MAGI reported on his/her return is $240,000 or more.
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> **Comment:** If the individual's MAGI only permits a partial Roth IRA contribution, then he/she can contribute to the Roth IRA up to that maximum phase-out amount, and the balance of their contribution could be made to a traditional IRA.

Timing: A traditional IRA contribution must be made by the individual's tax-fling due date. Extensions do **not** apply. Accordingly, for a 2024 IRA contribution, the contribution must be made to the IRA by April 15, 2025. In contrast, a conversion from a traditional IRA to a Roth IRA has no deadline.

Comment: However, a conversion should be done immediately after the contribution to the traditional IRA to ensure that the contribution's gains accrue, after the conversion, in the Roth IRA where the gains could eventually be tax-free.

***Pro Rata* Rule:** If the individual has both pretax and after-tax contributions in his/her traditional IRA, a conversion of that IRA to a Roth IRA will include a *pro rata* amount of the pretax and after-tax amounts.

> **Example:** Iris has a traditional IRA balance of $95,000. All of Iris's IRA balance is pretax, i.e., it has been deducted by Iris. Iris makes a nondeductible IRA contribution of $5,000 to her traditional IRA in 2024, which brings her IRA balance to $100,000. Iris immediately converts her $5,000 contribution to her 'new' Roth IRA. Iris did not take any other distributions or perform any other Roth conversions in 2024. While the $5,000 is a nondeductible contribution to Iris's traditional IRA and it would be tax-free when distributed or converted from her traditional IRA, a partial (less than $100,000) conversion would include only a portion of the $5,000 contribution because of the *pro rata* rule. Iris's conversion of the $5,000 would include: (i) $4,750 taxable amount; and (ii) $250 as a nontaxable amount. The remaining $4,750 of the $5,000 nondeductible contribution by Iris would remain in her traditional IRA and eventually come out for future distributions and Roth conversions. Iris's pretax and after-tax ratio is calculated using IRS Form 8606.

***Aggregation* Rule:** When the after-tax amount is calculated for a Roth IRA conversion, all the individual's traditional IRAs, SEP IRAs, and SIMPLE IRAs are aggregated and treated as one traditional IRA, which then complicates the Roth IRA conversion strategy.

Exploit a Qualified Plan: If the traditional IRA owner participates in an employer-sponsored qualified retirement plan, and that plan is designed to accept rollovers from an IRA (i.e., the employer has to elect this option) then the plan participant who also owns a traditional IRA can *roll-up* the pretax balance from his/her traditional IRA to the qualified plan, leaving behind the after-tax contributions to the traditional IRA.

> **Example:** Same facts as in Example 1, except Iris also participates in her employer's 401(k) plan, which plan accepts IRA rollovers. Iris could roll

$95,000 of her traditional IRA into her 401(k) account. That would leave her $5,000 after-tax contribution in her traditional IRA, which then allows Iris to complete a tax-free conversion of that $5,000 to a Roth IRA. In short, the *pro rata* rule will not apply.

Comment: A *roll-up* from a traditional IRA to an employer-sponsored qualified retirement plan cannot include after-tax amounts. Any required minimum distribution (RMD) due for the calendar year must be taken before the *roll-up*. Additionally, for this *roll-up* strategy to work, the plan participant cannot have rolled over any amounts from the qualified plan to the traditional IRA in the same calendar year.

Conclusion: A *backdoor* Roth IRA conversion sounds deceptively simple when it is explained. That said, there are a lot of 'moving parts' and rules that have to be met before the *backdoor* conversion strategy can be implemented. If you would like to read additional missives, click here.