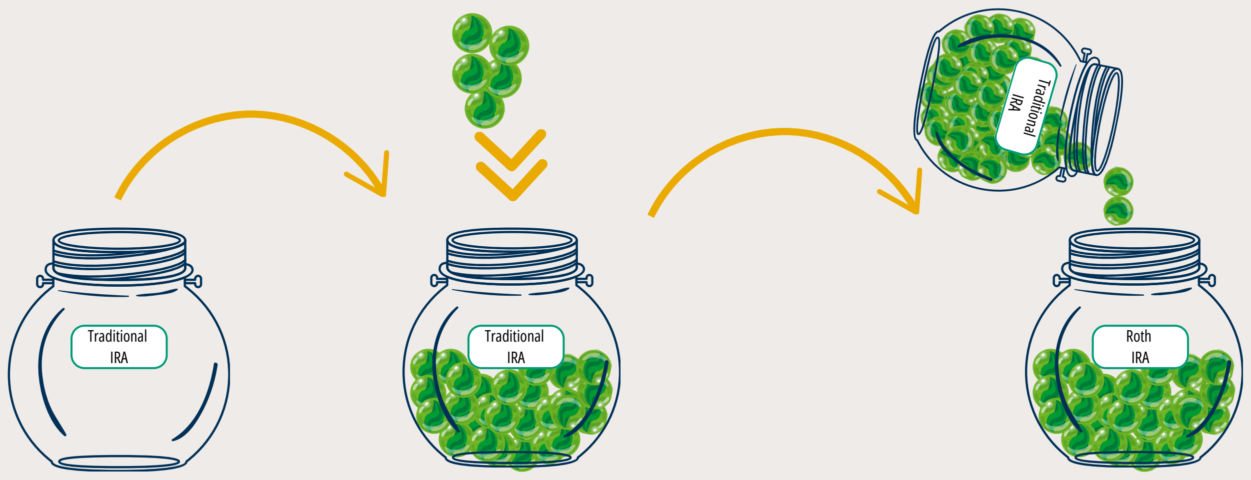
Backdoor Roth Contribution

Roth IRAs can be an important vehicle to help save for retirement, but not everyone qualifies to contribute to this account. The IRS imposes income restrictions that limit higher earners from making direct contributions, but there is an intriguing workaround: a strategy known as a backdoor Roth contribution. It's a complex process made simpler by an analogy using two items: marbles and jars.

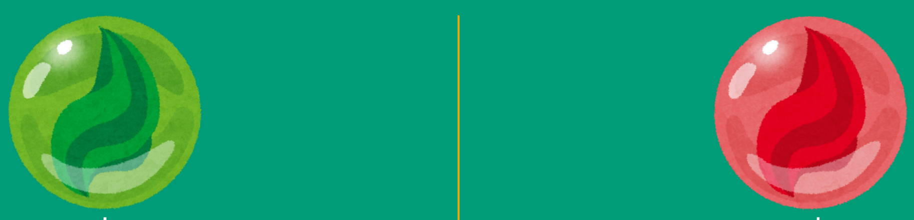
How does it work?

- Make a contribution to your IRA
- Convert the recently contributed money into your Roth IRA



So, what's the catch?

When done incorrectly, it can result in adding unwanted taxable income.

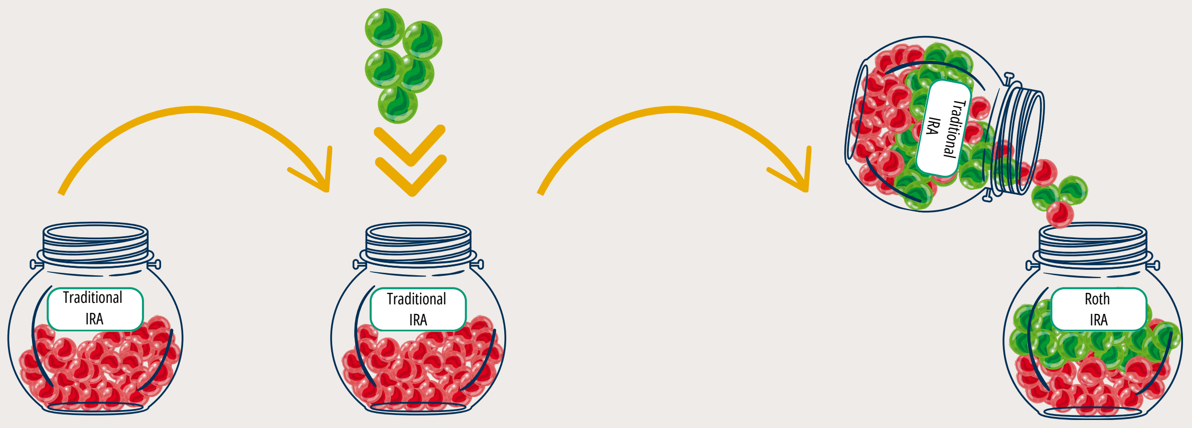


$ NOT TAXED*	$ TAXED*

*Tax treatment at time of withdrawal

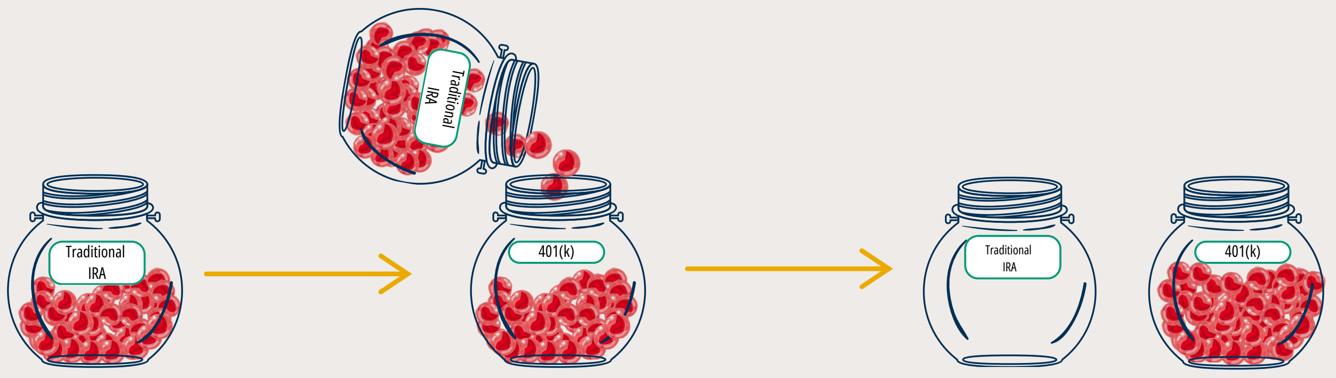
Scenario 1: Incorrect

We have red marbles in the traditional IRA jar to start. A contribution is made to your traditional IRA (green marbles). We don't have the ability to control which marbles are moved to the Roth IRA in the conversion, so this scenario results in unwanted taxable income.



Scenario 2: Correct

Before making the contribution to your traditional IRA, move your traditional IRA balance into a different non-IRA retirement account like a 401(k) through a tax-free rollover. By doing this, it removes the taxed, red marbles from the process. With a now empty IRA jar, we can make a backdoor Roth IRA contribution.



All or part of a backdoor Roth IRA conversion could be a taxable event. You may have to pay federal, state, and local taxes on converted earnings and deductible contributions.
A qualified distribution from a Roth IRA is tax-free and penalty-free. To be considered a qualified distribution, the 5-year aging requirement has to be satisfied and you must be age 59½ or older or meet one of several exemptions. Any withdrawals that include the converted amount, taken within the 5 years, are subject to a 10% penalty.

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