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Mega Back Door ROTH

In the realm of retirement planning and tax-efficient investment strategies, the Mega Backdoor ROTH Contribution has gained attention and merits some explanation to see if it's applicable to you. It is a powerful tool that would potentially allow you to further your savings with tax-free growth for years to come.

In general, the Mega Back Door ROTH builds on the traditional backdoor ROTH contribution many individuals have been doing for a while. With a back door Roth, an individual makes a non-deductible contribution to a traditional IRA and subsequently converts it to a ROTH IRA. A Mega Back Door ROTH is similar, in general an individual looks to contribute to an after-tax 401(k) and then convert those funds to a ROTH 401(k).

In practice there are a few limitations/sets that should be noted before jumping in to take advantage of the strategy. Here is a general overview of the process:

- Plan Eligibility: Your employer-sponsored retirement plans must allow for after-tax contributions and either immediate conversion to a ROTH 401(k) or in-service withdrawals to make a transfer to a ROTH IRA. Without these, the Mega Back Door becomes impossible, so it is important to review your plan summary or consult your plan administrator.
- Contribute After-Tax Funds: The goal is to take full advantage of the defined contribution limit ($66,000 for those under 50 and $73,500 for those over 50 for 2023). An individual can contribute up to the elective deferral limit ($22,500 for those under 50 and $30,000 for those over 50 for 2023) to the traditional 401(k) and may get some employer match. The remainder up to the defined contribution limit can be contributed on an after-tax basis.

For example, let's say you contribute the elective deferral limit of $22,500 in 2023 (it is almost always advisable to focus on maximizing this contribution first). Your employer also matched your contribution by adding $12,000 to your contributions. That brings your total pre-tax contributions for 2023 to $34,500. Because the total limit is $66,000 you can still contribute an additional $31,500 in after-tax dollars.

- Convert to ROTH: After contributions are made it is important to *immediately* initiate an in-plan conversion or an in-service withdrawal to move the funds to a ROTH 401(k) or ROTH IRA.

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Without this step, after-tax funds will not grow on a tax-free basis instead only growing on a tax-deferred basis. If funds are transferred to a ROTH 401(k), upon retirement the account can be converted to a ROTH IRA to enjoy the favorable tax rules behind a ROTH IRA.

There are also a few considerations to consider:

- If you have previously made after-tax contributions to your 401(k) without converting it, starting Mega Back Door ROTH contributions may lead to a taxable event. Upon conversion to a ROTH any current gains from your after-tax contributions that are converted will be taxable.
- After-tax contributions will have no tax benefit up front and will be less accessible than contributions to other investment vehicles. Personal financial circumstances, tax brackets, and retirement goals should be taken into account when considering this strategy.

The mega backdoor ROTH contribution offers a powerful opportunity to further your savings with tax-free growth and can be a valuable addition to a comprehensive retirement plan. It is important, however, to understand the limitations to make sure your plan is eligible, and the strategy is appropriate for your financial situation.