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Mega Backdoor Roth Highlights

An Opportunity to Expand Retirement Savings

The Mega Backdoor Roth strategy allows eligible retirement plan participants to contribute additional after-tax dollars to a retirement plan and convert those contributions to Roth savings. When a plan offers a Roth option, this strategy can help participants contribute additional retirement savings beyond the standard employee contribution limit.

What Is a Mega Backdoor Roth?

A Mega Backdoor Roth is a strategy that allows participants to make after-tax contributions beyond the standard employee deferral limit and move those contributions into a Roth account, either within the plan or through a rollover to a Roth IRA.

Unlike traditional pre-tax contributions, Roth savings can provide tax-free qualified withdrawals, including tax-free investment earnings, subject to applicable Roth distribution requirements.

How Much Can Participants Contribute?

The amount depends on the participant's contributions, employer contributions, and the plan's terms.

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For 2027:

- $25,500 is the standard employee elective deferral limit, indexed for inflation.
- $75,000 is the annual defined contribution limit under IRC Section 415(c), generally excluding eligible catch-up contributions.

For example, a participant who contributes the full $25,500 standard deferral limit could potentially contribute up to $49,500 in additional after-tax contributions, assuming no employer contributions or other annual additions count toward the limit.

Actual contribution capacity may be lower based on employer matching and nonelective contributions, forfeitures, plan provisions, and applicable testing requirements.

Who Can Participate?

Participants of any age may be eligible to use this strategy, provided the plan permits after-tax Roth contributions and offers an appropriate Roth conversion or rollover option.

Participation is subject to the plan's eligibility rules, contribution limits, and applicable nondiscrimination testing.

What Must a Plan Allow?

To support a Mega Backdoor Roth strategy, the plan generally needs to include provisions permitting:

- After-tax employee contributions beyond regular pre-tax or Roth elective deferrals.
- A Roth conversion or rollover option, such as an in-plan Roth conversion to a designated Roth account or an eligible in-service distribution that can be rolled over to a Roth IRA.

Participants and plan sponsors should review their plan document and coordinate with their recordkeeper and third-party administrator to confirm that the necessary Roth features are available and can be properly administered.

How Does It Work?

1. Make regular employee deferrals. Participants may first maximize their standard employee contributions, up to the 2027 limit of $25,500, if their goal is to maximize total retirement savings.
2. Determine the remaining contribution capacity. Subtract applicable employee deferrals, employer contributions, and other annual additions from the $75,000 annual limit, subject to the applicable rules.
3. Make after-tax contributions. Direct additional eligible contributions into the plan's after-tax contribution source.
4. Convert or roll over the contributions to Roth. Follow the plan's procedures for an in-plan Roth conversion or an eligible rollover to a Roth IRA.
5. Address tax reporting. Roth conversions and rollovers may trigger Form 1099-R reporting. The taxable amount depends on the transaction and whether the contributions have generated earnings.

Important consideration: Converting after-tax contributions promptly may help minimize taxable investment earnings before conversion. Any earnings converted to Roth are generally taxable in the year of conversion.

What Should Plan Sponsors Consider?

- Nondiscrimination testing: After-tax employee contributions are generally included in the Actual Contribution Percentage (ACP) test unless an applicable exemption or alternative testing method applies.
- Plan design and administration: Confirm that the plan document, recordkeeping system, and administrative procedures support the intended contribution and conversion process.
- Participant education: Explain contribution limits, tax implications, and the importance of coordinating contributions with employer contributions and other annual additions.
- Roth distribution rules: Qualified Roth distributions can be tax-free. Roth IRAs are not subject to lifetime required minimum distributions for the original account owner; designated Roth accounts in employer plans are also exempt from lifetime RMDs for the participant under current law, subject to applicable rules.

A Plan Design Opportunity

The Mega Backdoor Roth strategy may offer participants another way to build retirement savings while giving plan sponsors an opportunity to evaluate whether their plan's contribution and Roth features align with participant needs. Implementation should be reviewed with the plan's retirement plan service providers and appropriate tax or legal advisors.

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