

The Roth IRA Five-Year Rules – You Can Have More Than One!

You can **always** take a distribution of basis from the Roth IRA. Basis is annual contributions and converted amounts. **These distributions will not be taxed** when they are withdrawn as they were subject to tax when they went into the Roth IRA. For converted amounts there may be 10% penalty (see rule #2)

Ordering Rules

There are ordering rules for Roth-IRA distributions.

1. Contributions come out first.
2. Converted amounts come out next.
3. After tax amounts converted come out next
4. Earnings come out last.

Qualified Distributions

Distributions must be qualified to be **free of all tax and penalties**.

You must have had a Roth IRA for **Five Years**,

AND

You must be 59 ½

OR

the distribution is due to death,

OR

the distribution is due to the disability of the account owner,

OR

the distribution qualifies for the first time home buyer exception.

Rule #1 – Applies to all Roth IRAs made with annual contributions and determines if distributions of earnings are taxable and subject to 10% penalty.

The **five year rule** starts on January 1st of the year you make your first Roth-IRA contribution. This can be as late as your tax filing deadline of April 15th 2010 for a 2009 contribution. It covers all future contributions to that Roth IRA and all new Roth-IRAs made with annual contributions you may establish. In other words, you only have one 5 year rule for annual contributions.

If a distribution is qualified (see above), all funds come out of the Roth IRA income tax and penalty free. If the distribution is not qualified, a distribution of earnings (see ordering rules above) will be subject to income tax and the 10% penalty.

Rule #2 – Applies to all Roth IRA conversions and determines if distributions of converted amounts are subject to 10% penalty but not income tax

The five year rule for conversions starts on January 1st of the year you make a Roth-IRA conversion by Dec 31st. This rule applies separately to each conversion. **If you do conversions in three different years, you have three different five year holding periods to track.**

If converted amounts are distributed (see ordering rules above) before they have been held for five years, AND the account owner is under the age of 59 ½ at the time of the distribution, the 10% early distribution penalty will be applied to the amount of the distribution. (If after-tax amounts were converted to the Roth, then the distribution of the after-tax amounts will never be subject to the penalty.) This rule applies separately to each conversion. Distribution of earnings must be qualified to be free of all tax and 10% penalty.