6 RULES FOR TAX-FREE ROTH IRA DISTRIBUTIONS

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Roth IRAs offer a trade-off. You decide to pay taxes now on your contribution (or conversion) in exchange for tax-free earnings down the road. Don't miss out on Roth IRA benefits by making mistakes when you take a distribution. Here are six rules you need to know to make sure money comes out of your Roth IRA tax-free.

1. Aggregate your Roth IRAs. For tax purposes, all of your Roth IRAs are considered one Roth account. There is no tax benefit gained by keeping conversions in a separate Roth IRA from your contributions. This is sometimes called the aggregation rule.

2. **Follow the ordering rules.** Funds leave your Roth IRAs in a certain order. Contributed amounts are distributed first. Converted amounts are distributed next, first in, first out. Last out would be earnings.

3. **Contributions are always available tax and penalty free.** Not only do your contributions come out first, they are always available tax and penalty free. This means that if you need to tap your Roth IRA, you can easily access contributions without adverse tax consequences.

4. **Converted funds may be subject to penalty.** Converted funds are always distributed tax-free. This makes sense since you already paid taxes when you converted them. However, amounts that were taxable at conversion may be subject to the 10% early distribution penalty if you are under the age of 59½ at the time of the distribution and the conversion was less than five years ago. This five-year clock begins separately for each conversion you do. What if you are over age 59 ½ when you take converted dollars from your Roth IRA? Then, you have no worries about this five-year clock.

5. **Qualified distributions of earnings are tax-free.** Earnings are not subject to tax if the distribution is a qualified distribution. Your distribution is qualified if it is made after you have owned any Roth IRA account for five years AND you are over the age of 59½, or are dead, or disabled, or taking the funds for a first-time home purchase.

6. **Watch the five-year clock for qualified distributions of earnings.** The five-year period for qualified distributions of earnings can be confusing. It is different than the five-year period for penalty-free distributions of converted funds that is discussed above. It does not re-start with each Roth IRA contribution or conversion. If you contributed $1 dollar to your Roth IRA for 2014, and then in 2016 you converted your one-million-dollar traditional IRA to the Roth IRA, then as of January 1, 2019, all the Roth money would be considered to have been held for five years. Your Roth IRA 5-year clock began on the first day of the year for which the first dollar of Roth contributions was made.