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nonqualified Roth distribution may be tax-free anyway—maybe even all of it.

**Ken Berry, JD** • Dec. 28, 2023



Are you considering a contribution to a Roth IRA or a conversion of some or all of the

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**Basic rules:** There's no current tax break for contributing to a Roth or converting traditional IRA funds into a Roth. However, qualified distributions from a Roth IRA existing for at least five years are 100% exempt from federal income tax. For this purpose, qualified distributions include those made in the following situations:

- After attaining age 59½;
- Made due to death or disability; or
- Used to pay qualified homebuyer expenses (up to a lifetime limit of \$10,000).

The problem for some taxpayers is that they have to keep their hands off the Roth money for at least five years. To add insult to injury, you're hit with the 10% penalty tax if you're under the magic age of 59½. But you have an ace up your sleeve: Roth payouts are taxed under favorable ordering rules.

Specifically, the IRS says that funds are treated as being distributed from a Roth IRA in the following order.

1. Roth IRA contributions. This means you can withdraw any amount you contributed tax-free in any event.
2. Contributions from converting a traditional IRA into Roth status (i.e., "taxable conversion contributions"). These may be withdrawn tax-free even if they are part of a nonqualified distribution, but the 10% penalty tax generally applies to withdrawals within five years, unless you're age 59½ or older.
3. Contributions from converting nontaxable traditional IRA balances into Roth IRA status (i.e., "nontaxable conversion contributions"). Such contributions may also be withdrawn on a tax-free basis subject to the 10% penalty.

#### 4. Earnings within the Roth IRA. These amounts are taxable when withdrawn unless

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withdrawals earlier than expected. The tax damage may be nominal or nonexistent. Your professional advisor can provide additional guidance if needed.

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