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## Marc A. Hebert's 'Money \$ense':The Roth IRA five-year rule

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The Roth IRA account can be a valuable vehicle to use for retirement savings.

Unlike the traditional deductible IRA, you do not receive a tax deduction when you make a contribution to a Roth.

The reverse is also true, providing certain parameters are met.

Unlike a traditional IRA, your distributions from a Roth IRA do not count as taxable income. We will review some of these parameters in this article.



One important rule to keep in mind is called the Roth five-year rule.

This generally refers to the stipulation that the earnings on Roth distributions are tax-free only if five years have elapsed since making your very first contribution.

The distribution must also take place after you are age 59½, disabled or when your beneficiaries inherit your account after your death.

There are also exceptions due to the coronavirus. These rules seem simple enough. But are there any other details that you need to know?

When we speak about the five-year rule, what does that mean? When does the clock start?

The time frame could be shorter than five years because the clock actually starts on Jan. 1 of the tax year for which the first contributions are made.

For example, say you opened and funded your Roth IRA on Dec. 31, 2019. The five-year clock started Jan. 1, 2019. It will end on Jan. 1, 2024. Even if you don't make your contribution until Dec. 31, the year will still count against the five required under the rule.

If you had waited until April 2020 to make your 2019 contribution, then the clock still started Jan. 1, 2019.

Contributing to one Roth IRA starts the clock for any other Roth IRA you may have. Future Roth IRA contributions don't restart the clock. Transfers from one Roth IRA to another also doesn't restart the clock.

For employer Roth 401(k) plans, the rules change slightly. The five-year rule is applied to each Roth 401(k) account.

Say you roll your assets from a former employer's Roth 401(k) plan into your current employer's Roth 401(k) plan. The clock starts with the first plan.

If you first contributed to the Roth 401(k) in 2013, then rolled the assets into a new plan in 2019, the new account will have met the five-year requirement.

Here's another scenario. Let's say you have left your job and want to roll your Roth 401(k) into a Roth IRA.

What happens to the clock now?

If the Roth IRA is a brand new account, it starts the clock all over. This is true regardless of how long the funds have been in the Roth 401(k).

Given this, it might make some sense to open a Roth IRA as soon as possible if you are eligible. Once you fund the Roth IRA, the clock starts. Even if the account is minimally funded, it will start that five-year window.

As the rules can be somewhat complicated, be sure to discuss any Roth IRA contributions and withdrawals with a certified financial planner or a personal tax advisor prior to completing any transaction.

There is one last case to consider.

What if you convert a Traditional IRA to a Roth IRA?

This means you take the funds in your Traditional IRA and transfer them over into the Roth IRA.

If there were any deductible funds in the Traditional IRA, taxes will be paid on the transfer. Taxes will also be paid on the tax-deferred earnings.

Any withdrawals of the converted assets within the five years may incur a 10% early-distribution period. There may be exceptions to this, and if you are over age 59½ you may not incur the penalty.

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