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What is the Roth IRA five-year rule?

Actually, there are *two* five-year rules you need to know about. The first five-year rule determines when you can begin receiving tax-free qualified distributions from your Roth IRA. Withdrawals from your Roth IRA—including both your contributions and any investment earnings—are completely tax and penalty free if you satisfy a five-year holding period *and* one of the following also applies:



- You've reached age 59½ by the time of the withdrawal
- The withdrawal is made due to a qualifying disability
- The withdrawal is made for first-time homebuyer expenses (\$10,000 lifetime limit)
- The withdrawal is made by your beneficiary or estate after your death

This five-year holding period begins on January 1 of the tax year for which you made your first contribution (regular or rollover) to any Roth IRA you own. For example, if you make your first Roth IRA contribution in March 2015 and designate it as a 2014 contribution, your five-year holding period begins on January 1, 2014 (and ends on December 31, 2018). You have only one five-year holding period for determining whether distributions from any Roth IRA you own are tax-free qualified distributions. (Roth IRAs you *inherit* are subject to different rules.)

The second five-year rule is a little more complicated. When you convert a traditional IRA to a Roth IRA, the amount you convert (except for any after-tax contributions you've made) is subject to income tax at the time of conversion. However, your conversion isn't subject to the 10% early distribution penalty, even if you haven't yet reached age 59½.

But what the IRS giveth it can also taketh away. If you withdraw any portion of your taxable conversion within five years, you'll have to pay the 10% early distribution penalty on those funds that you previously avoided—unless you've reached age 59½ or qualify for another exemption from the penalty tax. This five-year holding period starts on January 1 of the year you convert your traditional IRA to a Roth IRA. And if you have more than one conversion, each will have its own separate five-year holding period for this purpose.

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