WELLS FARGO ADVISORS

Roth IRA distribution rules

Roth IRAs are often seen as a preferred investment account because of the focus on the "income-tax free" distributions that are available. However, this is where a Roth IRA can become complicated. That's because the IRS rules around distributions from a Roth IRA are fraught with specifics, depending on the status of each account and each owner. It pays to know the rules.

Qualified and nonqualified distributions

Roth IRAs have two types of distributions, qualified and nonqualified. Knowing the difference will help you understand if you will owe income tax on the distribution. You may owe a 10% additional tax on early distributions, meaning those taken before you are age 59½, that are included in gross income.

Qualified distributions, which are tax-free and not included in gross income, occur when your account has been open for more than five years and you are at least age 59½, or as a result of your death, disability, or using the first-time homebuyer exception.

The five-year waiting period for qualified Roth IRA distributions begins for all of your Roth IRAs on January 1 of the first taxable year for which the account was funded and ends on December 31 of the fifth year. If, for example, you open a Roth IRA for the first time in 2019 and make a 2018 Roth contribution, that contribution is retroactive to January 1, 2018, which is also when your five-year waiting period begins.

A *nonqualified* distribution is one that does not meet the above requirements. Does that mean nonqualified distributions are included in gross income? Not necessarily.

Roth IRA distribution rules

Unlike Traditional IRAs, there are ordering rules when taking nonqualified distributions from a Roth IRA.

- **Contributions come first** — The first amounts distributed from any of your Roth IRAs, if you have several accounts, are annual contributions. Because Roth contributions are not deductible, they are not subject to tax or included in gross income and can be taken at any time.

Did you know ...

Annual Roth contributions can be distributed at any time and are not subject to tax or included in gross income.

- **Converted dollars are next** — After you have exhausted all of your contributions, the next amounts distributed are from any conversions you have completed. These conversion amounts are distributed tax-free on a first in, first out basis. Converted amounts taken before the five-year holding period, **or** you are age 59½ or older, whichever is first, may have a 10% additional tax, unless an exception applies.
- **Earnings are last** — The last money is distributed from earnings. Earnings taken before the account has been open for longer than five years **and** you are at least age 59½ or older, or you are disabled, or the payment is made to your beneficiary after your death, or using the first-time homebuyer exemption, are subject to income tax and the 10% additional tax, unless another exception applies.
- **Exceptions to the 10% additional tax** — The exceptions include distributions after reaching age 59½, death, disability, eligible medical expenses, certain unemployed individual's health insurance premiums, qualified first-time homebuyer ($10,000 lifetime maximum), qualified higher education expenses, Substantially Equal Periodic Payments (SEPP), Roth conversion, qualified reservists distribution, or IRS levy.

Keep in mind

- You do not have to take required minimum distributions (RMDs) from a Roth IRA during your lifetime, optimizing the opportunity to build tax-free wealth.
- If your spouse is the Roth IRA beneficiary, they will not have RMDs if they roll over or transfer the Roth IRA and treat it as their own. This allows for an additional period of tax-free compounding of potential earnings that can help grow your family's wealth.
- Beneficiaries can distribute earnings tax-free from an Inherited Roth IRA as long as the Roth had been funded for more than five years.
- Non-spouse beneficiaries who inherit a Roth IRA, your children, for example, should begin RMDs if they want to take advantage of the stretch IRA strategy.[1] If annual RMDs are not taken, the Inherited Roth IRA would need to be depleted within five years, ending tax-free compounding of potential earnings.

Together we'll go far

1. Stretching an IRA simply refers to the ability to take RMDs over the beneficiary's single life expectancy (using the term-certain calculation method) rather than over the life expectancy of the original IRA owner.

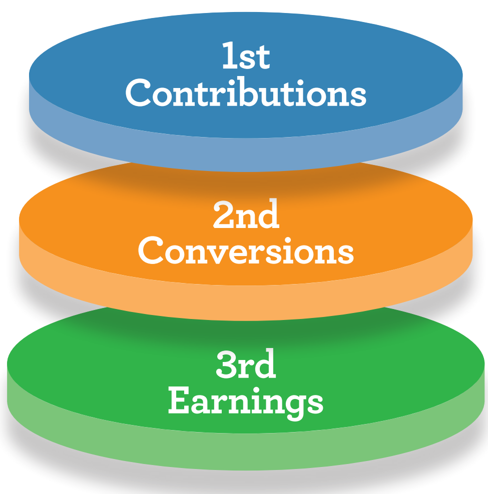
Talk to Wells Fargo Advisors

At Wells Fargo Advisors, we want to work closely with our investors in making wise choices for their future. To learn more about the Roth IRA and how it might fit your retirement planning needs, please contact your Financial Advisor with Wells Fargo Advisors. We look forward to helping you and your family plan your future retirement.

With you every step of the way

Everyone has a different vision of retirement that requires a unique financial strategy. Wells Fargo Advisors can support you in your retirement planning process by providing the guidance needed to make informed choices. We will meet with you and help create a comprehensive plan that takes into account your complete financial picture. Your Financial Advisor will be with you every step of the way to monitor your progress and adapt your plan as needed. Working together, we'll design and implement a retirement plan that can help you live out your unique vision of retirement.

Distributions from Roth IRAs — ordering rules



Contributions — Distributions are not subject to tax or included in gross income and can be taken at any time.

Conversions — No taxes are owed (already paid at conversion).
No 10% additional tax owed if:
- More than five years have lapsed; or
- Age 59½ has been obtained; or
- One of the exceptions to the penalty have been met

Please note: each Roth conversion has its own five-year holding period.

Earnings — No taxes or 10% additional tax are owed after five years **and** you are at least age 59½, you are disabled, or the payment is made to your beneficiary after your death, or using the qualified first-time homebuyer exception ($10,000 lifetime maximum). Exceptions to the 10% additional tax apply.