

# Roth IRA Basics



# Introduction to Roth IRAs

- Contributions are made on an after-tax basis
- There's no up-front tax benefit
- Qualified distributions are entirely free from federal income tax
- Caution: Different rules may apply for state tax purposes



# Traditional IRA vs. Roth IRA

## Traditional IRA

- Can make annual contribution if you have taxable compensation
- Deductible contributions depend on income, filing status, and coverage by retirement plan
- Can make after-tax (nondeductible) contributions
- Distributions subject to federal income tax, except for after-tax contributions
- Distributions prior to age 59½ may be subject to additional 10% penalty tax
- Distributions required after 72
- Funds grow tax deferred

## Roth IRA

- Can make annual contribution if you have taxable compensation
- Ability to contribute depends on income level and filing status
- All contributions are after-tax (no up-front deduction)
- Qualified distributions are entirely free from federal income taxes
- For nonqualified distributions, earnings subject to federal income tax and 10% penalty tax may apply if under age 59½
- No lifetime required distributions
- Funds grow tax deferred/tax free

# Roth Tax-Free Qualified Distributions

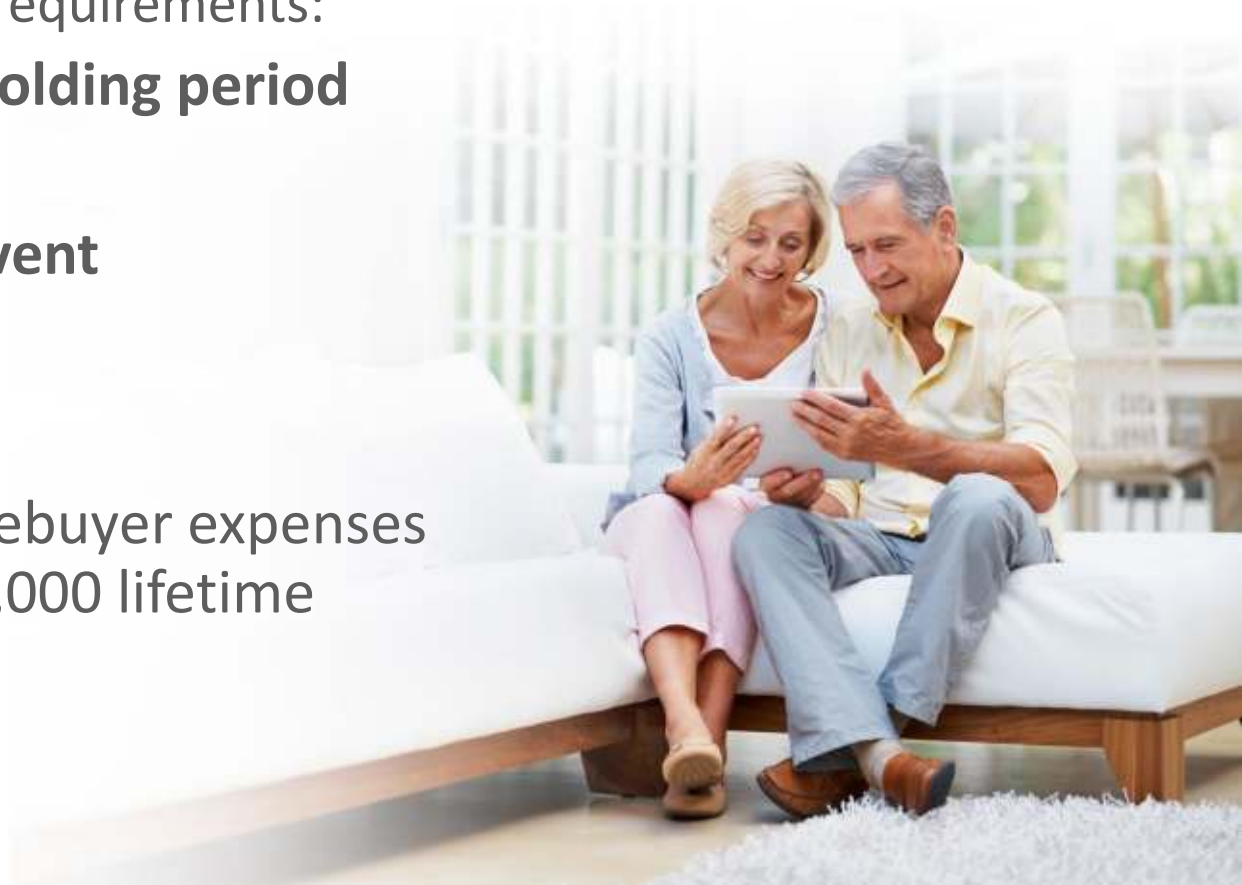
**Qualified distributions are federal income tax free.**

For a distribution to be qualified, it must meet BOTH of the following requirements:

- **Satisfy five-year holding period**

AND

- **Have qualifying event**
  - Age 59½
  - Disability
  - First-time homebuyer expenses (limited to \$10,000 lifetime from all IRAs)
  - Death



# Roth Qualified Distributions: The Five-Year Holding Period

- Five-year holding period begins on the first day of tax year for which you first made a contribution (annual, rollover, or conversion) to ANY Roth IRA
- Five-year holding period ends after five calendar years
- Applies to your beneficiaries after your death as well
- Spouse beneficiary can roll over to own Roth IRA or treat your Roth IRA as his or her own. In either case, the five-year holding period begins on the *earlier* of:
  - January 1 of tax year your spouse first established any Roth IRA, or
  - January 1 of tax year you first established any Roth IRA

## **Period begins on January 1 of first tax year for which you made a contribution to any Roth IRA**

- Can make a regular (annual) contribution to an IRA for a tax year until April 15 of following year
- If you make regular contribution to first Roth IRA on April 15, 2022, and designate contribution for 2021, five-year holding period begins on January 1, 2021

# Qualified Distributions — Example 1

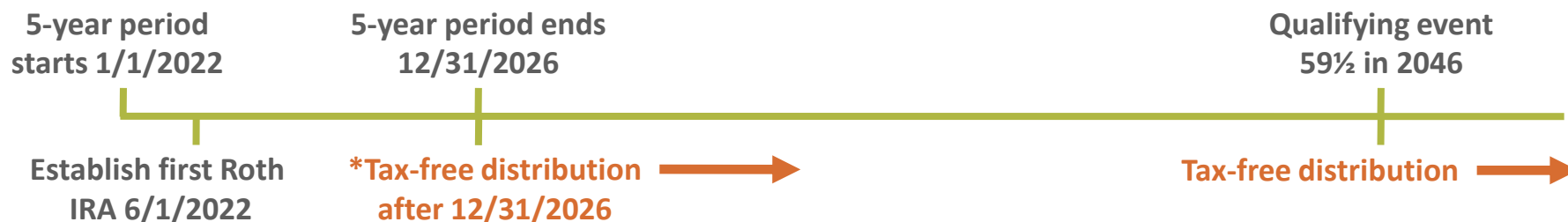
- Age 60
- Establish first Roth IRA on December 31, 2022, by converting a traditional IRA to a Roth IRA
- Must have qualifying event AND satisfy five-year holding period
- Here qualifying event has occurred — you've attained age 59½
- Five-year holding period begins January 1, 2022
- Five-year holding period ends December 31, 2026
- Tax-free qualified withdrawals from this Roth IRA, and any other Roth IRA you own, available anytime after December 31, 2026





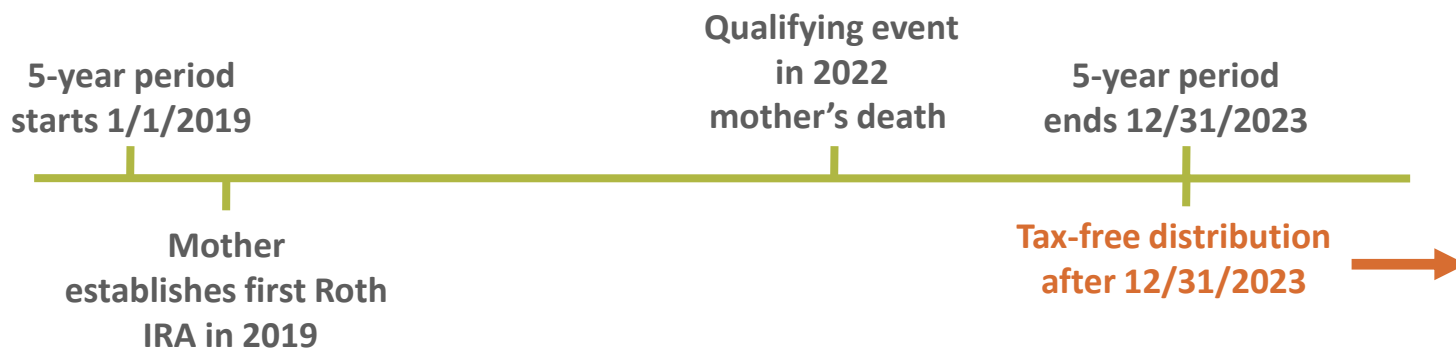
# Qualified Distributions — Example 2

- Age 35
- Establish first Roth IRA on June 1, 2022, by making a rollover from a 401(k) plan to the Roth IRA
- Must have qualifying event AND satisfy five-year holding period
- Five-year holding period begins January 1, 2022
- Five-year holding period ends December 31, 2026
- Tax-free qualified withdrawals available from this Roth IRA, and any other Roth IRA you own:
  - In 2046, after you attain age 59½
  - After December 31, 2026, if you become disabled or die\*
  - After December 31, 2026, if you have first-time homebuyer expenses (up to \$10,000 lifetime from all IRAs)\*



# Qualified Distributions — Example 3

- You inherit a Roth IRA from your mother in 2022
- Your mother established her first Roth IRA in 2019 by making a regular annual contribution
- Must have qualifying event AND satisfy five-year holding period
- Qualifying event is your mother's death
- Five-year holding period begins January 1, 2019
- Five-year holding period ends December 31, 2023
- Tax-free qualified withdrawals are available from the inherited Roth IRA anytime after December 31, 2023

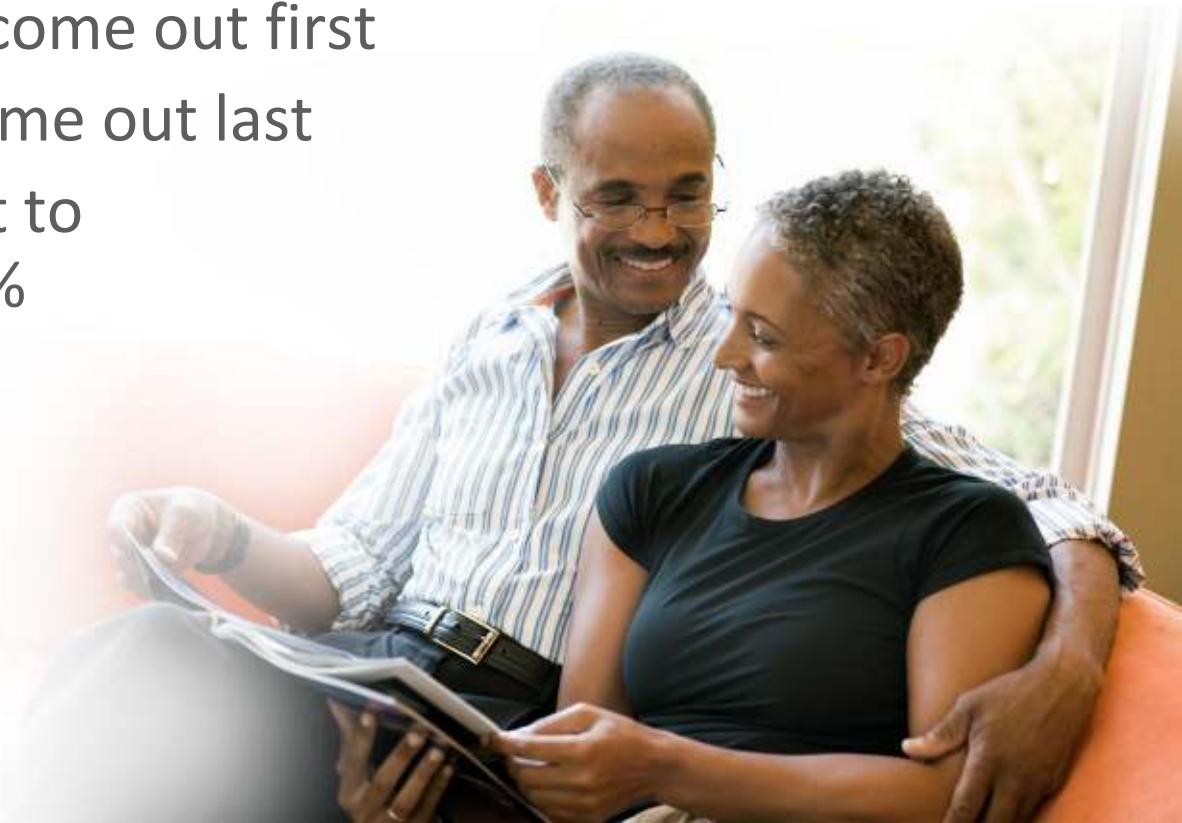




# Nonqualified Roth Distributions

**Nonqualified distribution: You haven't satisfied the five-year holding period or you don't have a qualifying event**

- Your contributions come out tax free
- Your contributions come out first
- Taxable earnings come out last
- Earnings are subject to income tax, and 10% penalty tax unless exception applies



# Ways to Fund a Roth IRA



Regular Annual  
Contributions



Convert Traditional IRA  
to Roth IRA



Rollover from Eligible  
Employer Plan to Roth IRA

# Funding Annual Roth Contributions



- You can contribute up to \$6,000 to a Roth IRA in 2022
- Individuals age 50 or older can make additional “catch-up” contribution of \$1,000
- Annual contributions may be limited depending on income level and filing status:

Federal filing status	2022 Roth contribution reduced if MAGI is:	You can't contribute to a Roth IRA in 2022 if your MAGI is:
Single or head of household	More than \$129,000 but less than \$144,000	\$144,000 or more
Married filing jointly or qualifying widow(er)	More than \$204,000 but less than \$214,000	\$214,000 or more
Married filing separately	More than \$0 but less than \$10,000	\$10,000 or more

# Converting a Traditional IRA to a Roth IRA

- Taxed in year of conversion as if you took a withdrawal (but 10% early distribution does not apply)
  - Trade off immediate taxation for possibility of tax-free qualified distributions in future
  - You can also convert SIMPLE IRAs (after two-year waiting period) and SEP-IRAs to Roth IRAs



# Ways to Convert a Traditional IRA to a Roth IRA

- Rollover
- Trustee-to-trustee transfer
- Same-trustee transfer



# Calculating the Conversion Taxes

- Taxed as if you took a withdrawal from the traditional IRA
- 10% penalty tax doesn't apply (but may be recaptured if you make a nonqualified withdrawal from your Roth IRA within five years of any conversion)





# Calculating the Conversion Taxes

If you've made only deductible contributions to your traditional IRAs, then the entire amount you convert is subject to income tax.

**IRA**

**Only  
deductible  
contributions  
and earnings**

**= Fully taxable conversion**

# Calculating the Conversion Taxes

## IRA

TAXABLE  
Deductible  
contributions  
and earnings

NONTAXABLE  
Non-deductible  
contributions

- If you've made nondeductible (after-tax) contributions to your traditional IRA, any distribution consists of pro rata amount of taxable and nontaxable dollars
- Can't just convert nontaxable dollars in a traditional IRA for tax-free conversion

# Calculating the Conversion Taxes

Must aggregate all traditional IRAs you own, including SEP and SIMPLE IRAs, when calculating the taxable amount of a withdrawal or conversion

## IRA

### TAXABLE

Deductible  
contributions  
and earnings

### NONTAXABLE

Non-deductible  
contributions

# Who Can Convert to a Roth?

## Exception

- You can't convert an inherited traditional IRA to a Roth IRA (special rules apply to spouse beneficiaries)



# Using the “Back Door” to Fund Annual Roth Contributions

- Even if you can't contribute to a Roth IRA because of the income limits, you can contribute to a traditional IRA as long as you have earned income
- Anyone can convert a traditional IRA to a Roth, regardless of income or marital status
- You can make nondeductible contributions initially to a traditional IRA
- Convert that traditional IRA to a Roth
- Remember to aggregate your traditional IRAs when calculating tax



# Converting Employer Plan Dollars to a Roth IRA



- Eligible distributions from 401(k), 403(b), 457(b), and qualified plans can be rolled over to traditional or Roth IRA
- Your employer will identify an eligible rollover distribution
- Amounts rolled over to a Roth IRA are taxed except for any after-tax contributions
- Anyone can roll over to a Roth IRA, regardless of income limits or marital status — even non-spouse beneficiaries
- Rollovers from employer plans can be complicated, and can have serious tax implications

*In addition to rolling your employer-plan money into an IRA, you may also be able to 1) leave the money in the plan, if allowed; 2) transfer assets to a new employer's plan; or 3) withdraw the funds.*



# Is a Roth IRA Appropriate for You?

## Pros

- Beneficial if you expect to be in a higher tax bracket when you take payouts
- Qualified distributions are tax free, won't impact Social Security
- Lifetime distributions not required; more assets can compound tax free for longer time
- May be able to leave more to heirs, income tax free



# Is a Roth IRA Appropriate for You?

## Cons

- May not be appropriate if you expect to be in a lower tax bracket when you'll take payouts (particularly if you plan to convert funds)
  - You pay taxes now; potential negative impact on Social Security, other items
  - Using IRA funds to pay conversion taxes may have serious drawbacks
- May not be appropriate if you'll need to use the funds soon
- Risk of future law changes
- State tax treatment may differ

# Thank You



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