Roth IRAs

The Roth IRA differs from the traditional IRA in that contributions are never deductible and, if certain requirements are met, account distributions are free of federal income tax.[1]

Funding a Roth IRA

Annual contributions: A Roth IRA may be established and funded at any time between January 1 of the current year, up to and including the date an individual's federal income tax return is due, (generally April 15 of the following year), not including extensions.

Conversion of a traditional IRA account: A traditional IRA may be converted to a Roth IRA, with the conversion being a *taxable* event. For the year of conversion, the taxpayer must include in gross income previously deducted contributions plus net earnings (or minus net losses). For individual retirement annuities, gross income is generally increased by the fair market value of the contract on the date of conversion (through a re-designation) or distribution (if held inside an IRA). If a retirement annuity is completely surrendered, the cash received is the amount includable in income. Any 10% penalty tax for early withdrawal is waived. However, if a taxpayer withdraws amounts from the Roth IRA within five years of the conversion, the 10% penalty tax will apply to those amounts deemed to be part of the conversion, unless an exception applies.

Recharacterized Contributions

In certain situations, a taxpayer who contributes to one type of IRA may "recharacterize" the contribution as if it were made to another type of IRA. For example, a taxpayer who contributes to a traditional IRA can recharacterize the contribution as if it had been made to a Roth IRA, and vice versa. Prior to 2018, a taxpayer who converted a traditional IRA to a Roth IRA could "unwind" the conversion, recharacterize the converted funds, and move them back into a traditional IRA. However, for tax years beginning in 2018, the Tax Cuts and Jobs Act of 2017 (TCJA) repealed the ability to recharacterize a Roth conversion to a traditional IRA.

[1] Income tax treatment of Roth IRAs at the state or local level may differ.

Rollovers from a qualified plan: Distributions from qualified retirement plans, IRC Sec. 457(b) governmental plans, and IRC Sec. 403(b) plans may also be rolled over to a Roth IRA.

These conversions are taxable events, with gross income for the year of conversion being increased by previously deducted contributions plus net earnings (or minus net losses).

Direct rollover from a designated Roth Account: Funds may be rolled into a regular Roth IRA from a designated Roth account that is part of a 401(k), 403(b), 457(b) governmental plan, or from a Roth SEP IRA or Roth SIMPLE IRA. Such a rollover is not a taxable event and the filing status and MAGI limitations normally applicable to regular Roth contributions do not apply.

Military death payments: Under the provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008, an individual who receives a military death gratuity and/or a payment under the Servicemembers' Group Life Insurance (SGLI) program may contribute to a Roth IRA an amount no greater than the sum of any military death gratuity and SGLI payment. Such a contribution is considered a qualified rollover contribution and must be made within one year of receiving the death gratuity or insurance payment. The annual dollar contribution limit and income-based phase-out of the dollar contribution limit do not apply to such contributions.

529 Plan Rollover to a Roth Account: For distributions after 2023, an individual for whom a Sec. 529 Qualified Tuition Plan has been in existence for at least 15 years may make tax and penalty-free contributions to a Roth IRA from the 529 plan in a direct, trustee-to-trustee transfer. Such contributions are limited to a lifetime maximum of $35,000, are subject to the annual IRA contribution limits, and may not exceed the aggregate amount contributed to the 529 plan (and earnings) before the five-year period ending on the date of distribution.

Type of Arrangements Permitted

There are currently two types of Roth IRAs.

- **Individual retirement accounts:** Trusts or custodial accounts with a corporate trustee or custodian.
- **Individual retirement annuities:** Special annuities issued by a life insurance company.

Contribution Limits

Limits: For 2025, an individual may contribute (but not deduct) the lesser of $7,000 or 100% of compensation[1] for the year. For a married couple, an additional $7,000 may be contributed on behalf of a lesser earning (or nonworking) spouse, using a spousal account.

A husband and wife may contribute up to a total of $14,000, as long as their combined compensation is at least that amount.[2] If an IRA owner is age 50 or older, he or she may contribute an additional $1,000 ($2,000 if the spouse is also age 50 or older).

Other IRAs: The contribution limits for a Roth IRA are coordinated with those of a traditional IRA; a taxpayer may not contribute more than the annual limit for that tax year into a single IRA or a combination of traditional and Roth IRAs. Excess contributions to a traditional or Roth IRA are subject to a 6% excise tax.

Contribution phase out: For 2025, the maximum contribution to a Roth IRA is phased out for single taxpayers with MAGI between $150,000 and 165,000. For married couples filing jointly, the phase-out range is a MAGI of 236,000 to $246,000. For married individuals filing separately, the phase-out range is a MAGI of $0 to $10,000.[3]

Taxation of Distributions

A distribution from a Roth IRA that is a "qualified" distribution is excluded from gross income and is not subject to federal income tax. A distribution is qualified if it is made after a five-year waiting period[4] and at least one of the following requirements is met:

- after the taxpayer reaches age 59½; or
- due to the taxpayer's death; or
- because the taxpayer becomes disabled; or
- to pay for first-time-home-buyer expenses up to $10,000.

[1] "Compensation" includes taxable wages, salaries, or commissions or the net income from self-employment.

[2] These amounts apply to 2025. For 2024, the maximum allowable contributions were $7,000 for a single individual and $14,000 for a married couple.

[3] For 2024, the phase-out ranges were: (1) MFJ – MAGI of $230,000 - $240,000 and (2) Single - $146,000 - $161,000. For those using the MFS filing status, the phase-out range is $0 - $10,000, which does not change.

[4] Generally, five years after a contribution is first made, or amounts are converted to a Roth IRA.

The **earnings** portion of a "non-qualified" distribution is subject to tax. To determine any taxable distribution, the funds are considered to be withdrawn in a specified order:

- Any withdrawal is considered to come first from nondeductible **contributions**, which are not subject to tax.
- After all contributions have been withdrawn, any **conversion** amounts are considered next. A distribution of converted funds is not included in gross income, but may be subject to the 10% premature distribution penalty if the funds are withdrawn within five years of being converted.
- Once all contributions and conversions have been withdrawn, any remaining funds are deemed to be **earnings**, and, when distributed, are included in gross income.

Premature Distributions

If a **taxable** distribution is received prior to the account owner reaching age 59½, a 10% federal tax penalty for "early" withdrawal is added to the regular income tax due. The 10% penalty may not apply if one of a number of exceptions applies (See IRC Sec. 72(t)). All taxable distributions are included in the IRA owner's gross income in the year of distribution.

Distribution Requirements

Roth IRAs are not subject to the mandatory required minimum distribution (RMD) rules during the life of the owner (triggered at age 73), applicable to traditional IRAs.[1] However, there are mandatory distribution requirements applicable to non-spouse beneficiaries who *inherit* a Roth account.

Qualified Charitable Distributions (QCD)

Federal income tax law provides for an exclusion from gross income of up to $100,000 for distributions made from a Roth or traditional IRA *directly* to a qualified charitable organization. Such a distribution is known as a Qualified Charitable Distribution, or QCD. The amount excluded from gross income may be reduced if an individual continues to make

[1] Under current regulations, the age to begin RMDs increases after 2022 to: (1) age 73 for those born from 1951 to 1959; and (2) to age 75 for those born after 1959. Previously, age 72 was the mandated age to begin RMDs.

deductible IRA contributions after reaching age 70½. If applicable, a QCD counts towards the taxpayer's RMD requirements. The IRA owner (or beneficiary of an inherited IRA) must be at least age 70½ when the distribution is made. No charitable deduction is allowed for a QCD.

The SECURE 2.0 Act added a provision allowing for a *one-time*, direct distribution from either a traditional or Roth IRA of up to $50,000 to a charitable remainder annuity trust (CRAT), a charitable remainder unitrust (CRUT), or to a charitable gift annuity (CGA). This new provision was effective for tax years beginning after December 29, 2022.

The Act also specified that the $100,000 or $50,000 amounts (applicable to 2023) were to be adjusted for inflation. In 2025, the annual QCD amount is $108,000 and the amount that may be distributed and contributed to a CRAT, CRUT, or CGA is $54,000 .

Transfers to Health Savings Accounts (HSAs)

Federal law allows for a limited, one-time, direct transfer of funds from an IRA to an HSA. If certain requirements are met, any otherwise taxable portion of the distribution is excluded from income and the 10% early distribution penalty will not apply.

Investment Alternatives

- **Banks, savings and loans, credit unions:** Certificates of deposit in Roth IRAs are generally insured by either the FDIC or the NCUA for amounts up to $250,000. Fixed and variable rates are available. There may be stiff penalties for early withdrawal.

- **Annuities:** Traditional, fixed individual retirement annuities issued by life insurance companies can guarantee fixed monthly income at retirement and may include a disability-waiver-of-premium provision. Variable annuities do not guarantee a fixed monthly income at retirement.

- **Money market:** Yield fluctuates with the economy. Investor cannot lock in higher interest rates. It is easy to switch to other investments.

- **Mutual funds:** A wide variety of mutual funds with many investment objectives are available.

- **Zero coupon bonds:** Bonds are issued at a deep discount from face value. There are no worries about reinvesting interest payments. Zero coupon bonds are subject to inflation risk and interest rate risk.

- **Stocks:** A wide variety of investments (and risk) is possible. Losses are generally not deductible.
- **Limited partnerships:** Some limited partnerships are especially designed for qualified plans, specifically in the areas of real estate and mortgage pools.

Prohibited Investments or Transactions

- **Life insurance:** Roth IRAs cannot include life insurance contracts.
- **Loans to IRA taxpayer:** Self-borrowing triggers a constructive distribution of the entire amount in an IRA.
- **Collectibles:** Purchase of art works, antiques, metals, gems, stamps, etc., will be treated as a taxable distribution. Coins issued under state law and certain U.S. gold, silver and platinum coins are exceptions. Certain kinds of bullion may be purchased.

Other Factors to Consider

- What is the yield? More frequent compounding will produce a higher return. Is the interest rate fixed or variable? If interest rates drop, a fixed rate may be better, especially if you can make future contributions at the same fixed rate. If interest rates go up, you may be able to roll the account to another Roth IRA.
- How often can you change investments? Is there a charge?
- Refunds of federal income taxes may be directly deposited into an IRA.
- Federal bankruptcy law protects assets in Roth IRA accounts, up to $1,512,350.[1] Funds rolled over from qualified plans are protected without limit.

[1] Effective April 1, 2022. The limit is indexed for inflation every three years.

Disclosure Notice

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