Roth Accounts and IRC 72(t)

Quick-Take: It makes little sense to take substantially equal periodic payments from a Roth IRA before the owner is age 59 1/2.

Background: We have covered the substantially equal periodic payment rules in prior missives. [IRC 72(t).] That Tax Code section allows a distribution from a retirement account to escape the 10% excise tax for *early* distributions taken prior to age 59 1/2.

IRC 72(t): This rule is that the taxable distributions can be taken from a retirement account prior to age 59 1/2 without any penalty (or excise tax) so long as those **annual distributions** continue for (i) either at least **five years** or (ii) until the account owner is **age 59 1/2 years**, **whichever period is *longer*.** After five years the funds can be accessed by the owner without having to satisfy the IRC 72(t) requirements , e.g., annual distributions; no alterations in the amount taken; no additional contributions, etc.

Roth Distribution Ordering Rules: Suppose an individual owns a Roth IRA. For whatever reason, he/she needs to take distributions from their Roth IRA, and they are not age 59 1/2. Roth IRAs follow tight distribution ordering rules that have been covered in prior missives. Assume the Roth IRA owner is age 55 and he/she needs money now. Contributions come out first from the Roth IRA, then 'conversion' contributions dollars come out, and finally Roth earnings come out from the Roth IRA as the distribution. Accordingly, this is a tax-efficient distribution scheme for the Roth IRA owner.

- **Contributions:** Roth contribution dollars come out first in a distributions tax and penalty-free, no matter the age of the Roth IRA owner. To that extent, there is no need to rely on IRC 72(t) to access Roth contribution dollars tax and penalty-free.
- **Conversions:** As for any 'conversion' dollars that are held in the Roth IRA, those dollars can next be distributed to the owner, but only if those dollars have been held in the Roth IRA for at least 5 years. If that 5-year holding condition is satisfied, the conversion dollars come out tax and penalty-free as well to the Roth owner. However, since the Roth IRA owner elected to take substantially equal periodic distributions of his/her Roth IRA, then *during* the mandatory distribution 5-year period, distributions of the conversion dollars will be subject to the 10% 'early distribution' excise tax if the Roth owner is under the age 59 1/2 (unless one of the few IRA age 59 1/2 exceptions to the penalty apply, e.g. disability.) In that case, the conversion dollars come out tax-free but not penalty-free to the Roth IRA owner.
- **Earnings:** If Roth IRA earnings are distributed to the owner prior to age 59 1/2 as part of the substantially equal periodic payments, they would be taxable, even though the earnings source is a Roth IRA. As a result, seems that an IRC 72(t) substantially

equal periodic distribution choice by the Roth IRA owner would be a way to obtain access to the Roth IRA's earnings, but they would still be taxable. In other words, taking distributions under IRC 72(t) from a Roth IRA seems almost pointless.

Conclusion: It does not make much sense to consider taking substantially equal periodic payments from a Roth IRA, considering that there are no annual required minimum distributions (RMDs) from a Roth IRA by its owner, and that the earnings on a Roth IRA are usually income tax-free if the 5-year holding period is satisfied. The IRC 72(t) decision forces *annual* distributions, which could cause distributions of conversion dollars *prior to age 59 1/2 years* and also a *tax on the earnings* before the five-year holding period is satisfied.