Northwestern Mutual®

Roth IRA Distributions During Owner's Life

Order of distributions. Distributions from a Roth IRA are treated as being made in the following order: ***first***, from regular contributions; ***second***, from conversion contributions; and ***third***, from earnings. This is known as the "**Ordering Rule**."

CLASSIFICATION OF DISTRIBUTION	INCOME TAX TREATMENT	10% PENALTY
Regular Contributions • Amounts directly contributed to the Roth IRA. • Regular contributions rolled over from other Roth IRAs. • Amounts rolled over from a designated Roth account (e.g., Roth 401(k) and Roth 403(b)) ("DRAC") that constituted: ◦ regular contributions to the DRAC; AND ◦ earnings that are rolled over from a DRAC in a **qualified distribution.**[1] A qualified distribution from a DRAC has the same requirements as a qualified distribution from a Roth IRA, except that the first-time homebuyer distribution is not a qualifying triggering event.[2]	No income tax	No penalty
Conversion Contributions Rollover contributions that are not from a Roth IRA or DRAC (i.e., a traditional IRA or 401(k)).	No income tax	**No penalty if:** • the distribution is made at least 5 years from the beginning of the individual's taxable year in which the conversion contribution occurred (for each conversion contribution); OR • a **10% Penalty Exception** applies
Earnings Any portion of the Roth IRA that is not a regular or conversion contribution, which **includes nonqualified distributions of earnings from a DRAC.**[3]	No income tax if it is a **Qualified Distribution**	**No penalty if:** • it is a **Qualified Distribution**; OR • a **10% Penalty Exception** applies

WHAT IS A QUALIFIED DISTRIBUTION?

1. The distribution is made at least 5 years from the beginning of the first taxable year for which the individual made any contribution to any Roth IRA (the ***5-year rule***). AND
2. One of the following applies (a ***triggering event***):
   a. The owner is age 59½ or older;
   b. The owner is deceased;
   c. The distribution is attributable to the owner's disability;[1] or
   d. The distribution is for a qualified first-time home buyer (up to $10,000 max over the owner's lifetime) used to acquire, construct, or reconstruct a principal residence[1]

IRA 10% PENALTY EXCEPTIONS

- Age 59½
- Death
- Disability
- A series of substantially equal periodic payments for life or life expectancy (SOSEPP)
- Qualified first-time homebuyer distribution
- Deductible medical expenses
- Health insurance premiums while unemployed
- Qualified higher education expenses
- Qualified reservist distribution
- Qualified birth or adoption expenses

Other Things to Know About Roth Distributions

Nonqualified distributions. Distributions that aren't qualified distributions are nonqualified distributions.

Property distributions. Property distributed from a Roth will have a fair market value basis in the hands of the Roth owner.

Corrective distributions. If contributions (with any associated earnings) are distributed by the due date of the year's tax return (including any filed extensions), it is treated as if they weren't contributed at all. There is no tax on the distribution of the contributions, however, any earnings distributed with the contributions are taxable income in the tax year of the contribution. No penalties are imposed on the distribution.

What happens when amounts are rolled over from a DRAC or Roth 401(k)

Unlike other rolled over amounts, funds that come from a DRAC are not classified as conversion contributions. Instead, the classification of the funds depends on whether it is considered to be "investment in the contract" with respect to the DRAC or not.

DRAC account "investment in the contract" is classified as Roth IRA "regular contributions."

Investment in the contract includes the following DRAC amounts:

- Designated Roth contributions.
- Amounts that would be qualified distributions from a DRAC. Qualified distributions from a DRAC include all earnings as long as the DRAC has been in existence for at least five years and either (a) the owner is dead or (b) the owner is at least 59½, or (c) distribution is attributable to the owner's disability.

Rolled over amounts not considered "investment in the contract" are classified as "earnings"

---

[1] Treas. Reg. §1.408A-10, A-3(a), third sentence. Regular contributions to a DRAC are defined to include amounts considered to be "investment in the contract" under A-6 of §1.402A-1, which includes qualified distributions
"Qualified distribution" from a DRAC requires that the following requirements be met: (1) it is at least 5 years from the beginning of the year in which the taxpayer first made a contribution to a DRAC in that particular plan; (I.R.C. §402A(d)(2)(B)(i)) and (2) either (a) the owner has reached age 59 ½; (b) the owner has died, or (b) it is attributable to the owner's disability. I.R.C. §402A(d)(2)(A).

[2] I.R.C. §§402A(d)(2)(A) and (d)(2)(B)(i). The 5-year rule is measured from the beginning of the year in which the taxpayer first contributed to a DRAC in that particular plan.

[3] Treas. Reg. §1.408A-10, A-3(a), second sentence.

Advanced Planning, February 2020