

TRANSFERRING A ROTH IRA AFTER DIVORCE – 3 LOGICAL CONSIDERATIONS

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Surprisingly, the rules governing what happens when an ex-spouse acquires a Roth IRA after divorce are unclear. There are no specific directions in the Tax Code or in the regulations. However, there is definitive guidance for a spouse who inherits a Roth IRA due to death. It makes sense to look to these rules after death for direction on how to process a Roth IRA transfer after a divorce. Of course, with no definitive route, this is only speculation until the IRS provides a roadmap. As such, be sure to document whatever course of action you take should you find yourself in a Roth IRA transfer-on-divorce situation. Here are just three of the many key items to consider:

Transferring the Assets. IRS Publication 590-A identifies two commonly used methods of transferring IRA assets to a spouse or former spouse after divorce: 1.) Retitling/changing the name on the IRA, and 2.) Making a direct transfer of IRA assets. While this language is specific to Traditional IRAs, we know that the same methods of transfer also apply to Roth IRAs.

It is imperative that the transfer of assets be completed correctly as a tax-free transfer. Rollovers will not work! Failure to properly move qualified dollars from one spouse to the other can result in unnecessary complications. Despite the best intentions of the participants, there have been multiple occasions where transfer errors resulted in the needless loss of thousands of dollars in taxes and penalties.

The Roth 5-Year “Forever” Clock. Federal regulations discuss how what I call the Roth “5-year forever” clock works when a Roth IRA is transferred after death. The regulations say that *“The beginning of the 5-taxable-year period...is not redetermined when the Roth IRA owner dies. Thus, in determining the 5-taxable-year period, the period the Roth IRA is held in the name of a beneficiary, or in the name of a surviving spouse*

who treats the decedent's Roth IRA as his or her own, includes the period it was held by the decedent."

This answer indicates that the 5-year forever clock started by the Roth IRA owner prior to his or her death will carry over to the beneficiary. The beneficiary, even a spouse beneficiary, does not have to restart the 5-year forever clock. Based on these guidelines for the Roth IRA clock post-death, it appears that an ex-spouse will have the same opportunity to carry over the clock when Roth IRA assets are transferred to him or her after a divorce. (The other Roth 5-year clock – the one for conversions - requires its own full article of explanation.)

Types of Roth IRA Dollars: Contributions, Conversions, Earnings. A Roth IRA can consist of three types of dollars: contributions, conversions, and earnings. When a Roth IRA is transferred upon divorce, it would seem logical that these assets would maintain the same character after transfer. Contributory dollars, conversion dollars and earnings should all remain as such, and should transfer to the receiving spouse based on the pro-rata rule. (You can't just give your ex-spouse all the taxable Roth IRA earnings and keep the tax-free basis for yourself.)

This short article only scratches the surface of some items to consider when a Roth IRA is transferred after a divorce. Be sure to seek competent advice before making any moves, and document all decisions and transactions should the IRS ask questions.

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