

# ROTH IRA DISTRIBUTION ORDERING RULES

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This may seem like a rudimentary topic, but it is the basics that are often so confusing. A fundamental understanding of Roth IRA distributions is essential for Roth IRA owners. In a blog post from June 8 (“One Roth IRA Bucket”), I created a scenario where a person had five Roth IRAs, a couple of traditional IRAs, and was doing Roth conversions. The point of that exercise was to demonstrate how the IRS knows what dollars within all of a person’s Roth IRAs are contributions, what are conversions, and what are earnings. Additionally, I stressed that the IRS treats the entirety of a person’s Roth IRAs, regardless of how many, as a single Roth IRA.

Why is it so important to know which dollars are which within a Roth IRA? Because Roth IRA distributions follow strict ordering rules. There is no such thing as FIFO (“first in, first out”) with a Roth IRA. LIFO (“last in, first out”) and pro rata also have zero bearing on Roth IRA withdrawals. In fact, there is a simple ordering procedure for Roth IRA distributions:

- Contributions come out first. When they are depleted...
- Converted dollars come next. When they are depleted...
- Earnings come out last.

That’s it. Those are the ordering rules, and it does not matter from which Roth IRA you take a distribution. Remember, all the IRS sees when it looks at all of your Roth IRA accounts is one bucket of Roth IRA dollars, subdivided into contributions, conversions and earnings.

What about access to these dollars? A person can always withdraw Roth IRA funds, no questions asked. The issue is whether those dollars will be subject to the 10%

early withdrawal penalty and/or taxes. This article will not get into the weeds of the Roth 5-year clocks, nor will it cover exceptions to the 10% penalty. Space is limited. However, below is an overview of the different types of Roth IRA dollars (contributions, conversions and earnings) and a brief explanation of when those funds are available.

**Contributions.** Roth IRA contributions are always available tax- and penalty-free. It does not matter how long the Roth IRA was opened or how old you are. If you made any contribution to a Roth IRA in any year, those dollars can be withdrawn at any time for any reason. Fortunately, based on the ordering rules, Roth IRA contributions come out first. Until you exceed the amount of contributions with your withdrawals, converted dollars and earnings will stay put.

**Conversions.** Conversions come out next. Since the tax was paid in the year of conversion, these dollars come out tax-free. Roth IRA converted dollars are penalty-free after 5 years OR age 59 ½. The word “or” is key. If either of these targets are hit, the converted dollars are available free and clear. There are no other variables. Did you hit your 5-year conversion clock on these specific converted dollars? OR, are you 59 ½ or older? If yes for either, then you have full access to the converted Roth IRA funds.

**Earnings come out last.** They are available tax- and penalty-free after 5 years AND 59 ½. The word “and” is crucial. BOTH must be satisfied. (Note that earnings are always penalty-free if you are over 59 ½.) If you had any Roth IRA for 5 years AND meet the age limit, congratulations! All your Roth IRA dollars will forever be tax- and penalty-free.

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