Fix My Portfolio

I’m 68 and want to eventually convert my whole 401(k) to Roth. Will I have to wait five years to touch it?

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By Beth Pinsker Follow

The five-year rules for Roth accounts can make some tricky accounting for conversions

Two different Roth IRA five-year rules are at play in this reader’s situation regarding a 401(k) conversion. GETTY IMAGES

Got a question about the mechanics of investing, how it fits into your overall financial plan and what strategies can help you make the most out of your money? You can write me at beth.pinsker@marketwatch.com.

Dear Fix My Portfolio,

I’m 68 and my wife is 65 and we’re both retired. I need some clarification on Roth IRA conversions and withdrawals. I have an existing Roth IRA account that I opened more than 10 years ago. Last year, this year and every year for the next three *out of my brokerage funds.*

My plan is to make this Roth IRA account large enough to fund our household expenses out of interest and dividend distributions along with our Social Security funds without touching the principal. I am trying to convert most of my 401(k) money to Roth to avoid or to minimize the impact of required minimum distributions.

My understanding is that since I have owned this Roth IRA for more than five years, there should not be any penalty for withdrawing even the recently converted traditional IRA or 401(k) funds from this Roth IRA account or any earned interest and dividends.

Is this understanding correct or should I open a Roth IRA account for every new batch of 401(k) converted money and wait for five years and then start withdrawing the interest and dividends from these new accounts? I hope that you can help me understand this five-year withdrawal rule and associated penalty so that I can plan our household expenses.

T. S.

Dear T.S.,

You've got an ambitious schedule set up to manage your retirement funds, and it might be a little more complicated than you intended because there are two different Roth IRA five-year rules at play in your situation. One set of rules governs the posttax contributions you make directly into the account from your income. The other is for funds that get converted from a 401(k) or other qualified retirement plan. Tricky? You bet.

You seem to have a good handle on the first five-year rule, which is that your Roth IRA has to be open for five years before you can take out the earnings tax-free, regardless of your age. If you started that account when you were 58 and contributed to it over the last 10 years from your income, then you have unfettered access to both the principal and earnings now, at 68, without taxes, penalties or fees.

Note that Roth IRAs are individual accounts, so this just goes for you. If your wife also has a Roth IRA, that would be on her own timeline and based on her age. But if she's now also over the five-year threshold, she can also access any funds in there tax-free, because she's older than 59½.

A new timeline for conversions

over pretax money to a Roth IRA from a qualified retirement plan, paying the tax on it out of pocket. "You have to wait to access it – you can't have your cake and eat it too," says Kashif Ahmed, a certified financial planner based in Bedford, Mass.

Unless you're into meticulously keeping spreadsheets to note your contributions into the account and can track the growth of every dollar, your best bet would be to create new Roth IRA accounts for each new conversion. "He should bucket these out – open different accounts, keep it separate," says Ahmed, who does this for clients who want to do a multiyear Roth conversion strategy.

"It's not hard to manage. If you have seven accounts, so what? Most people go paperless, so you get consolidated views online," says Ahmed. "The account custodians don't charge anything extra to have multiple accounts."

But the real question is that given the extra hassles, are the conversions what you want to do? You say your goal is to reduce your required minimum distributions and cover your living expenses out of the Roth accounts without touching the principal. You never give a total amount of your assets, so it's hard to say whether it's a good idea or not.

Generally speaking, if you're going to end up spending the majority of your retirement savings by the time you die, then paying the taxes now on a Roth conversion might not be the best use of your cash on hand. You can just leave your money in your 401(k) and pay tax as you withdraw it, and go about your business.

"When people see the amount of the tax that has to come out of their pocket, and they typically don't want to do it," says Ahmed. "You're betting your tax bracket will be higher in the future. What if it isn't? It's important to have both legs – have tax-free money and tax deferred – just in case it's not what you thought it would be."

But if you have a significant amount and your goal is to leave it to heirs in the most efficient way, then transferring as much as you can to a Roth would make more sense. In that case, you're not doing it for your own ease and use, and so the number of accounts and the five-year waiting period shouldn't impact you much. You'd intend that money for long-term use for inheritance and you could continue to live off the money in your 401(k) for your own retirement spending needs. And you could do that immediately – without having to deal with any waiting periods.

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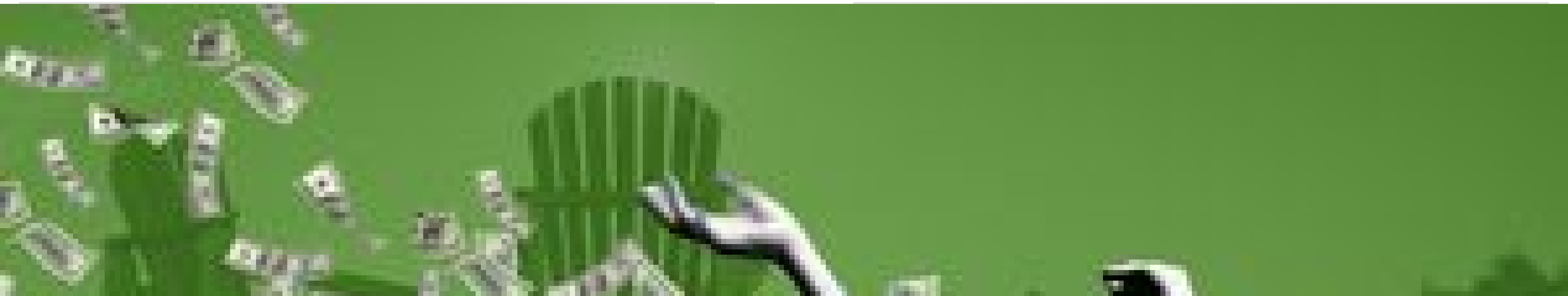
- I earn $75,000 and was counting on my kids receiving need-based college aid, but now I'm inheriting $250K and don't know how to hide it
- I retired at 55 with $2 million in my 401(k), should I buy an annuity with the $200,000 in my taxable brokerage or use it to fund a Roth conversion?



We have $2 million for retirement and want to spend every single dollar before we die

Beth Pinsker

Beth Pinsker is a financial-planning columnist at MarketWatch. She has been a certified financial planner (CFP®) since 2018. Previously, she was a personal finance columnist and editor at Reuters, an editorial director at Fidelity and editor-in-chief of Walletpop.com. Prior to covering personal finance, she was a film critic and entertainment business reporter, writing for Entertainment Weekly, The Dallas Morning News and many more publications. You can follow her on Twitter @bethpinsker.