
Recharacterization for Roth IRA Conversions

A Roth Recharacterization is the process of undoing a Roth Conversion by transferring the converted funds back to an IRA

The deadline to recharacterize is October 15 of the year following the year of the conversion

Anyone can do a recharacterization for any reason.

A partial recharacterization can be done.

The re-characterized funds go back to a traditional IRA and are treated as if they never left the IRA even for conversions from 401(k) plans.

The recharacterization **must be done as a trustee to trustee transfer.**

The recharacterized funds can go back to the same IRA or a different IRA custodian.

The recharacterized amount must include gains and losses.

Caution: If 300 shares of stock were originally converted to an existing Roth-IRA, re-characterization of the 300 shares may require more Roth assets than just the 300 shares to be transferred back to the IRA. The gain/loss calculation is made on all the assets in the Roth-IRA not just the 300 shares of stock.

To avoid this problem open a new Roth-IRA for the conversion of 300 shares of stock. If the price of the stock drops by 50% then the 300 shares can be re-characterized. If the stock appreciates in value, then after the October 15th deadline the two Roth-IRA accounts can be combined.

Age 70 ½ Recharacterization Surprise

If you are age 70 ½ or older and recharacterize the year following the year of the Roth Conversion you must take a Required Minimum Distribution (RMD) before Dec 31st for the amount recharacterized; a tax trap most individuals or their advisers are not aware of.

How could that be, you say, because there is no age 70 ½ RMD for Roth-IRA or Roth Conversion. According to IRS regulations, after the recharacterization, the funds are treated as if they never left the IRA. So there is a RMD due and if not paid there is a 50% penalty tax.

The RMD is calculated using the Dec 31, 2009 Roth-IRA balance for the amount recharacterized in 2010. The deadline to recharacterize a 2009 Roth Conversion is October 15, 2010. That doesn't leave much time to distribute the RMD before Dec 31, 2010.

If you recharacterize in the same year of the Roth Conversion there is no problem as you took the RMD prior to completing the Roth Conversion.

General Information only – review with your tax adviser before taking action.