ED SLOTT'S IRA ADVISOR

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TAX & ESTATE PLANNING FOR YOUR RETIREMENT SAVINGS

Roth Recharacterization Traps and How to Avoid Them

The Roth recharacterization provides one of the few second chances in the tax code. In essence it's a do-over, a chance to start over. The provision allows you to undo (to reverse) a Roth conversion as if it never happened and no tax is owed. Any tax paid on the conversion is refunded. That's a pretty good deal, given how rigid and unforgiving the tax code is in most other areas. There is a time limit though. Anyone who converts to a Roth IRA has until October 15th of the year after the conversion to recharacterize it. October 15, 2010 is the last day to recharacterize a 2009 conversion.

The recharacterization must be done as a trustee-to-trustee transfer and the funds must go back to a traditional IRA, even if the conversion was from a company plan. Partial recharacterizations are permitted.

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Unlike most tax decisions, a Roth recharacterization allows you to make the call *after* you've gathered all (or at least most) of your relevant tax information. Unfortunately though, nothing is ever as straightforward as it sounds and like nearly everything else in life, if you aren't careful to watch out for traps, they're likely to spring on you at the most inopportune times. Below are the most common Roth recharacterization traps you will face when dealing with clients and how you can avoid, or in some cases, even fix them.

Failing to Recharacterize an Ineligible 2009 Conversion

Two key restrictions remained in 2009; clients were ineligible to convert to a Roth IRA if they had either modified adjusted gross income (MAGI) of over $100,000 or if they were married, but filed separate. October 15, 2010 will be the last recharacterization deadline for someone that is forced to recharacterize because they did not qualify for a Roth conversion due to income limits or filing status.

For example, Byron (who is 45 and files a joint return) and his wife had earnings of $90,000, putting them comfortably under the $100,000 MAGI limit. Believing that they would qualify, Byron converted his $200,000 IRA to a Roth IRA. On December 22, 2009 however, Byron's boss surprised him and gave him a $15,000 bonus. Now, they have exceeded the MAGI limit by $5,000.

If you find that one of your clients, like Byron, converted in 2009 but was not eligible to do so, it's not too late to

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