

IRAs: Roth Conversions and Recharacterizations After the 2017 Tax Act

Taxpayers may convert a traditional IRA to a Roth IRA regardless of modified AGI or filing status. Conversion to a Roth IRA may be appropriate if you anticipate being in a higher tax bracket at the time of distribution. It also may be suitable if you expect a long span of time between contribution and distribution, to allow for investment growth. This is because, assuming applicable I.R.C. requirements are met, Roth accounts are taxed upon contribution rather than distribution, any investment earnings that accumulate will never be taxed.

There are, however, annual limits to both traditional and Roth IRA contributions. For 2022, 2021, and 2020, the maximum amount that can be contributed to a traditional or Roth IRA is the lesser of your total annual compensation, or \$6,000. Individuals who have attained age 50 may make additional catch-up contributions. The otherwise maximum contribution limit for an individual who has attained age 50 before the end of the taxable year is increased by \$1,000 for a total of \$7,000 for 2022, 2021, and 2020. The annual contribution limit is reduced for any contributions made to other traditional or Roth IRAs; thus, contributions to all of your traditional and Roth IRAs for a taxable year cannot exceed the annual contribution limit.

In order to maximize the benefit of untaxed growth of Roth IRAs without violating annual contributions limits, you can convert other retirement contributions (including traditional IRA contributions, and §401(k), §403(b), and §457(b) deferral amounts (subject to separate annual limitations)) to a Roth IRA. There is no limit on how much you can convert during a taxable year. Tax is due upon the conversion, just as it would be if it were an original Roth contribution.

You may also treat a regular contribution made to a Roth or traditional IRA as having been made to the other type of IRA. To recharacterize a regular contribution, you tell the trustee of your account to transfer the amount of the contribution plus earnings to a different type of IRA in a trustee-to-trustee transfer, or to a different type of IRA with the same trustee. Recharacterization elections can be made only if the transfer is accomplished by the filing deadline for the owner's federal income tax return, including extensions, for the year for which the original contribution was made to the first IRA.

It is important to note that, although previously permitted, effective January 1, 2018, once a conversion from a traditional, SEP, or SIMPLE IRA is made to a Roth IRA, it cannot be recharacterized (unwound). This is also true for amounts rolled over from other retirement plans (i.e., §401(k), §403(b), or §457(b) plans) to a Roth IRA. Therefore, a Roth IRA conversion made on or after January 1, 2018, cannot be recharacterized. However, a Roth IRA conversion made in 2017 may be recharacterized as a contribution to a traditional IRA if the recharacterization is done by October 15, 2018.

Generally, if you are younger than 59½ and take a distribution large enough to convert the desired amount to your Roth IRA and to cover the taxes due upon conversion, you will also have to pay a 10% early distribution penalty tax on any excess not directly rolled over to the Roth account. Thus, it would be better to pay the tax out of a separate source of funds.