Money Matters

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Question of the Month: Are IRAs Reversible?

By Aaron Skloff

Q: After evaluating all the pros and cons, we finally decided to convert our Traditional IRAs to Roth IRAs. Can we reverse the conversion and its tax implications if the financial markets drop?

The same way the IRS permits you to convert all or a portion of your Traditional IRAs to Roth IRAs, the IRS also permits you to reverse all or a portion of the conversion through a "recharacterization". When you recharacterize you reverse the conversion and its full tax implications.

The deadline for recharacterizing is the extended due date of your tax return for the year of the contribution or conversion. This would be April 15, 2011 or October 15, 2011 with an extension.

Ideally, you would reconvert the assets again at their depressed valuation. If only it were that simple. Remember, we are talking about the IRS. You cannot convert, recharacterize, and then reconvert to a Roth IRA within the same tax year. If you convert and then recharacterize, you may not reconvert back to a Roth IRA before the **later** of:

1) The taxable year following the taxable year in which the amount was initially converted to a Roth IRA **or**
2) The end of the 30-day period, beginning on the day you recharacterized from the Roth IRA to the Traditional IRA

If your Traditional IRA holds very volatile securities, consider converting just those securities into their own Roth IRAs. In the event those securities decline in value it will reduce your headaches if you choose to recharacterize just those Roth IRAs. In the event those securities increase in value you do not have to do anything.

For example, let's say you have a Traditional IRA that holds one stock, Google. As Google is a very volatile stock, consider converting that Traditional IRA into its own Roth IRA. If Google drops, recharacterize the Roth IRA that holds solely Google. If it rises, do nothing.

Work Closely with Your CPA and Financial Advisor. Work closely with your CPA and Financial Advisor, when considering Roth IRA conversions and/or recharacterizations. Conversions and recharacterizations can have significant impacts on your income and your estate's taxes.

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