

§ 1.408A-5

26 CFR Ch. I (4-1-04 Edition)

period (unless accelerated because of distribution or death).

Q-12. Can an individual convert a traditional IRA to a Roth IRA if he or she is receiving substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) from that traditional IRA?

A-12. Yes. Not only is the conversion amount itself not subject to the early distribution tax under section 72(t), but the conversion amount is also not treated as a distribution for purposes of determining whether a modification within the meaning of section 72(t)(4)(A) has occurred. Distributions from the Roth IRA that are part of the original series of substantially equal periodic payments will be nonqualified distributions from the Roth IRA until they meet the requirements for being a qualified distribution, described in § 1.408A-6 A-1(b). The additional 10-percent tax under section 72(t) will not apply to the extent that these nonqualified distributions are part of a series of substantially equal periodic payments. Nevertheless, to the extent that such distributions are allocable to a 1998 conversion contribution with respect to which the 4-year spread for the resultant income inclusion applies (see A-8 of this section) and are received during 1998, 1999, or 2000, the special acceleration rules of § 1.408A-6 A-6 apply. However, if the original series of substantially equal periodic payments does not continue to be distributed in substantially equal periodic payments from the Roth IRA after the conversion, the series of payments will have been modified and, if this modification occurs within 5 years of the first payment or prior to the individual becoming disabled or attaining age 59½, the taxpayer will be subject to the recapture tax of section 72(t)(4)(A).

Q-13. Can a 1997 distribution from a traditional IRA be converted to a Roth IRA in 1998?

A-13. No. An amount distributed from a traditional IRA in 1997 that is contributed to a Roth IRA in 1998 would not be a conversion contribution. See A-3 of this section regarding the remedy for a failed conversion.

[T.D. 8816, 64 FR 5603, Feb. 4, 1999]

§ 1.408A-5 Recharacterized contributions.

This section sets forth the following questions and answers that provide rules regarding recharacterizing IRA contributions:

Q-1. Can an IRA owner recharacterize certain contributions (i.e., treat a contribution made to one type of IRA as made to a different type of IRA) for a taxable year?

A-1. (a) Yes. In accordance with section 408A(d)(6), except as otherwise provided in this section, if an individual makes a contribution to an IRA (the FIRST IRA) for a taxable year and then transfers the contribution (or a portion of the contribution) in a trustee-to-trustee transfer from the trustee of the FIRST IRA to the trustee of another IRA (the SECOND IRA), the individual can elect to treat the contribution as having been made to the SECOND IRA, instead of to the FIRST IRA, for Federal tax purposes. A transfer between the FIRST IRA and the SECOND IRA will not fail to be a trustee-to-trustee transfer merely because both IRAs are maintained by the same trustee. For purposes of section 408A(d)(6), redesignating the FIRST IRA as the SECOND IRA will be treated as a transfer of the entire account balance from the FIRST IRA to the SECOND IRA.

(b) This recharacterization election can be made only if the trustee-to-trustee transfer from the FIRST IRA to the SECOND IRA is made on or before the due date (including extensions) for filing the individual's Federal income tax return for the taxable year for which the contribution was made to the FIRST IRA. For purposes of this section, a conversion that is accomplished through a rollover of a distribution from a traditional IRA in a taxable year that, 60 days after the distribution (as described in section 408(d)(3)(A)(i)), is contributed to a Roth IRA in the next taxable year is treated as a contribution for the earlier taxable year.

Q-2. What is the proper treatment of the net income attributable to the amount of a contribution that is being recharacterized?

A-2. (a) The net income attributable to the amount of a contribution that is

being recharacterized must be transferred to the SECOND IRA along with the contribution.

(b) If the amount of the contribution being recharacterized was contributed to a separate IRA and no distributions or additional contributions have been made from or to that IRA at any time, then the contribution is recharacterized by the trustee of the FIRST IRA transferring the entire account balance of the FIRST IRA to the trustee of the SECOND IRA. In this case, the net income (or loss) attributable to the contribution being recharacterized is the

difference between the amount of the original contribution and the amount transferred.

(c)(1) If paragraph (b) of this A-2 does not apply, then, for purposes of determining net income attributable to IRA contributions, the net income attributable to the amount of a contribution is determined by allocating to the contribution a *pro rata* portion of the earnings on the assets in the IRA during the period the IRA held the contribution. This attributable net income is calculated by using the following formula:

$$\text{Net Income} = \text{Contribution} \times \frac{(\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance})}{\text{Adjusted Opening Balance}}$$

(2) For purposes of this paragraph (c), the following definitions apply:

(i) The term *adjusted opening balance* means the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions or transfers (including the contribution that is being recharacterized pursuant to section 408A(d)(6) and any other recharacterizations) made to the IRA during the computation period.

(ii) The term *adjusted closing balance* means the fair market value of the IRA at the end of the computation period plus the amount of any distributions or transfers (including contributions returned pursuant to section 408(d)(4) and recharacterizations of contributions pursuant to section 408A(d)(6)) made from the IRA during the computation period.

(iii) The term *computation period* means the period beginning immediately prior to the time the particular contribution being recharacterized is made to the IRA and ending immediately prior to the recharacterizing transfer of the contribution. If a series of regular contributions was made to the IRA, and consecutive contributions in that series are being recharacterized, the computation period begins immediately prior to the time the first of the regular contributions being recharacterized was made.

(3) When an IRA asset is not normally valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent, regularly determined, fair market value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of this paragraph (c), notwithstanding A-3 of this section, recharacterized contributions are taken into account for the period they are actually held in a particular IRA.

(4) In the case of an individual with multiple IRAs, the net income calculation is performed only on the IRA containing the particular contribution to be recharacterized, and that IRA is the IRA from which the recharacterizing transfer must be made.

(5) In the case of multiple contributions made to an IRA for a particular year that are eligible for recharacterization, the IRA owner can choose (by date and by dollar amount, not by specific assets acquired with those dollars) which contribution, or portion thereof, is to be recharacterized.

(6) The following examples illustrate the net income calculation under section 408A(d)(6) and this paragraph:

Example 1. (i) On March 1, 2004, when her Roth IRA is worth \$80,000, Taxpayer A makes a \$160,000 conversion contribution to the Roth IRA. Subsequently, Taxpayer A discovers that she was ineligible to make a

Roth conversion contribution in 2004 and so she requests that the \$160,000 be recharacterized to a traditional IRA pursuant to section 408A(d)(6). Pursuant to this request, on March 1, 2005, when the IRA is worth \$225,000, the Roth IRA trustee transfers to a traditional IRA the \$160,000 plus allocable net income. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) The adjusted opening balance is \$240,000 [$\$80,000 + \$160,000$] and the adjusted closing balance is \$225,000. Thus the net income allocable to the \$160,000 is $-\$10,000$ [$\$160,000 \times (\$225,000 - \$240,000) \div \$240,000$]. Therefore, in order to recharacterize the March 1, 2004, \$160,000 conversion contribution on March 1, 2005, the Roth IRA trustee must transfer from Taxpayer A's Roth IRA to her traditional IRA \$150,000 [$\$160,000 - \$10,000$].

Example 2. (i) On April 1, 2004, when her traditional IRA is worth \$100,000, Taxpayer B converts the entire amount, consisting of 100 shares of stock in ABC Corp. and 100 shares of stock in XYZ Corp., by transferring the shares to a Roth IRA. At the time of the conversion, the 100 shares of stock in ABC Corp. are worth \$50,000 and the 100 shares of stock in XYZ Corp. are also worth \$50,000. Taxpayer B decides that she would like to recharacterize the ABC Corp. shares back to a traditional IRA. However, B may choose only by dollar amount the contribution or portion thereof that is to be recharacterized. On the date of transfer, November 1, 2004, the 100 shares of stock in ABC Corp. are worth \$40,000 and the 100 shares of stock in XYZ Corp. are worth \$70,000. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) If B requests that \$50,000 (which was the value of the ABC Corp. shares at the time of conversion) be recharacterized, the net income allocable to the \$50,000 is \$5,000 [$\$50,000 \times (\$110,000 - \$100,000) \div \$100,000$]. Therefore, in order to recharacterize \$50,000 of the April 1, 2004, conversion contribution on November 1, 2004, the Roth IRA trustee must transfer from Taxpayer B's Roth IRA to a traditional IRA assets with a value of \$55,000 [$\$50,000 + \$5,000$].

(iii) If, on the other hand, B requests that \$40,000 (which was the value of the ABC Corp. shares on November 1) be recharacterized, the net income allocable to the \$40,000 is \$4,000 [$\$40,000 \times (\$110,000 - \$100,000) \div \$100,000$]. Therefore, in order to recharacterize \$40,000 of the April 1, 2004, conversion contribution on November 1, 2004, the Roth IRA trustee must transfer from Taxpayer B's Roth IRA to a traditional IRA assets with a value of \$44,000 [$\$40,000 + \$4,000$].

(iv) Regardless of the amount of the contribution recharacterized, the determination of that amount (or of the net income allocable thereto) is not affected by whether the recharacterization is accomplished by the

transfer of shares of ABC Corp. or of shares of XYZ Corp.

(7) This paragraph (c) applies for purposes of determining net income attributable to IRA contributions, made on or after January 1, 2004. For purposes of determining net income attributable to IRA contributions made before January 1, 2004, see paragraph (c) of this A-2 of § 1.408A-5 (as it appeared in the April 1, 2003, edition of 26 CFR part 1).

Q-3. What is the effect of recharacterizing a contribution made to the FIRST IRA as a contribution made to the SECOND IRA?

A-3. The contribution that is being recharacterized as a contribution to the SECOND IRA is treated as having been originally contributed to the SECOND IRA on the same date and (in the case of a regular contribution) for the same taxable year that the contribution was made to the FIRST IRA. Thus, for example, no deduction would be allowed for a contribution to the FIRST IRA, and any net income transferred with the recharacterized contribution is treated as earned in the SECOND IRA, and not the FIRST IRA.

Q-4. Can an amount contributed to an IRA in a tax-free transfer be recharacterized under A-1 of this section?

A-4. No. If an amount is contributed to the FIRST IRA in a tax-free transfer, the amount cannot be recharacterized as a contribution to the SECOND IRA under A-1 of this section. However, if an amount is erroneously rolled over or transferred from a traditional IRA to a SIMPLE IRA, the contribution can subsequently be recharacterized as a contribution to another traditional IRA.

Q-5. Can an amount contributed by an employer under a SIMPLE IRA Plan or a SEP be recharacterized under A-1 of this section?

A-5. No. Employer contributions (including elective deferrals) under a SIMPLE IRA Plan or a SEP cannot be recharacterized as contributions to another IRA under A-1 of this section. However, an amount converted from a SEP IRA or SIMPLE IRA to a Roth IRA may be recharacterized under A-1 of this section as a contribution to a

SEP IRA or SIMPLE IRA, including the original SEP IRA or SIMPLE IRA.

Q-6. How does a taxpayer make the election to recharacterize a contribution to an IRA for a taxable year?

A-6. (a) An individual makes the election described in this section by notifying, on or before the date of the transfer, both the trustee of the FIRST IRA and the trustee of the SECOND IRA, that the individual has elected to treat the contribution as having been made to the SECOND IRA, instead of the FIRST IRA, for Federal tax purposes. The notification of the election must include the following information: the type and amount of the contribution to the FIRST IRA that is to be recharacterized; the date on which the contribution was made to the FIRST IRA and the year for which it was made; a direction to the trustee of the FIRST IRA to transfer, in a trustee-to-trustee transfer, the amount of the contribution and net income allocable to the contribution to the trustee of the SECOND IRA; and the name of the trustee of the FIRST IRA and the trustee of the SECOND IRA and any additional information needed to make the transfer.

(b) The election and the trustee-to-trustee transfer must occur on or before the due date (including extensions) for filing the individual's Federal income tax return for the taxable year for which the recharacterized contribution was made to the FIRST IRA, and the election cannot be revoked after the transfer. An individual who makes this election must report the recharacterization, and must treat the contribution as having been made to the SECOND IRA, instead of the FIRST IRA, on the individual's Federal income tax return for the taxable year described in the preceding sentence in accordance with the applicable Federal tax forms and instructions.

(c) The election to recharacterize a contribution described in this A-6 may be made on behalf of a deceased IRA owner by his or her executor, administrator, or other person responsible for filing the final Federal income tax return of the decedent under section 6012(b)(1).

Q-7. If an amount is initially contributed to an IRA for a taxable year, then

is moved (with net income attributable to the contribution) in a tax-free transfer to another IRA (the FIRST IRA for purposes of A-1 of this section), can the tax-free transfer be disregarded, so that the initial contribution that is transferred from the FIRST IRA to the SECOND IRA is treated as a recharacterization of that initial contribution?

A-7. Yes. In applying section 408A(d)(6), tax-free transfers between IRAs are disregarded. Thus, if a contribution to an IRA for a year is followed by one or more tax-free transfers between IRAs prior to the recharacterization, then for purposes of section 408A(d)(6), the contribution is treated as if it remained in the initial IRA. Consequently, an individual may elect to recharacterize an initial contribution made to the initial IRA that was involved in a series of tax-free transfers by making a trustee-to-trustee transfer from the last IRA in the series to the SECOND IRA. In this case the contribution to the SECOND IRA is treated as made on the same date (and for the same taxable year) as the date the contribution being recharacterized was made to the initial IRA.

Q-8. If a contribution is recharacterized, is the recharacterization treated as a rollover for purposes of the one-rollover-per-year limitation of section 408(d)(3)(B)?

A-8. No, recharacterizing a contribution under A-1 of this section is never treated as a rollover for purposes of the one-rollover-per-year limitation of section 408(d)(3)(B), even if the contribution would have been treated as a rollover contribution by the SECOND IRA if it had been made directly to the SECOND IRA, rather than as a result of a recharacterization of a contribution to the FIRST IRA.

Q-9. If an IRA owner converts an amount from a traditional IRA to a Roth IRA and then transfers that amount back to a traditional IRA in a recharacterization, may the IRA owner subsequently reconvert that amount from the traditional IRA to a Roth IRA?

A-9. (a)(1) Except as otherwise provided in paragraph (b) of this A-9, an IRA owner who converts an amount from a traditional IRA to a Roth IRA

during any taxable year and then transfers that amount back to a traditional IRA by means of a recharacterization may not reconvert that amount from the traditional IRA to a Roth IRA before the beginning of the taxable year following the taxable year in which the amount was converted to a Roth IRA or, if later, the end of the 30-day period beginning on the day on which the IRA owner transfers the amount from the Roth IRA back to a traditional IRA by means of a recharacterization (regardless of whether the recharacterization occurs during the taxable year in which the amount was converted to a Roth IRA or the following taxable year). Thus, any attempted reconversion of an amount prior to the time permitted under this paragraph (a)(1) is a failed conversion of that amount. However, see § 1.408A-4 A-3 for a remedy available to an individual who makes a failed conversion.

(2) For purposes of paragraph (a)(1) of this A-9, a failed conversion of an amount resulting from a failure to satisfy the requirements of § 1.408A-4 A-1(a) is treated as a conversion in determining whether an IRA owner has previously converted that amount.

(b)(1) An IRA owner who converts an amount from a traditional IRA to a Roth IRA during taxable year 1998 and then transfers that amount back to a traditional IRA by means of a recharacterization may reconvert that amount once (but no more than once) on or after November 1, 1998 and on or before December 31, 1998; the IRA owner may also reconvert that amount once (but no more than once) during 1999. The rule set forth in the preceding sentence applies without regard to whether the IRA owner's initial conversion or recharacterization of the amount occurred before, on, or after November 1, 1998. An IRA owner who converts an amount from a traditional IRA to a Roth IRA during taxable year 1999 that has not been converted previously and then transfers that amount back to a traditional IRA by means of a recharacterization may reconvert that amount once (but no more than once) on or before December 31, 1999. For purposes of this paragraph (b)(1), a failed conversion of an amount resulting from a failure to satisfy the re-

quirements of § 1.408A-4 A-1(a) is not treated as a conversion in determining whether an IRA owner has previously converted that amount.

(2) A reconversion by an IRA owner during 1998 or 1999 for which the IRA owner is not eligible under paragraph (b)(1) of this A-9 will be deemed an excess reconversion (rather than a failed conversion) and will not change the IRA owner's taxable conversion amount. Instead, the excess reconversion and the last preceding recharacterization will not be taken into account for purposes of determining the IRA owner's taxable conversion amount, and the IRA owner's taxable conversion amount will be based on the last reconversion that was not an excess reconversion (unless, after the excess reconversion, the amount is transferred back to a traditional IRA by means of a recharacterization). An excess reconversion will otherwise be treated as a valid reconversion.

(3) For purposes of this paragraph (b), any reconversion that an IRA owner made before November 1, 1998 will not be treated as an excess reconversion and will not be taken into account in determining whether any later reconversion is an excess reconversion.

(c) In determining the portion of any amount held in a Roth IRA or a traditional IRA that an IRA owner may not reconvert under this A-9, any amount previously converted (or reconverted) is adjusted for subsequent net income thereon.

Q-10. Are there examples to illustrate the rules in this section?

A-10. The rules in this section are illustrated by the following examples:

Example 1. In 1998, Individual C converts the entire amount in his traditional IRA to a Roth IRA. Individual C thereafter determines that his modified AGI for 1998 exceeded \$100,000 so that he was ineligible to have made a conversion in that year. Accordingly, prior to the due date (plus extensions) for filing the individual's Federal income tax return for 1998, he decides to recharacterize the conversion contribution. He instructs the trustee of the Roth IRA (FIRST IRA) to transfer in a trustee-to-trustee transfer the amount of the contribution, plus net income, to the trustee of a new traditional IRA (SECOND IRA). The individual notifies the trustee of the FIRST IRA and the trustee of the SECOND IRA that he is recharacterizing his

IRA contribution (and provides the other information described in A-6 of this section). On the individual's Federal income tax return for 1998, he treats the original amount of the conversion as having been contributed to the SECOND IRA and not the Roth IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the SECOND IRA and not to the Roth IRA. The result would be the same if the conversion amount had been transferred in a tax-free transfer to another Roth IRA prior to the recharacterization.

Example 2. In 1998, an individual makes a \$2,000 regular contribution for 1998 to his traditional IRA (FIRST IRA). Prior to the due date (plus extensions) for filing the individual's Federal income tax return for 1998, he decides that he would prefer to contribute to a Roth IRA instead. The individual instructs the trustee of the FIRST IRA to transfer in a trustee-to-trustee transfer the amount of the contribution, plus attributable net income, to the trustee of a Roth IRA (SECOND IRA). The individual notifies the trustee of the FIRST IRA and the trustee of the SECOND IRA that he is recharacterizing his \$2,000 contribution for 1998 (and provides the other information described in A-6 of this section). On the individual's Federal income tax return for 1998, he treats the \$2,000 as having been contributed to the Roth IRA for 1998 and not to the traditional IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the Roth IRA for 1998 and not to the traditional IRA. The result would be the same if the conversion amount had been transferred in a tax-free transfer to another traditional IRA prior to the recharacterization.

Example 3. The facts are the same as in *Example 2*, except that the \$2,000 regular contribution is initially made to a Roth IRA and the recharacterizing transfer is made to a traditional IRA. On the individual's Federal income tax return for 1998, he treats the \$2,000 as having been contributed to the traditional IRA for 1998 and not the Roth IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the traditional IRA for 1998 and not the Roth IRA. The result would be the same if the contribution had been transferred in a tax-free transfer to another Roth IRA prior to the recharacterization, except that the only Roth IRA trustee the individual must notify is the one actually making the recharacterization transfer.

Example 4. In 1998, an individual receives a distribution from traditional IRA 1 and contributes the entire amount to traditional IRA 2 in a rollover contribution described in section 408(d)(3). In this case, the individual cannot elect to recharacterize the contribution by transferring the contribution amount, plus net income, to a Roth IRA, because an amount contributed to an IRA in a

tax-free transfer cannot be recharacterized. However, the individual may convert (other than by recharacterization) the amount in traditional IRA 2 to a Roth IRA at any time, provided the requirements of § 1.408A-4 A-1 are satisfied.

[T.D. 8816, 64 FR 5605, Feb. 4, 1999, as amended by T.D. 9056, 68 FR 23589, May 5, 2003]

§ 1.408A-6 Distributions.

This section sets forth the following questions and answers that provide rules regarding distributions from Roth IRAs:

Q-1. How are distributions from Roth IRAs taxed?

A-1. (a) The taxability of a distribution from a Roth IRA generally depends on whether or not the distribution is a qualified distribution. This A-1 provides rules for qualified distributions and certain other nontaxable distributions. A-4 of this section provides rules for the taxability of distributions that are not qualified distributions.

(b) A distribution from a Roth IRA is not includible in the owner's gross income if it is a qualified distribution or to the extent that it is a return of the owner's contributions to the Roth IRA (determined in accordance with A-8 of this section). A qualified distribution is one that is both—

(1) Made after a 5-taxable-year period (defined in A-2 of this section); and

(2) Made on or after the date on which the owner attains age 59½, made to a beneficiary or the estate of the owner on or after the date of the owner's death, attributable to the owner's being disabled within the meaning of section 72(m)(7), or to which section 72(t)(2)(F) applies (exception for first-time home purchase).

(c) An amount distributed from a Roth IRA will not be included in gross income to the extent it is rolled over to another Roth IRA on a tax-free basis under the rules of sections 408(d)(3) and 408A(e).

(d) Contributions that are returned to the Roth IRA owner in accordance with section 408(d)(4) (corrective distributions) are not includible in gross income, but any net income required to be distributed under section 408(d)(4) together with the contributions is includible in gross income for the taxable year in which the contributions were made.