

Roth IRAs



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Establishing a Roth IRA

To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up [IRC §408A(b)]. A deemed IRA and payroll deduction IRA can be designated a Roth IRA, but SEP IRAs and SIMPLE IRAs cannot be designated as Roth IRAs. [IRC §408A(f)]

IRS forms. No specific form is required, but the IRS has provided the following forms (reproduced in [Tab 12](#)) to act as model agreements:

- Form 5305-R, *Roth Individual Retirement Trust Account*, if a grantor/trustee relationship exists. 
- Form 5305-RA, *Roth Individual Retirement Custodial Account*, if a custodian/depositor relationship exists. 
- Form 5305-RB, *Roth Individual Retirement Annuity Endorsement*, if an issuer/annuitant relationship exists. 

Caution: Designated Roth accounts are separate accounts under 401(k), 403(b) or 457 plans that accept elective deferrals referred to as Roth contributions. Designated Roth accounts are not IRAs and should not be confused with Roth IRAs. Contributions, up to their respective limits, can be made to Roth IRAs and designated Roth accounts according to an individual's eligibility to participate. A contribution to one does not impact eligibility to contribute to the other. See [Designated Roth Accounts on Page 5-11](#) for more information.

CONTRIBUTING TO A ROTH IRA

WHAT IS A ROTH IRA?

A Roth IRA is an individual retirement account that, unless specified, is subject to the rules that apply to a traditional IRA (see [Tab 1](#)). However, as explained in this tab, there are several significant differences between the two.



Major Differences Between Roth and Traditional IRAs

	Roth IRA	Traditional IRA
Are contributions deductible?	No.	Yes. ¹
Are distributions taxable?	No. ²	Yes, to the extent they exceed basis.
How is basis allocated to distributions?	Basis in all Roth IRAs distributed before earnings.	A portion of total basis in all non-Roth IRAs is allocated to each distribution.
Can owner contribute after age 70½?	Yes.	No.
Are distributions required during account owner's lifetime?	No.	Yes, starting for the year owner reaches age 70½. ³

¹ Deduction may be phased out for individuals (or their spouses) who are covered by an employer retirement plan. See [Individuals Covered By Employer Plans on Page 1-4](#).

² If a qualified distribution (see [Qualified Distributions on Page 2-8](#)). If a nonqualified distribution, distributions are taxable after basis is recovered.

³ But, the distribution for that year can be made as late as April 1 of the following year.

No Deduction Allowed

Roth IRA contributions are not deductible [IRC §408A(c)(1)]. As nondeductible IRA contributions, they increase the owner's basis in the Roth IRA, which can be withdrawn tax-free, even if the distribution is not a qualifying distribution. See [Ordering rules on Page 2-8](#).

No Age Limit for Contributions

Unlike traditional IRAs, contributions can be made to a Roth IRA regardless of the account owner's age [IRC §408A(c)(4)]. Therefore, subject to the contribution limit (see [Contribution Limit below](#)) anyone with compensation can make Roth IRA contributions.



Contribution Limit

The contribution limit for Roth IRAs depends on whether contributions are made only to Roth IRAs or to both traditional IRAs and Roth IRAs. [IRC §408A(c)(2)]

Roth IRA contributions only. If contributions are made only to Roth IRAs, the 2016 maximum contribution (not counting rollovers) is the lesser of:

- \$5,500 (\$6,500 if age 50 or older by year-end) or
- Compensation.

However, if modified AGI is above a certain amount, the contribution limit may be reduced. See [Contribution Limit Reduced Due to AGI on Page 2-2](#).

Compensation. Compensation is defined the same way as for traditional IRA contributions. It includes wages, salaries, tips, professional fees, bonuses and other amounts received for providing personal services. It also includes commissions, self-employment income, nontaxable combat pay, military differential pay and taxable alimony and separate maintenance payments. See [What Is Compensation? on Page 1-3](#).



Contributions to both Roth and traditional IRAs. If an individual makes both Roth IRA and traditional IRA contributions for the same year, the Roth IRA contribution limit is reduced by contributions for the year to all IRAs other than Roth IRAs. *Exception:* Employer contributions for an individual (including a self-employed individual) under a SEP or SIMPLE IRA plan do not affect the Roth IRA contribution limit. [IRC §408A(f)(2); Reg. §1.408A-3, Q&A 3]

Repayment of reservist distributions. Individuals can repay qualified reservist distributions even if the repayments would cause total IRA contributions for the year to exceed the general contribution limit. However, the total repayments cannot be more than the amount of the distribution. See [Qualified reservist distributions on Page 1-3](#).

Note: Repayments of qualified reservist distributions to a Roth IRA increase the basis in the Roth IRA.

Contribution Limit Reduced Due to AGI

The Roth IRA contribution limit is reduced when modified AGI reaches certain levels. [IRC §408A(c)(3)]



Roth IRA Contribution Phase-Out (2016)	
Filing Status	Modified AGI Phase-Out Range
MFJ, QW	\$184,000 – 194,000
Single, HOH	117,000 – 132,000
MFS ¹	0 – 10,000

¹ Individuals filing MFS who did not live with their spouse at any time during the year are treated as single.

Modified AGI for Roth IRA Contributions [IRC §408A(c)(3)(B)]

Adjusted Gross Income (AGI)

- Income from Roth IRA conversions.
 - Income from Roth IRA rollovers from employer retirement plans.
 - + Deduction for traditional IRA contributions.
 - + Student loan interest deduction.
 - + Tuition and fees deduction.
 - + Domestic production activities deduction.
 - + Foreign earned income exclusion.
 - + Foreign housing exclusion or deduction.
 - + Exclusion of qualified bond interest used for education.
 - + Exclusion of employer-provided adoption benefits.
-
- = Modified AGI

Use the [Reduced Roth IRA Contribution Worksheet \(2016\) on Page 2-11](#) to compute the reduced contribution limit for individuals affected by the phase-out.

Example: Ryan is single and 45 years old. His 2016 compensation is \$109,000. He wants to make the maximum allowable Roth IRA contribution for 2016. His 2016 modified AGI is \$118,000. He has not made any traditional IRA contributions for 2016, so his Roth IRA contribution limit for 2016 is \$5,140, computed as follows:

1) Modified AGI for Roth IRA purposes.....	1) \$118,000
2) Beginning of phase-out range for single taxpayers	2) <117,000>
3) Excess modified AGI	3) 1,000
4) Amount of income in phase-out range for single taxpayers	4) 15,000
5) Divide line 3 by line 4.....	5) .067
6) Lesser of \$5,500 (\$6,500 if age 50 or older) or compensation	6) 5,500
7) Multiply line 5 by line 6	7) 369
8) Subtract line 7 from line 6. Round up to the nearest \$10.....	8) 5,140
9) Contributions for the year to other IRAs	9) 0
10) Subtract line 9 from line 6.....	10) 5,500
11) Enter the lesser of line 8 or line 10.....	11) \$ 5,140

Roth IRAs for Spouses

Individuals can contribute to a Roth IRA for their spouse if the spouses file a joint return. The maximum contribution for 2016 is the lesser of: [IRC §408A(c)(2)]

- \$5,500 (\$6,500 if age 50 or older by year-end) or
- The compensation limit for spousal IRAs described at [Spousal IRAs on Page 1-2](#).

Caution: The contribution limit is reduced when modified AGI exceeds certain levels. See [Contribution Limit Reduced Due to AGI in the previous column](#).

Deadline for Making Contributions

Contributions can be made to a Roth IRA for a year at any time during the year or by the due date of the return for that year (not including extensions). [IRC §408A(c)(7)]

Strategy: Individuals can make Roth IRA contributions for 2016 by the due date (not including extensions) for filing their 2016 tax return. This means that most people must make contributions for 2016 by April 17, 2017.



Tax Credit for Roth IRA Contributions

Certain individuals who make Roth IRA contributions qualify for the retirement saver's credit. See [Tax Credit for IRA Contributions on Page 1-10](#).

CONVERTING IRAS TO ROTH IRAS

Account owners may be able to convert amounts from either a traditional, SEP or SIMPLE IRA into a Roth IRA. (Reg. §1.408A-4)

Note: The term *traditional IRA* includes a SEP IRA but does not include a SIMPLE IRA (Reg. §1.408A-8, Q&A 1). However, for purposes of this discussion of converting to a Roth IRA, the term *traditional IRA* includes SEP and SIMPLE IRAs.

Traditional IRA Rollover Rules Apply

The conversion to a Roth IRA is treated as a rollover, regardless of the conversion method used. Most of the rules for rollovers described in [Tab 8](#) apply. *Exception:* The one-year waiting period between rollovers does not apply.

Amounts That Cannot Be Converted to a Roth IRA	
Description	IRC §
Required minimum distributions , including the distribution for the year the account owner reaches age 70½. See Required Minimum Distributions on Page 7-5 for more on the RMD rules.	408(d)(3)(E)
An IRA inherited by anyone other than the account owner's spouse. This includes a traditional IRA created when a nonspouse beneficiary transfers the deceased owner's IRA or retirement plan assets into a new IRA.	408A(e)(1); 408(d)(3)(C)

Note: A beneficiary of a deceased participant's qualified plan can convert the assets directly from the plan to a Roth IRA. See [Rollovers From an Employer Plan to a Roth IRA on Page 2-7](#).

Three ways to convert amounts from a traditional IRA to a Roth IRA: (Reg. §1.408A-4)

- **Rollover.** The account owner receives a distribution from a traditional IRA and rolls it over (contributes it) to a Roth IRA within 60 days after the distribution. The same property received from the traditional IRA must be rolled over into the Roth IRA. The entire distribution does not have to be rolled over, but the part not rolled over is generally taxable (except for the part that is a return of nondeductible contributions) and may be subject to the 10% penalty tax on early distributions.
 - **Trustee-to-trustee transfer.** Account owners can direct the trustee of the traditional IRA to transfer an amount from the traditional IRA to the trustee of the Roth IRA.
 - **Same trustee transfer.** If the trustee of the traditional IRA also maintains the Roth IRA, the account owner can direct the trustee to transfer an amount from the traditional IRA to the Roth IRA. Conversions of the entire account made with the same trustee can also be made by redesignating the traditional IRA as a Roth IRA, rather than opening a new account or issuing a new contract.
- 👁 **Observation:** Regardless of the method used, amounts from a traditional IRA that are transferred into a Roth IRA are often referred to as conversion contributions.



Income From a Conversion

Traditional IRA distributions that would be included in income if they were not converted to a Roth IRA are included in income in the year they are converted from a traditional IRA to a Roth IRA. However, any part of a distribution from a traditional IRA that is a return of basis is not included in income. [IRC §408A(d)(3)]

Effect on Substantially Equal Periodic Payment Stream

Account owners who have started taking substantially equal periodic payments from a traditional IRA (see [Substantially Equal Periodic Payments on Page 7-12](#)) can convert the traditional IRA to a Roth IRA and continue the periodic payments. The 10% penalty tax on early distributions will not apply even if the distributions are not qualified distributions (as long as they are part of a series of substantially equal periodic payments). (Reg. §1.408A-4, Q&A 12)

Reporting a Roth IRA Conversion

A conversion from a traditional IRA to a Roth IRA is reported on Form 8606, Part II. **Exception:** If the entire conversion is recharacterized, it is not reported on Form 8606. See [Recharacterizing IRA Contributions and Conversions in the next column](#).



IRA trustees are generally required to report to the IRA owner any amounts converted and recharacterized on Forms 1099-R and 5498 (which are also furnished to the IRS).

RECHARACTERIZING IRA CONTRIBUTIONS AND CONVERSIONS

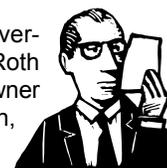
Generally, individuals can recharacterize an IRA contribution, a Roth IRA conversion or a Roth IRA rollover from a qualified retirement plan by making a trustee-to-trustee transfer from one IRA to another type of IRA. [IRC §408A(d)(6)]

If an individual properly elects to recharacterize the contribution, it is treated as if it were originally made to the second IRA, instead of to the first IRA. Any earnings transferred from the first IRA to the second IRA are treated as if earned in the second IRA.

⚠ **Caution:** A loss realized while the funds are held in the first IRA cannot be deducted. Instead, the loss is treated as if incurred while held in the second IRA.

🔄 **Recharacterizing to a SEP or SIMPLE IRA.** Roth IRA conversion contributions from a SEP IRA or SIMPLE IRA can be recharacterized to a SEP IRA or SIMPLE IRA (including the original SEP IRA or SIMPLE IRA). (Reg. §1.408A-5, Q&A 5)

🔗 **Strategy:** Recharacterizing a Roth IRA conversion is beneficial if, after the conversion, the Roth IRA's value declines significantly. If the account owner recharacterizes (undoes) the Roth IRA conversion, he will avoid paying taxes on value on the conversion date that no longer exists.



Example: In January 2016, James instructs the trustee of his traditional IRA to transfer \$50,000 to a new Roth IRA. James has no basis in his traditional IRA, so this conversion to a Roth IRA results in \$50,000 of taxable income in 2016.

James extends the due date for his 2016 return until October 16, 2017. In September 2017, the stock market falls dramatically and the value of his Roth IRA (that was worth \$50,000 when he converted) drops to \$30,000. To avoid paying tax on the \$20,000 of value he no longer has, James recharacterizes his Roth IRA conversion contribution. Using a trustee-to-trustee transfer, he moves the \$30,000 in the Roth IRA to a traditional IRA on October 10, 2017. Assuming he has met all the requirements to properly recharacterize the Roth IRA contribution, his Roth IRA conversion is treated as if it never occurred.

How to Recharacterize

To recharacterize an IRA contribution (including a conversion contribution to a Roth IRA) the contribution must be transferred from the first IRA (the one to which the contribution was made) to the second IRA in a trustee-to-trustee transfer.

👁 **Observation:** When a Roth IRA conversion is recharacterized, the conversion contribution to the Roth IRA is the contribution to the "first IRA" and the transfer of the funds (along with earnings)



back to a traditional IRA is the transfer to the “second IRA.” The traditional IRA is treated as if it were the original recipient of the contribution, so the individual does not recognize the income that would have been recognized on the Roth conversion. (Reg. §1.408A-5, Q&A 3)



Deadline. Generally, the transfer to the second IRA must be made by the due date (including extensions) for the tax return for the year for which the contribution to the first IRA was made [Reg. §1.408A-5, Q&A 6(b)]. But see [Extension of Time to Recharacterize on Page 2-5](#) for an exception.

Requirements. Individuals who recharacterize their IRA contribution must do all three of the following:

- 1) Instruct the trustee to transfer the contribution, as well as any net income allocable to it, to the second IRA. If there was a loss, the net income transferred may be a negative amount.
Note: In most cases, the net income allocable to the transfer is determined by the IRA trustee or custodian. However, the [Net Income Due to an IRA Contribution and Amount to Be Recharacterized Worksheet on Page 2-12](#) can be used to make the computation, if necessary.
- 2) Report the recharacterization on their tax return for the year during which the contribution was made. (See [Reporting a Recharacterization on Page 2-5](#).)
- 3) Treat the contribution as having been made to the second IRA on the date that it was actually made to the first IRA.

Notifying the IRA Trustees

To recharacterize a contribution, individuals must notify both the trustee of the first IRA (the one to which the contribution was originally made) and the trustee of the second IRA (the one to which the contribution is being moved) that they have elected to treat the contribution as having been made to the second IRA rather than the first. The notifications must be made by the date of the transfer. Only one notification is required if both IRAs are maintained by the same trustee. The notifications must include all of the following information: (Reg. §1.408A-5, Q&A 6)



- 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 any net income (or loss) allocable to the contribution to the trustee of the second IRA.
- The name of the trustee of the first IRA and the name of the trustee of the second IRA.
- Any additional information needed to make the transfer.

See the [Sample Trustee Notification to Recharacterize an IRA Contribution on Page 2-12](#).

Additional Rules

No deduction allowed. The contribution to the first IRA cannot be deducted. Any net income transferred with the recharacterized contribution is treated as earned in the second IRA. [IRC §408A(d)(6); Reg. §1.408A-5, Q&A 3]

Election to recharacterize cannot be changed. After the transfer to the second IRA has taken place, the election to recharacterize cannot be revoked. (Reg. §1.408A-5, Q&A 6)



Year conversion is made. For recharacterization purposes, individuals who receive a traditional IRA distribution in one tax year and roll it over into a Roth IRA in the following year (but still within the 60-day rollover period) treat the contribution to the Roth IRA as if it were made in the earlier tax year. (Reg. §1.408A-5, Q&A 1)

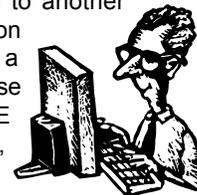
Same trustee. Recharacterizations made with the same trustee can be made by redesignating the first IRA as the second IRA, rather than transferring the account balance. (Reg. §1.408A-5, Q&A 1)

More than one IRA. Individuals with more than one IRA determine the net income to be included with the amount to be recharacterized based only on the account from which they withdraw the contribution. (Reg. §1.408A-5, Q&A 2)

Recharacterizing excess contributions. Only actual contributions can be recharacterized. Excess contributions for prior years that are being applied to current year contributions can be recharacterized only if the recharacterization would still be timely with respect to the tax year for which the applied contributions were actually made.

Example: Zara, age 40, contributed more than she was entitled to in 2016. Her excess contribution made in 2016 cannot be recharacterized after April 17, 2017, because contributions after that date are no longer timely for 2016.

No recharacterizing employer contributions. Employer contributions (including elective deferrals) to a SEP or SIMPLE plan cannot be recharacterized as contributions to another IRA (Reg. §1.408A-5, Q&A 5). This prohibition on recharacterizing employer contributions to a SEP IRA or SIMPLE IRA only applies when those contributions are made to the SEP or SIMPLE IRA. Once such contributions have been made, the SEP or SIMPLE IRA may be converted to a Roth IRA and subsequently recharacterized.



Caution: For a SIMPLE IRA, the two-year rule that applies to tax-free rollovers must be satisfied before the conversion. See [Two-Year Rule on Page 8-5](#).

See [Tab 3](#) for discussion of SIMPLE plans and [Tab 4](#) for discussion of SEPs.

Recharacterization not counted as rollover. The recharacterization of a contribution is not treated as a rollover for the one-year waiting period (see [Time Limit for Making a Rollover on Page 8-3](#)). This is true 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. (Reg. §1.408A-5, Q&A 8)

Deceased IRA owners. The election to recharacterize can be made on behalf of a deceased IRA owner by the executor, administrator or other person responsible for filing the decedent's final income tax return. (Reg. §1.408A-5, Q&A 6)

Effect of previous tax-free transfers. An amount moved from one IRA to another in a tax-free transfer (such as a rollover) generally cannot be recharacterized (Reg. §1.408A-5, Q&A 4). **Exception:** Individuals who mistakenly roll over or transfer an amount from a traditional IRA to a SIMPLE IRA can recharacterize the amount as a contribution to another traditional IRA.

Example: In 2016, Katherine receives a distribution from traditional IRA 1 and transfers it to traditional IRA 2 in a tax-free rollover. Katherine cannot elect to recharacterize the contribution to IRA 2 by transferring it (along with net income) to a Roth IRA. However, she can convert (other than by recharacterization) the amount in traditional IRA 2 to a Roth IRA at any time. Converting the amount in IRA 2 to a Roth IRA will result in taxable income, as if IRA 2 had been distributed to Katherine.