

Using Roth-IRA Re-characterization to Recoup Taxes on Portfolios Holding Losses

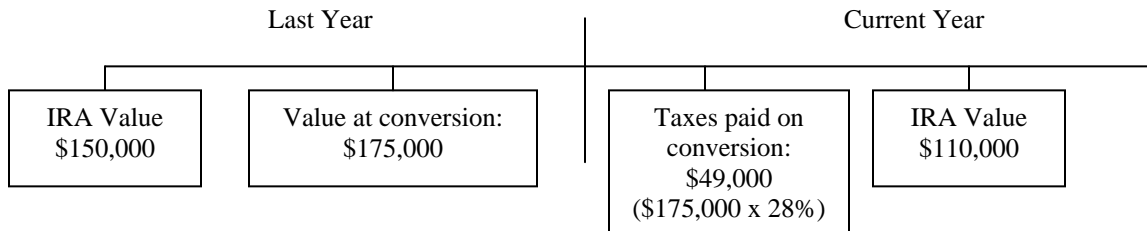
Benefit: If a recently converted Roth-IRA portfolio has losses, clients can use the October 15 re-characterization deadline to recoup the taxes paid when they did the conversion by re-characterizing the Roth-IRA back to a traditional IRA.

The Client: Janet Ambrose, 43, needed help in allocating her Roth-IRA. She felt her current advisor's portfolio recommendations were too risky and caused substantial losses. Last year, she also converted her \$175,000 IRA to a Roth-IRA to avoid taxation during retirement. The account value is now \$110,000.

The Problem: Mrs. Ambrose's accounts are allocated properly given her stated risk tolerance and time horizon. The market was simply going through a regular contraction.

While she is unable to recoup her investment losses (although she may with time), she is able to recoup some of the taxes paid when she converted the traditional IRA to a Roth-IRA.

A review of Mrs. Ambrose's history revealed the following:



The Tool: Use a Roth-IRA Re-characterization to Recoup Taxes on Portfolios Holding Losses

IRA owners are allowed to convert their traditional IRAs to Roth-IRAs. The primary benefit of this is that after age 59 ½ withdrawals from Roth-IRAs are not taxable, while withdrawals from traditional IRAs are. When a Roth-IRA conversion is done, IRA owners pay the taxes owed now on the promise of paying no taxes during retirement.

However, a Roth-IRA conversion is not written in stone. The IRS allows a Roth-IRA to be re-characterized back to a traditional IRA by Oct. 15 of the year following the conversion. By doing this Mrs. Ambrose will be able to recoup the taxes paid on the original Roth-IRA conversion by filing an amended return. As a bonus, the IRS will pay her interest on the \$49,000 they now owe her.

Mrs. Ambrose was resistant to this idea because she still wanted the tax-free withdrawals from her Roth-IRA at retirement.

The IRS requires that IRA owners wait until they are 59 ½ before they can meet those