REPORTING A RECHARACTERIZATION

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By Andy Ives, CFP®, AIF®
IRA Analyst

We know that Roth conversions are permanent. Recharacterization of a conversion is no longer allowed. Once the conversion is done, there is no going back. However, recharacterization is still available for IRA contributions. A traditional IRA contribution can be recharacterized to a Roth IRA or vice versa. A contribution can be recharacterized for any reason as long as it can be a valid contribution to the other type of IRA. This means that the person must be eligible to contribute to the type of IRA to which the funds are being recharacterized.

Why recharacterize? There are multiple scenarios where recharacterization could be the proper strategy. For example, an individual who contributed to a traditional IRA and later discovered the contribution was not deductible could recharacterize the contribution to a Roth IRA (assuming Roth IRA eligibility). A person who contributed to a Roth IRA not knowing his income for the year will be above the phaseout limits could recharacterize that contribution to a traditional IRA.

To recharacterize a contribution, the IRA custodian will transfer the funds, along with the earnings or losses ("net income attributable" or NIA), from the first IRA to the second. NIA is determined by a special IRS formula, which is the same formula used to determine NIA when removing an excess IRA contribution. The deadline for recharacterization is October 15 of the year following the year for which the original contribution was made. The recharacterized contribution is treated as if it had always been made to the intended IRA.

While this is a tax-free transaction, both IRAs report the transactions to the account owner and the IRS. The first IRA custodian will report the recharacterized amount, plus NIA, as a distribution on Form 1099-R. The second IRA (the receiving IRA) custodian will generate a Form 5498. On the Form 1099-R, both the recharacterized contribution amount and the NIA (i.e., the current fair market value of the recharacterized amount) are reported in Box 1, Gross distribution, with "0" in Box 2a, Taxable amount. The distribution code will be either an "N" or "R."

From the Instructions for Form 1099-R for 2025 recharacterizations:

"N—Recharacterized IRA contribution made for 2025. Use Code N for a recharacterization of an IRA contribution made for 2025 and recharacterized in 2025 to another type of IRA by a trustee-to-trustee transfer or with the same trustee."

"R—Recharacterized IRA contribution made for 2024 or a previous year. Use Code R for a recharacterization of an IRA contribution made for 2024 and recharacterized in 2025 to another type of IRA by a trustee-to-trustee transfer or with the same trustee."

Form 5498 will report the total amount being recharacterized in Box 4, Recharacterized contributions. Note: If an unwanted (or disallowed) Roth IRA contribution is recharacterized to a non-deductible traditional IRA contribution, be sure to file Form 8606 to claim that basis.