Take-Away: There are peculiar rules associated with excess retirement plan contributions, and especially that rules that provide when the earnings on those excess contributions must be reported by the account owner. There is also a remote possibility of double taxation of the excess contribution and its earnings.

Background: It is all too common when an individual makes an excess retirement plan contribution, either to an IRA or to a 401(k) account. Excess contributions can arise in several ways, to include: (i) exceeding the annual IRA or 401(k) contribution limit; (ii) contributing without eligible reported compensation; (iii) exceeding the Roth IRA phase-out income limits; (iv) rolling over dollars after the 60-day rollover period has expired; or (v) rolling over ineligible dollars to an IRA, e.g., rolling over a required minimum distribution (RMD.) Correcting these mistakes depends on whether it is an IRA or a 401(k) account to which the excess contribution was made. And any earnings on an excess contribution must also be addressed as well. Some of the peculiar rules that need to be followed to correct an excess contribution to a retirement account, include the following:

IRAs: For 2024 the contribution limit to an IRA is $7,000 for those individuals under the age of 50 years and $8,000 for those individuals who are 50 years old or older.

1. **October 15 Deadline:** The deadline to correct an excess contribution without the 6% excise tax imposed is usually October 15 of the year after the year of the excess contribution, e.g., October 15, 2024 for an excess contribution that was made to an IRA in 2023.

2. **6% Excise Tax:** Corrections made on or before October 15 deadline will avoid the 6% excess contribution excise tax. The excess contribution correction can be made in two different ways. Either: (i) withdraw the excess contribution, plus earnings (commonly referred to as the *net income attributable*); or (ii) recharacterize the excess contribution plus any gains, or losses, e.g., from a Roth IRA to a traditional IRA, or vice versa.

3. ***Net Income Attributable:*** The *net income attributable is taxable in the year in which the contribution was made.* Consequently, the earnings on an excess contribution made in 2023 to an IRA, even if it is 'fixed' in 2024, are reportable by the individual on his/her 2023 Form 1040. IRS Publication 590-A provides a worksheet that can be used to calculate that net *income attributable* amount. Earnings will be based on the overall IRA account performance, not just on the investment to which the excess contribution was made.

4. **Avoiding the Excise Tax:** If the correction of the excess contribution was made by October 15 of the year after the year the excess contribution occurred, the 6% excise tax will not be imposed, which means that it will not be necessary to file IRS Form 5329. In addition, there will be no penalty/excise tax imposed on the *net income attributable*, but income taxes will be due on the *net income attributable*. The SECURE Act 2.0 eliminated the 10% penalty on the *net income attributable* for those individuals who are under the age 59 ½.

5. **Fixing the Excess Contribution:** After the October 15 deadline has passed, any excess contributions remaining in the IRA can be corrected by either withdrawing the contribution or by carrying it forward to be used as a contribution in a future year. However, recharacterization of that contribution [traditional IRA to Roth IRA, or vice versa] is no longer available after the October 15 deadline.

6. **Form 5329:** The 6% excise tax applies in each calendar year the

excess contribution remains in the IRA as of December 31. The 6% excise tax is paid via IRA Form 5329. If multiple years pass with the excess contribution remaining in the IRA, a separate Form 5329 will be necessary for *each* of those calendar years.

7. ***Net Income Attributable* Stays in the Account:** Interestingly, if the October 15 deadline passes with the excess contribution remaining in the IRA, the *net income attributable* can remain in the IRA. When the excess contribution correction is finally made after the October 15 deadline by the account owner, only the excess contribution needs to be withdrawn by the account owner from the IRA.

8. **Statute of Limitations:** The SECURE Act 2.0 creates a 6-year statute of limitation in which to correct excess contributions. However, according to the U.S. Tax Court, that new statute of limitations provision is not retroactive. Accordingly, an IRA owner cannot avoid correcting excess contributions made for years prior to 2022. Restated, any excess contribution made by an individual *must be addressed* by the IRA owner.

401(k): In 2023 the maximum amount of pre-tax and Roth contributions an individual could make was $22,500, plus an additional $7,500 if the individual was at least age 50. For 2024 the contribution limits are $23,000 plus an additional $7,000 if the individual was at least age 50-year-old, or a combined $30,000.

Multiple 401(k) Plans: Suppose the participant's excess contribution was made to a 401(k) account in 2023. This 2023 limit on contributions applies to *all* qualified plans, which are combined for this purpose of determining excess contributions. Most 401(k) plans have internal controls that prevent a plan participant from exceeding the income deferral/contribution limit. However, if the plan mistakenly allows an excess contribution, it is up to the qualified plan administrator to fix the problem. However, complications arise if the participant has more than one 401(k) account during the year, e.g., the participant changes jobs, since one plan administrator will not know about the existence of the 'other' 401(k) plan, or how much was contributed to that 'other' plan. An excess contribution can be determined by the plan participant by looking on Box 12 of his/her W-2s and adding them together.

Contact a Plan Administrator: If an excess contribution was made to the participant's 401(k) plan(s), the participant should immediately contact the plan administrator of one of the plans to make them aware of the excess contribution problem. This is important to avoid *double taxation* (see the Example below.)

April 15 Deadline: The error leading to an excess contribution to the 401(k) account must be fixed by April 15. Therefore, if an excess contribution was made to a 401(k) account in 2023, it must be fixed by April 15, 2024.

Corrective Distribution: The 401(k) plan can fix the mistake by making a *corrective distribution* to the plan participant. That *corrective distribution* amount is the excess contribution amount, adjusted for earnings or losses on the excess contribution amount. The participant will receive a corrected W-2 that adds back the excess contribution deferrals to the participant's taxable income for the prior year. If a Form 1040 has already been filed, then the participant will have to amend his/her income tax return. Earnings on the excess contribution are taxable to the participant in the year of the 'fix', not the prior calendar year.

Example: Bud, age 45, made $15,000 of 2023 pre-tax contributions to Ajax's 401(k) plan. Bud left his employment at Ajax in July, 2023. Bud immediately went to work for Zylon. Bud made $12,500 of Roth contributions to Zylon's 401(k) plan in 2023. Bud failed to keep track of his total 2023 contributions to the two 401(k) plans. Consequently, Bud 2023 total contributions to the two 401(k) plans was $27,500. That aggregate amount exceeded Bud's 2023 deferral limit by $5,000 [$27,500- $22,500 = $5,000.] Bud's excess deferrals in 2023 also earned $800. Bud became aware of this excess contribution problem when he consulted his CPA in early 2024. Bud contacted the Zylon plan administrator. On March 31, 2024, the Zylon plan administrator makes a corrective distribution of $5,800 to Bud. Zylon also sends Bud a corrected 2023 W-2 that shows an additional $5,000 taxable income for Bud for 2023. Bud must include the $800 of *net income attributable* as taxable income for 2024.

Double Taxation: What if the corrective distribution is not paid to Bud by April 15, 2024? Bud will face double taxation. In that case the excess deferral will not be paid to Bud, but he will still have to pay taxes on the excess contribution ($5,000) as part of his 2023 income. And the excess contribution, along with its related $800 of earnings on the excess contribution, will be taxable to Bud a second time in the year that those amounts are eventually distributed to Bud.

Conclusion: Strange rules, indeed. Obviously, it is best to avoid an excess contribution if possible. Participating in two (or more) 401(k) plans in the same calendar year can lead to far more complications, including the possibility of becoming double taxed on the same excess contribution amount, plus earnings on that excess contribution amount.

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