

Fixing Excess 401(k) Contributions

Quick-Take: Fixing an excess 401(k) contribution needs to be done by April 15, 2025. Having a tax filing extension for a 2024 Form 1040 will not give the participant any additional time in which to implement the 'fix.'

Background: By way of brief background, the maximum amount of pre-tax and Roth contributions to a 401(k) account that could be made for 2024 was \$23,000, plus another \$7,500 if the participant was at least age 50. Contributions to all retirement plans are aggregated during the year to which these dollar amount limits apply [excluding, however, from the aggregation a contribution to a 457(b) plan.] If a qualified plan mistakenly allowed a participant to overcontribute to their retirement account, it is up to the plan to correct the mistake.

Corrective Distributions: The responsibility to fix the overcontribution may not fall on the plan administrator's shoulders, however, if the mistaken contribution arose if the participant made a job change during the year and his/her excess contribution for the calendar year resulted from contributions made to two separate qualified plans. In this admittedly limited scenario, the burden is then placed on the plan participant to 'fix' the overcontribution.

Steps to Take: The participant must contact the administrator of one of the two qualified plans to make the plan administrator aware of the problem. The qualified plan administrator that is contacted must fix the error by then making a *corrective distribution* to the participant. A *corrective distribution* is the excess amount over the \$23,000 (or \$30,500) contribution limit for 2024, adjusted for earnings or losses attributable to that excess amount. The participant will then receive a corrected W-2 statement that adds back the excess deferrals to the participant's reported 2024 wages. Earnings on the excess contribution are taxable to the participant in 2025.

Double Taxation: To avoid double taxation the contribution error must be corrected by April 15, 2025. If the mistaken contribution amount is not corrected by April 15, 2025, the participant will be hit with double taxation. The excess deferral amount will not be paid to the participant, but that amount will still count as 2024 taxable income. And the excess amount, along with its related earnings, will be taxable to the participant a second time, in the year that they are distributed to the participant.

Example: Ben, age 47, made \$18,000 of pre-tax contributions to his employer ABC's 401(k) plan in 2024. Ben changed jobs mid-year, and he started aggressive contributions to his new employer, XYZ's, 401(k) plan, where he made another \$12,500 of pre-tax contributions. Therefore, Ben made in 2024 \$30,500 in total contributions to the two 401(k) plans. Accordingly, Ben made excess contributions of \$7,500 in 2024 [$\$30,500 - \$23,000 = \$7,500$.] Those excess deferral contributions made by Ben earned \$700 in 2024. When visiting his CPA in 2025 Ben learned of his excess contributions mistake. Ben contacted XYZ company about his mistake. On March 31, 2025, the XYZ 401(k) plan made a corrective distribution of \$8,200 to Ben [$\$7,500$ excess + $\$700$ earnings = $\$8,200$.] XYZ also sends Ben a corrective W-2 that shows an additional \$7,500 of 2024 taxable income Ben earned. Ben must also include the \$700 earnings as taxable income for 2025.

Conclusion: Most individuals are fully aware of the April 15 tax filing date. Many individuals are also aware that it is fairly easy to obtain from the IRS an extension in which to file their Form 1040 income tax return for the prior year. They then make the mistake of assuming that if they made an excess contribution to their 401(k) account for the prior year, they have until October 15 of the following year to fix that problem. Having filed an extension to file a Form 1040 for 2024 will not give a plan participant more time to receive a corrective distribution to fix the problem.

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