



## A Different Fix: Excess IRA vs. 401(k) Plan Contributions

Excess IRA contributions occur for many reasons, like making a contribution without eligible compensation, accidentally exceeding the Roth IRA phase-out limits, rolling over a required minimum distribution (RMD), etc. Excess contributions to 401(k) plans can also occur. A plan participant might contribute to one plan, quit, get a new job, and then inadvertently exceed the combined annual deferral limits to plan #2 at the new job. Regardless of why an excess happened in either an IRA or a 401(k), the correction methods between the two are drastically different.

The penalty for an excess IRA contribution is 6% of the excess if it is not timely corrected. With a “timely” correction, the excess is typically removed from the IRA, along with the earnings, i.e., the “net income attributable” or “NIA,” by October 15 of the year after the year of the excess (October 15, 2026 for a 2025 excess). Corrections made after the October deadline do not require the removal of the NIA.

Another IRA correction method allowed prior to the October 15 deadline is recharacterization. While recharacterization of Roth IRA contributions is no longer allowed, recharacterization of IRA contributions is still permitted. A traditional IRA contribution can be recharacterized to a Roth IRA or vice versa. This can be a valuable tool for the right person. An IRA contribution can be recharacterized for any reason at all as long as it can be a valid contribution to the other type of IRA. An excess IRA contribution could also be “carried forward” to a later year, but the 6% penalty would still apply in the year of the excess. Ultimately, the 6% penalty applies for each year the excess remains in the IRA as of December 31, and that penalty is paid via Form 5329.

With a 401(k), the corrective process is completely different. There is no recharacterization option, and the 6% penalty (applicable to IRAs) has no bearing. The deadline for correction is April 15 of the year after the year of the excess contribution. If the excess 401(k) contribution (plus earnings) is not removed from the plan by the deadline, those dollars remain in the plan. The fallout is double taxation. The excess 401(k) contribution must be reported as taxable income for the year of the excess contribution, and those dollars are taxed again upon distribution from the plan.

**Example:** Daniel, age 47, works for ABC Co. and participates in their 401(k) plan. For 2025, Daniel defers a total of \$15,000 from his salary into the ABC Co. plan. In June of 2025, Daniel quits his job at ABC Co. for a better opportunity with XYZ, Inc. One of the perks offered by XYZ, Inc. is immediate eligibility for the XYZ, Inc. 401(k). Daniel starts salary deferrals and, over the remainder of 2025, defers \$12,000 into the XYZ, Inc. 401(k). For 2025, Daniel has deferred a combined total of \$27,000 into the ABC Co. and XYZ, Inc. 401(k) plans. This puts him \$3,500 over the 2025 salary-deferral limit of \$23,500. If the \$3,500 excess (plus earnings) is not removed from one of the plans by April 15, 2026, then those dollars remain in the 401(k). Daniel will be taxed on the \$3,500 of income in 2025, and the excess (plus earnings) will again be taxed upon withdrawal in the future.

IRAs and 401(k) plans have many similarities. However, the correction methods for fixing an excess contribution are not one of them.

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