Excess Contributions & Recharacterizations

Agenda

- Discuss what an excess contribution is
- Learn causes of excess contributions
- Identify how to correct excess contributions
- Understand the rules for recharacterizations
- Identify how to report each transaction

Excess Contributions

Sources of Excess Contributions

An excess contribution occurs when IRA owners contribute more than they are eligible to contribute

- Amounts greater than the allowable annual contribution amount (regular, catch-up, or spousal)
- Invalid rollovers
- Failed conversions (Roth IRAs only)

Amounts Exceeding Annual Limit

Traditional or Roth IRAs:

- Regular or spousal contribution exceeds contribution limit

Contribution Year	Regular	Catch-up (age 50 or older)
2026	$7,500	$1,100
2025	$7,000	$1,000

- Exceeds owner's earned income (or couple's earned income if married filing joint federal income tax return)

Roth IRAs only:

- Owner's MAGI exceeds allowable limit

Roth IRA Contribution Income Limits

Tax Filing Status	MAGI Threshold (2025)	MAGI Threshold (2026)
Married Filing Jointly	$236,00 - $246,000	$242,00 - $252,000
Single	$150,000 - $165,000	$153,000 - $168,000
Married Filing Separately	$0 - $10,000	$0 - $10,000

Invalid Rollovers

Ineligible amounts that are rolled to an IRA (invalid rollovers) are treated as annual IRA contributions for the year the invalid rollover contribution was made

- If the invalid rollover amount plus any other annual contributions made for the year exceed the annual contribution limit, the amount that is over the contribution limit must be treated as an excess annual contribution

Examples of invalid rollovers:

- Rollovers made more than 60 days after receipt
- Violation of the one-rollover-per-12-month restriction
- An employer plan distribution that is a part of a series of substantially equal periodic payments for a period of 10 years or more
- Substantially equal periodic payments from an IRA
- A rollover contribution of other ineligible rollover distributions from an employer plan

Failed Conversions (Roth IRAs Only)

SIMPLE IRA assets that are converted to a Roth IRA, and it has been less than two years since the SIMPLE IRA owner first received a SIMPLE IRA contribution under the employer's SIMPLE IRA plan

- Failed conversions of these ineligible amounts are treated as an annual contribution to the Roth IRA for the year the failed conversion was made, potentially creating an excess annual contribution in the Roth IRA

Excess Contribution Consequences

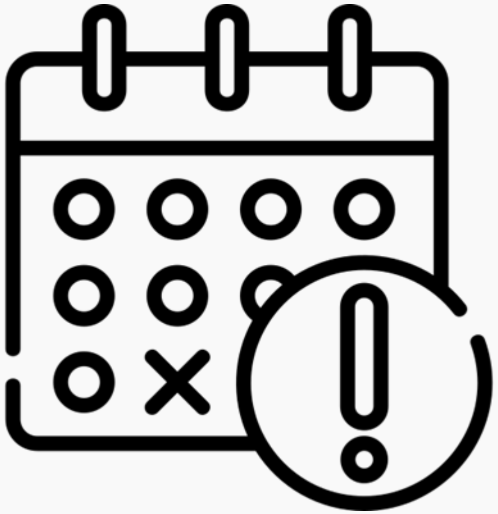
- 6% penalty for failure to correct the excess by IRS deadline

Example: Sue Smith, age 54, contributed $8,000 to her Roth IRA for 2025. Upon completing her 2025 tax return she learned that her and her husband's joint MAGI for 2025 was $350,000. As a result, she is ineligible for a Roth IRA contribution for 2025, and she has an excess annual contribution of $8,000. If she doesn't correct the excess by the IRS deadline, she will owe a 6% penalty (or $480) to the IRS.

Correcting Excess Contributions

General Rule:

Tax return due date (generally 4/15), plus extensions



After Tax Return Due Date:

IRA owners who did not originally file for an extension may still remove an excess contribution without penalty if they

- file a timely tax return;
- remove the excess within six months (October 15th for most); and
- amend their tax return to show the removal of the excess.

Correcting Excess Contributions

Before Deadline

- Remove the excess contribution, **plus net income attributable (NIA)**
- Recharacterize the excess, **with NIA** (if eligible)
- Unwanted contributions can be treated as excess contributions and removed before the deadline

After Deadline

- Remove the excess contribution
- Redesignate for subsequent year (if eligible)
- 6% penalty each year excess remains in the IRA

Correcting Excess Contributions - Before Deadline

- NIA is calculated based on the entire period the excess remained in the IRA
- Calculation considers a proportional share of the total earnings in the account, relative to the excess contribution amount
- Use on-line tools or forms from vendor to complete NIA calculation
- Worksheet 1-4 found in IRS Publication 590-A provides guidance:

1.	Enter the amount of your IRA contribution for 2025 to be returned to you	**1.**	______
2.	Enter the fair market value of the IRA immediately prior to the removal of the contribution, plus the amount of any distributions, transfers, and recharacterizations made while the contribution was in the IRA	**2.**	______
3.	Enter the fair market value of the IRA immediately before the contribution was made, plus the amount of such contribution and any other contributions, transfers, and recharacterizations made while the contribution was in the IRA	**3.**	______
4.	Subtract line 3 from line 2	**4.**	______
5.	Divide line 4 by line 3. Enter the result as a decimal (rounded to at least three places)	**5.**	______
6.	Multiply line 1 by line 5. This is the net income attributable to the contribution to be returned	**6.**	______
7.	Add lines 1 and 6. This is the amount of the IRA contribution plus the net income attributable to it to be returned to you	**7.**	______

Correcting Excess Contributions - Before Deadline

Example: On June 4, 2025, Liz contributed $3,000 to her Traditional IRA. She later determined she was not eligible for the contribution. On January 10, 2026, Liz instructs the IRA custodian to remove the excess contribution and the earnings attributable to the contribution. Prior to her contribution, the FMV of her IRA was $44,982.36. She has made no other contributions or distributions and there will be no loss of earnings penalty for the withdrawal. The current FMV of the IRA (before the removal of the excess contribution) is $48,050.25.

1.	Enter the amount of your IRA contribution for 2025 to be returned to you	1.	$3,000
2.	Enter the fair market value of the IRA immediately prior to the removal of the contribution, plus the amount of any distributions, transfers, and recharacterizations made while the contribution was in the IRA	2.	$48,050.25
3.	Enter the fair market value of the IRA immediately before the contribution was made, plus the amount of such contribution and any other contributions, transfers, and recharacterizations made while the contribution was in the IRA	3.	$47,982.36
4.	Subtract line 3 from line 2	4.	$67.89
5.	Divide line 4 by line 3. Enter the result as a decimal (rounded to at least three places)	5.	0.0014148
6.	Multiply line 1 by line 5. This is the net income attributable to the contribution to be returned	6.	$4.24
7.	Add lines 1 and 6. This is the amount of the IRA contribution plus the net income attributable to it to be returned to you	7.	$3,004.24

Correcting Excess Contributions - Before Deadline

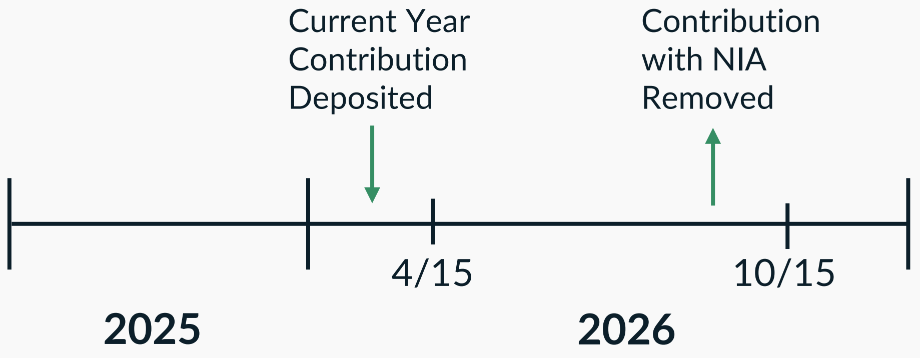
Financial Organization Responsibilities

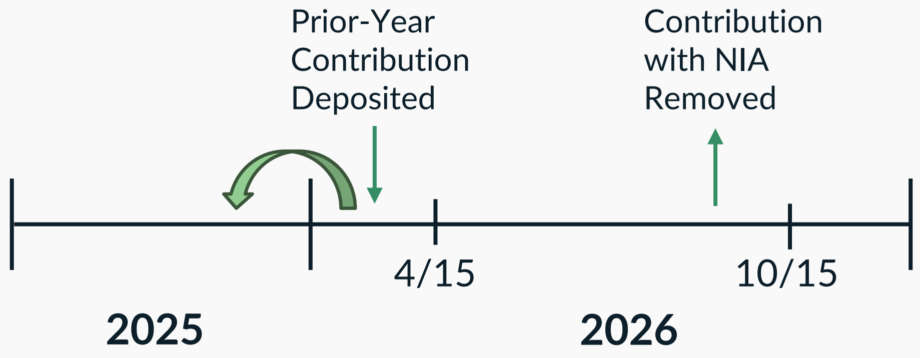
- Report the full amount of the original contribution on Form 5498
  - Box 1 – If Traditional IRA contribution
  - Box 10 – If Roth IRA contribution

- Distribution of excess contribution must report on IRS Form 1099-R
  - Box 1 – Excess contribution, plus NIA
  - Box 2a - NIA
  - Box 7
    - Traditional IRA - Code 8 or Code P (as applicable)
    - Roth IRA - Use code 8 or P with code J

Correcting Excess Contributions - Before Deadline

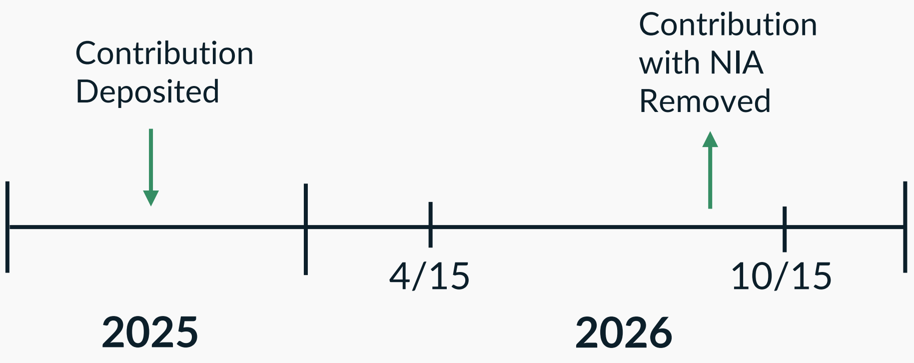
- Code 8 – *Excess contribution plus earnings taxable in the current year*
  - Use Code 8 if contribution is deposited and withdrawn in the same calendar year
  - Also used when the contribution is a prior year contribution and removed in the same calendar year in which it is made (but still prior to the owner's tax filing due date, plus extensions for the contribution being removed)
  - Use along with Code J for Roth IRAs





Correcting Excess Contributions - Before Deadline

- Code P – *Excess contribution plus earnings taxable in prior year*
  - ➢ Use Code P if contribution is deposited in one calendar year and removed in the next calendar year (prior to the IRA owner's tax filing due date, plus extensions)
  - ➢ Use along with Code J for Roth IRAs



Correcting Excess Contributions – After Deadline

Before Deadline

- Remove the excess contribution, **plus net income attributable (NIA)**
- Recharacterize the excess, **with NIA** (if eligible)
- Unwanted contributions can be treated as excess contributions and removed before the deadline

After Deadline

- Remove the excess contribution
- Redesignate for subsequent year (if eligible)
- 6% penalty each year excess remains in the IRA

Correcting Excess Contributions - After Deadline

Remove Excess Amount

- Distribute only the excess amount (do not calculate or remove NIA)
- Financial organization reports the distribution on Form 1099-R (using the applicable distribution code for the owner's age and IRA type)
- Owner must pay 6% excess contribution penalty on IRS Form 5329

Example – Tommy made a $5,000 contribution into a Roth IRA for 2024. However, he was ineligible for the contribution because he had no earned income in 2024. Unfortunately, this error was not discovered until December 2025, which was after the deadline to correct the excess, so Tommy is subject to an excess contribution penalty of $300 (6% x $5,000) for 2024.

When Tommy corrects the excess in December 2025, he will request a distribution from his Roth IRA for $5,000. Because the excess has been removed from the Roth IRA he will not incur the excess contribution penalty for 2005.

Correcting Excess Contributions - After Deadline

Redesignate Excess Amount

- Take the contribution that was not eligible for one year and carry it forward as a contribution for the next year(s) (this is completed by the owner when they complete their tax return)
- Contribution remains in the IRA, and no additional reporting is required by the financial organization
- Owner must pay 6% excess contribution penalty on IRS Form 5329

Example – Tommy made a $5,000 contribution into a Roth IRA for 2024. However, he was ineligible for the contribution because he had no earned income in 2024. Unfortunately, this error was not discovered until December 2025, which was after the deadline to correct the excess, so Tommy is subject to an excess contribution penalty of $300 (6% x $5,000) for 2024.

Because Tommy had earned income in 2025, he can redesignate the $5,000 contribution as a 2025 contribution. He will not be subject to the excess contribution penalty for 2025 because the excess contribution no longer exists within the Roth IRA.

Recharacterizations

What is a Recharacterization?

- A recharacterization is treating a contribution made to one type of IRA as having been made to a different type of IRA
- Can be used to correct an excess contribution prior to the owner's tax filing due date, plus extensions (only if the owner is eligible to contribute to the receiving IRA type)
- May also be elected if the owner is eligible for the initial contribution but changes their mind

Traditional IRA → Roth IRA

Roth IRA → Traditional IRA

Recharacterization Process

IRA Owner

- Makes an irrevocable election to treat the contribution as having been made to the second IRA rather than to the first
- Attaches a statement to their tax return confirming the recharacterization for the year during which the contribution was made

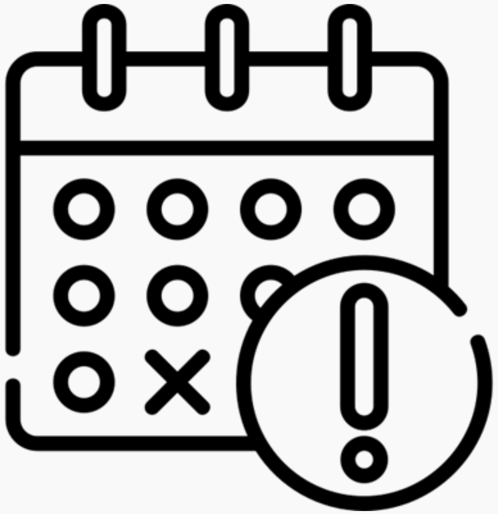
Financial Organization

- Transfers the contribution amount, plus any **net income attributable**, from the first IRA to the second IRA (direct movement)
- Tax reporting
  - the original contribution (Form 5498),
  - the recharacterization distribution (Form 1099-R, Code R or N), and
  - the recharacterized contribution (Form 5498).

Recharacterization Deadline

General Rule:

Tax return due date (generally 4/15), plus extensions



After Tax Return Due Date (4/15):

IRA owners who did not originally file for an extension may still recharacterize a contribution if they

- file a timely tax return;
- complete the recharacterization within six months (October 15th for most); and
- amend their tax return to report the recharacterization

Reporting Recharacterizations

Original contribution – Form 5498

- Box 1 – If Traditional IRA contribution
- Box 10 – If Roth IRA contribution

Recharacterized distribution –Form 1099-R

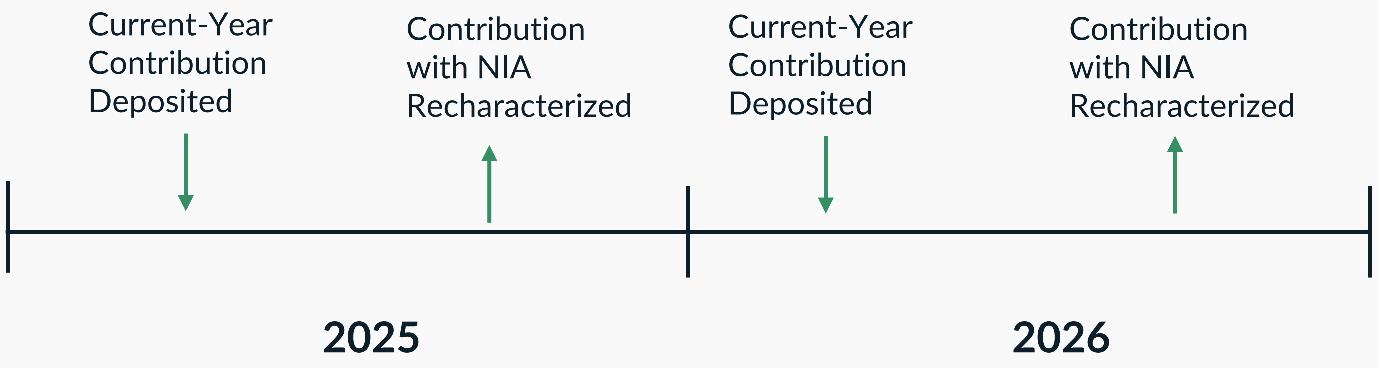
- Box 1 - Contribution, plus NIA
- Box 2a - $0
- Box 7 – Code N (same year recharacterization) or Code R (prior year recharacterization)

Recharacterized contribution –Form 5498

- Box 4 – Total amount being recharacterized (contribution, plus NIA)
- Box 7 – Check IRA type

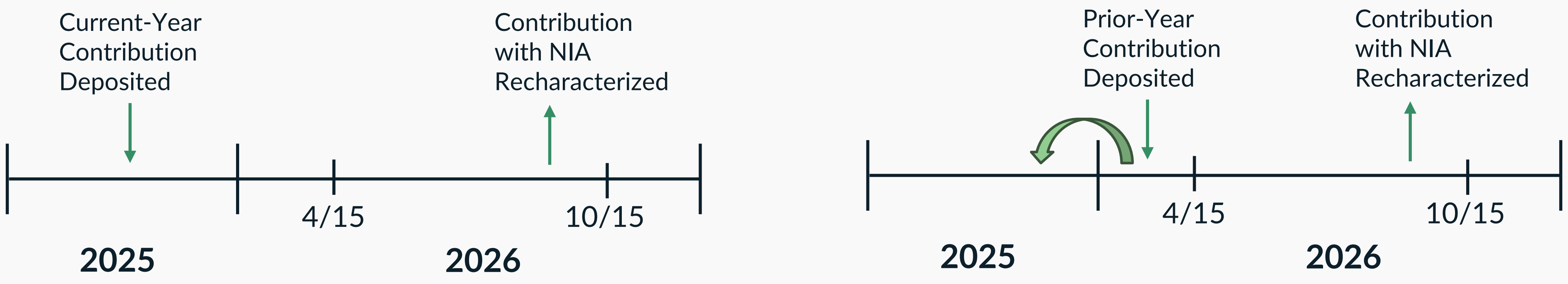
Reporting Recharacterizations

- Code N – *Recharacterized IRA contribution made for current year*
  - ➢ Use Code N if contribution is deposited in for one calendar year and recharacterized in the same calendar year (prior to the IRA owner's tax filing due date, plus extensions)



Reporting Recharacterizations

- Code R – *Recharacterized IRA contribution made for the prior year*
  - Use Code R if the contribution being recharacterized is a contribution for a prior year (prior to the IRA owner's tax filing due date, plus extensions)



Summary

- What causes excess contributions
- Correcting excess contributions
- What is a recharacterization

Questions?

CHAT WITH US OR CALL US AT 888.470.4542

MONDAY–FRIDAY, 8:00 A.M.–5:00 P.M., CT