

## Excess Contribution to Roth IRA

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Originally Published: April 26, 2007

### Mary would like to know:

My husband and I have both been contributing to Roth's - 1600.00 combined per year. This past year, because he left a job, had a vacation buy out, and started a new job, we are over the salary limit for the Roth, among other things. We are stymied by what to do. Next year our income will not be over the limit. Do we have to take out everything? Only the amount contributed this past year? What if we did nothing? We have continued contributing, but are wondering about converting to a traditional IRA - all of the investment or only the amount from last year?. Any suggestions would be appreciated? In addition, we have lost the tuition deduction for the 2 college kids and the 2 other children under 17 because of this income this year.

Thanks!

### My response:

Dear Mary,

The law provides a way to fix an excess contribution that was made to a Roth IRA. If you do not fix the excess contribution (or you do not fix it properly) you are required to pay a 6% penalty tax EACH YEAR the excess contribution remains in error.

You can avoid the 6% penalty tax by taking the excess contribution and any earnings attributed to the excess contribution out as a distribution on or before the due date (including extensions) for filing your return for the year of the excess contribution. You are required to report and pay tax on the net income attributable to the excess contribution in the year of the excess contribution, even if you take it out during the following year. The earnings will be taxed like any other taxable distribution of earnings from a Roth IRA, and will be subject to the early distribution penalty if you're under 59-1/2 unless an exception applies.

Another potential way to correct the excess contribution is to have the trustee of your Roth IRA make a direct transfer to a trustee for a regular IRA (the IRS refers to this as a "recharacterization"). To avoid penalties, the transfer must occur on or before the due date (including extensions) for filing your return for the year of the excess contribution. This transfer must include the amount of the excess contribution and the earnings that are attributed to it. If this is done properly the contribution will be treated as if it went to the regular IRA in the first place and you don't have to pay tax on the earnings that are transferred from one IRA to another.

As you can see, by recharacterizing the excess contribution and its earnings you can eliminate the 6% penalty tax and you're allowed to keep the earnings in an IRA, instead of taking the earnings out and paying tax on them. Of course you'll benefit from a recharacterization only if you're permitted to contribute to a regular IRA. If your excess contribution to the Roth IRA would also be an excess contribution in a regular IRA you can't use this method to avoid a penalty.

If you'd like to research this further you can start with [IRS Publication 590: Individual Retirement Arrangements](#) and for various worksheets, calculators and other articles on the Roth IRA you may wish to visit <http://rothira.com>

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**Gina L. Gwozdz** is a CPA who has chosen to specialize in taxes. Visit her website at <http://GLGcpa.com> to view more Tax Tip Articles.