

FATAL ERROR: MISTAKES THAT CANNOT BE FIXED – PART 2

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In our Slott Report entry from March 2 (“[Fatal Error: Mistakes That Cannot Be Fixed – Part 1](#),”) we discussed three irreversible mistakes and the negative consequences of each. Despite any repercussions, certain IRA and retirement plan transactions simply cannot be unwound. As a follow-up to the March 2 entry, here are a few more “fatal errors” that cannot be fixed:

***Roth Conversions.** While recharacterization of IRA contributions is still allowed, recharacterization of Roth conversions is not permitted. Once the conversion is entered, whatever taxes due will be due. A Roth conversion done by mistake or one that is not wanted “after sleeping on it” cannot be undone. Be sure you understand the ramifications of hitting [ENTER].*

***NUA Stock Rolled Over to an IRA.** The net unrealized appreciation (NUA) tax strategy enables a person to pay long-term capital gains tax on the appreciation of company stock purchased within a company retirement plan. But if the shares are rolled over to an IRA, the NUA opportunity is forever lost. This is a fatal error. The rollover cannot be reversed, and any potential NUA tax savings disappear.*

***Modifying a 72(t) Plan.** A 72(t) distribution program allows a person under age 59½ to access retirement dollars with no 10% early withdrawal penalty. But this is a slippery slope. A modification to a 72(t) distribution schedule, such as randomly changing the amount of the distributions or adding new funds to the account, will disqualify the 72(t) program. The 10% early distribution penalty will apply retroactively to all distributions taken prior to age 59½.*

***The “Same Property” Rollover Rule.** The same property withdrawn from an IRA is the only property eligible to be rolled over. If an IRA owner withdraws cash, then only cash can be rolled over. If a specific stock is withdrawn, then only that stock can be rolled over. If a different property is rolled over, the “illegal” assets in the receiving IRA must be withdrawn as an excess, and the original distribution will face any applicable tax and (potentially) an early withdrawal penalty. (Note that the only exception to this rule is for a distribution from an employer plan where the asset can be sold and the cash from the sale can be rolled over to an IRA.)*

***Prohibited Transactions.** Examples of prohibited transactions include, among other things, self-dealing and transactions with a “disqualified person.” A prohibited transaction will*

generally disqualify the IRA as of the first day of the year and the assets will become includable in income for that year. Essentially, the entire IRA is deemed to be distributed, and there is no universal fix.

This is not the end of the fatal error list. For example, it is imperative to understand how to divide IRA and retirement plan assets after divorce. Also, be sure to recognize that missing the deadline to establish inherited IRAs could saddle the beneficiaries with a less desirable payout structure. Be careful with all IRA and retirement plan transactions. Some roads are one-way streets, and there is no going back. If the wrong path is taken, there could be no recourse to correct whatever subsequent disaster follows.

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