

HOW AN EXCESS IRA CONTRIBUTION CAN HAPPEN TO YOU

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Not all funds in an IRA belong there. When a contribution is not permitted in an IRA, it is considered an excess contribution and needs to be fixed to avoid penalties. Some excess contributions are easy to understand. Others may surprise you. Here are some ways an excess IRA contribution can happen to you:

Your income is too high to make a Roth IRA contribution.

A common cause of excess Roth IRA contributions is contributing in a year when income is too high. If your income fluctuates or you have unexpected income in the year, you are particularly vulnerable. Watch out for the annual income limits. For traditional IRAs, there are no income limits for eligibility to contribute, so this is never a problem.

You do not have enough earned income or taxable compensation.

A more frequent occurrence is an IRA owner not having sufficient earned income or taxable compensation to fund an IRA contribution for the year. While you can use a spouse's taxable compensation to fund your IRA, a multitude of different income sources do not qualify for an IRA contribution, including Social Security, rental income and investment income. You may have a high income, but still not be eligible to fund an IRA. If you go ahead anyway, the result is an excess IRA contribution.

You contribute more than the annual limit.

If you contribute more than the annual limit to an IRA for the year, that will be an excess contribution. This may seem like an easy rule to follow. You may wonder who is going around contributing tens of thousands of dollars to IRAs in violation of the contribution limits. In fact, most IRA custodians will not accept contributions over the yearly limit. However, an individual with multiple IRAs with different custodians could exceed the limit by contributing to each of them.

You violate the 60-day or once-per-year rollover rule.

You may be surprised to know that a failed rollover attempt can result in an excess contribution. How can this happen? Well, there are a variety of ways you can end up in this

position. One possibility would be a violation of one of the rollover rules. If you mistakenly roll over after the 60-day rollover period has already expired, or if you violate the once-per-year rollover rule, you will end up with an excess contribution instead of a rollover in your IRA.

You roll over your RMD.

If you are older, you may be at greater risk of excess contribution due to rollover mistakes. Older clients can be at a higher risk for excess contributions due to rollover mistakes. This is because of the rule that says that the required minimum distribution (RMD) for the year cannot be rolled over. In fact, the RMD for the IRA must be taken before any of the funds in the IRA are eligible for rollover. For example, an RMD must be taken before doing a Roth IRA conversion. If you mistakenly roll over your RMD, you will end up with an excess contribution.

You make a contribution to an inherited IRA.

If you inherit an IRA from someone who is not your spouse, you may not contribute to that inherited IRA or combine it with your own IRA. If you do, you will have an excess contribution.
The Fix for Excess Contributions

Now you know what can cause excess IRA contributions. That is the first step in avoiding them. If, despite your best efforts, an excess contribution occurs, the bad news is that the problem will not go away or fix itself. An excess contribution can be subject to penalties each year it remains in the IRA. The good news is that excess contributions can be corrected and often without penalty. For the right fix for your situation, be sure to talk to a knowledgeable tax or financial advisor.

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