Plan Benefit, Contribution and Deduction Limits Are Increased Beginning in 2002

By Kandice K. Bridges

EGTRRA affects benefit and contribution limits for both defined contribution and defined benefit plans.

Employers' Deduction Limits Increased. The deduction limits on employer contributions to profit sharing and stock bonus plans are increased from 15% to 25% of the compensation of the employees covered by the plan, starting next year. For this limit, money purchase pension plans are regarded as a profit sharing or stock bonus plan. The compensation used to calculate the maximum deduction limit (for both defined benefit and defined contribution plans) will include salary reduction contributions under Internal Revenue Code ("Code") sections 125, 132(f)(4), 401(k), 403(b) and 457. Elective deferrals next year under Code sections 401(k) and 403(b) will not be subject to the deduction limit.

2001 Planning Tip: References in your enrollment materials to a "maximum deferral of 15% of pay" should be considered, unless your plan has that limit in its terms.

This change is effective for years beginning after December 31, 2001. These new deduction limits will allow employers to provide additional benefits in profit sharing plans, and money purchase pension plans may no longer be needed to reach desired contribution levels.

Benefit and Contribution Limits. The benefit and contribution limits that have been changed are set forth below:

- For defined contribution plans, the annual addition limit will be the lesser of $40,000 or 100% of compensation. The $40,000 will be indexed for cost of living adjustments in $1,000 increments.

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- The limit on the amount of compensation that can be taken into account for various purposes under a plan will be increased from $170,000 to $200,000. This amount will be increased in $5,000 increments to reflect cost of living adjustments.
- The elective deferral limitations for 401(k) plans, 403(b) annuities and simplified employee pension plans ("SEPs") will be as follows: $11,000 for 2002; $12,000 for 2003; $13,000 for 2004; $14,000 for 2005; and $15,000 for 2006 and thereafter. The $15,000 amount will be indexed for cost of living adjustments in increments of $500 beginning in 2007.
- For defined benefit plans, the annual benefit limit will be increased to $160,000. The limit will be reduced for benefits that begin before age 62 and will be increased for benefits beginning after age 65.
- The exclusion allowance for 403(b) annuities is repealed after 2001 and is replaced with the applicable Code section 415 limit.

Catch-Up Contributions. EGTRRA provides that certain individuals who are age 50 and over may elect to reduce their salary and make "catch-up contributions" to certain employer-sponsored retirement plans. These additional contributions will be made without regard to most of the qualification restrictions and limits that otherwise would apply to elective deferrals. An eligible person will be a plan participant: (i) who has reached the age of 50 before the close of the plan year; and (ii) for whom no other elective deferrals may be made to the plan because of the application of those limitations or restrictions in the Code that will not apply now or in the plan. The maximum amount of additional elective deferrals that a plan may allow will be the lesser of: (i) the applicable dollar amount (from the next paragraph); or (ii) the excess (if any) of the participant's compensation for the year over the participant's other elective deferrals for the year.

The applicable dollar amount is different depending upon what type of plan is in question. For all plans (other than a Simple 401(k) plan and a SIMPLE IRA plan), the applicable dollar amount will be as follows:

$1,000 for 2002

$2,000 for 2003

$3,000 for 2004

$4,000 for 2005

$5,000 for 2006 and thereafter.

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After December 31, 2006, the Internal Revenue Service ("Service") will adjust the applicable dollar amounts in increments of $500 to take into account cost of living adjustments.

A plan that wants to allow catch-up contributions must allow all eligible participants the right to elect to make them.

The Service has promised guidance regarding how catch-up contributions are to be implemented and administered.

2001 Planning Tip: Companies that want to offer catch-up contributions in 2002 need to revise the election materials they are distributing this fall to include an election to make this contribution.

Multiple Use Test Repealed. The multiple use test, used in determining whether the actual deferral percentage and actual contribution percentage tests for a year have been satisfied, is repealed for plan years beginning after December 31, 2001.