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ISSUE BROCHURE

Limits and Coordination of Retirement Savings Plans

Because of the impact on tax revenues, the federal government has established strict limits to the amount participants can contribute to tax favored programs. Many of our participants have multiple plan types available, including governmental 457(b), 403(b), 401(a), 401(k), and Deemed IRAs. Coordination rules dictate how much a participant and their employers can contribute to one or a combination of these types of plans. In addition to contribution limits, the amount a participant can borrow against their accounts is also controlled.

The goal of this paper is to explore the various limits and coordination requirements our plan participants may encounter.

Plan Loans

<u>Coordination of Loans</u>

One of the least understood coordination requirements regulates plan loans. If a participant has accounts in two or more plans sponsored by the same employer, or accounts with two or more vendors, they must coordinate all loans (that are subject to IRC 72(p)) from all plans and vendors. For example, school districts can allow employees to save with several different 403(b) vendors or a county may allow employees to save with several 457 vendors. The loans must be coordinated between all accounts and vendors and with their defined benefit plan, if any. This is true even if the participant makes their monthly payment directly to the vendor. Because of these coordination requirements it is important to educate participants and also to work closely with plan vendors and record keepers to ensure compliance.

<u>Dollar Limit</u>

There are dollar and percentage limitations on the amount allowed for a loan or loans. Loans can be no greater than the lesser of: 1) $50,000 minus the highest outstanding loan balance in the last 12 months (in all accounts combined), or 2) the greater of 50% of the accounts or $10,000. The highest outstanding loan balance applies to any and all of the plans listed under section 72(p) that the participant owns or participates in. The $10,000 rule allows participants with balances of $10,000 or under to take 100% of their account, if the plan allows.

For example: suppose a participant has a 403(b) account with vendor A and a 457 account with vendor B, with $60,000 in each plan. This participant takes a plan loan from vendor A for $30,000. During the subsequent 12 month period, the most he could borrow from vendor B is $20,000 (for a total of $50,000).

Elective Deferrals & Non-Elective Contributions

<u>457</u>

For section 457(b) governmental plans, the annual limit on contributions is established in section 457(b)(2) and includes elective deferrals as well as employer contributions. The limit applies to all 457 plans the individual is participating in. For example, if a member is able to contribute to two governmental 457 plans with different employers during the same year, they must combine all contributions to both plans for limit testing.

The 2008 dollar limit is the lesser of $15,500 or 100% of the participant's compensation. Changes in the 457 limit are according to code section 415(d), except that the cost-of-living adjustments are in multiples of $500.

<u>*402(g)*</u>

Section 402(g) establishes the combined limitation on elective deferrals for the following retirement plans:

- 401(k)
- 403(b)
- Designated Roth contributions (Roth 401(k) and Roth 403(b))
- Section 501(c)(18) plans, to the extent excluded from income
- SIMPLE plans
- Simplified employee pension (SEP) plans

The dollar limit on elective deferrals for an individual is the amount stated in section 402(g)(3). This dollar amount can be adjusted on January 1st of each year based on the cost-of-living increase during the prior year. The cost-of-living regulations are outlined in IRC 415(d) regarding qualified 401(a) plans, except that the cost-of-living adjustments are in multiples of $500. The 2008 dollar limit is $15,500.

The 402(g) limit applies to the combined total of all elective deferrals to the plans listed under 402(g). (The 457 contributions are *not* included in this coordination requirement.) Because this is a combined limit, it is important to coordinate the total plan contributions in order not to exceed the maximum. It is also important to note that the limit does not increase with the number of plans. If an individual has a 403(b) account in addition to a 401(k) plan, the limit is $15,500 between both plans. If the limit is exceeded, a return of the excess deferrals, and their earnings, must be issued.

<u>*415(c) Annual Additions and Compensation*</u>

Annual additions are the sum of all employer contributions, employee

Plan	Employee	Employer	Combined Total	Catch-Up	Restrictions & Coordination
457(b)	$15,500	$15,500	$15,500	$5,000 age 50 or $15,500 Special	Must coordinate with all 457 plans. Special catch-up limited to unused in prior years.
403(b)	$15,500	$46,000	$46,000	$5,000 age 50 and $3,000 15 yr	Must coordinate with Qualified & other 403(b) plans.
401(k)	$15,500	$46,000	$46,000	$5,000	Must coordinate with 403(b) and other Qualified plans.
IRAs	$5,000	Not allowed	$5,000	$1,000	Must coordinate with all IRAs

Loans	$ Maximum	% Maximum	Restrictions
72(p)	$50,000	50% of account balance	Loans are restricted to the lesser of 50% of the account or $50,000 during a 12 month period. All loans must be coordinated.

contributions, and forfeitures for a given year. The annual additions limits apply to the following plans:

- 401(k)
- 403(b)
- SEP
- Mandatory employee contributions to defined benefit plans
- Certain medical benefit accounts

The annual addition limit is set forth and adjusted annually in section 415(d). Under the limitation, the annual additions cannot be greater than $46,000 (2008 limit) or 100% of the individual's compensation for the year.

The definition of compensation and the rules on what is included and excluded from the calculation of compensation are quite complicated. IRS Publication 7001 (Rev. 3-2006) details what is and is not included in the calculation of an individual's compensation. A plan may adopt a safe harbor definition of section 415 by using the information found in IRS Publication 7001. Generally, this includes wages, salaries, commissions, bonuses, and other earned income. Compensation also covers payments to an employee for unused sick leave, unused vacation, and other leave.

Termination and Post Employment Compensation

Any payments made to an employee within the latter of 2 ½ months after the severance of employment or the end of the plan year can be included in income with respect to section 415. This particular rule is important to employers paying out unused sick leave, unused vacation, and other bonuses to retiring or terminated employees because these payments are generally paid out after the employee has left employment. It is also possible for payments using the 2 ½ month rule to cross calendar years. For example: an employee that retires December 31, 2007 can have payments made as annual additions until March 15, 2008. One thing to remember is the annual addition cannot exceed 100% of the employee's compensation for the year. So if the payment does cross calendar years, the payment cannot exceed the employee's compensation for that particular year.

There are some important additions to the 2 ½ month rule that must be noted. A 403(b) plan is subject to Section 415, but a rule exists that allows a 403(b) to receive non-elective contributions for up to 5 years after retirement. This particular rule can be found in the regulations section 1.403(b)-4(d)(1) or IRS Publication 571 (regarding 403(b) accounts). A 457 plan is not subject to section 415 but it is important to note that a 457 plan has a 2 ½ month rule as well. The 457 rule allows a qualified payment after severance of employment by the later of 2 ½ months after severance of employment or the end of the year containing the last day of employment.

Catch-Up Contributions

In addition to the 402(g) and 457 limits on elective deferrals, the Internal Revenue Code allows "catch-up" contributions for certain individuals. There are three different types of catch-up contributions possible, each with its own qualification and coordination rules.

Age 50 Catch-Up

The first is the age 50 catch-up, which is detailed in code section 414(v). It applies to the following plans:

- 401(k)
- 403(b)
- Designated Roth contributions (Roth 401(k) and Roth 403(b))
- SIMPLE plans
- 457 government plans
- Simplified employee pension (SEP) plans

To be eligible for this catch-up, the individual must be age 50 or older and eligible to contribute. The definition of age 50 or older includes individuals that will attain the age of 50 before the end of the year. The 2008 catch-up limit is $5,000 and will be adjusted for inflation according to section 415(d) in the same manner as the 402(g) and 457 deferral limit.

Like the 402(g) limit, the age 50 catch-up limit is also a combined total that applies to all plans. The only exception to this rule is the 457 governmental plan. As with the regular contribution limits, the 457 age 50 catch-up limit is not combined or coordinated with the other plans and can be used in addition to a 401(k) or 403(b) catch-up if the individual qualifies. For example: an eligible employee 50 or older could contribute a combined total of $20,500 ($15,500 in regular contributions and $5,000 for the catch-up) into their 401(k)/403(b) plans and an additional $20,500 into their 457 plan, for a grand total of $41,000. (Remember that contributions to the 401(k) directly offset available contributions to a 403(b), and this coordination requirement also applies to the age 50 catch-up.)

457 Special Catch-Up

An individual may be eligible to contribute up to double the normal annual limit into a 457 plan for one or more of the last three taxable years prior to normal retirement age. In order to qualify, the individual must have underutilized their 457 plan in prior years. The term "underutilized" simply means that the participant did not contribute the full amount possible each year to the plan. The regulations can be found in section 1.457-4(c)(3) within the final regulations.

To determine the underutilized amount, the participant would calculate the amount they could have deferred minus the amount they actually deferred during each year of employment with the employer that sponsors the plan. The underutilized limits can be taken from any year after December 31, 1978.

For years prior to 2002, participants are subject to the rules established before the repeal of the coordination limitation, which required coordination between the 457 and plans subject to 402(g) (i.e. 401(k) and 403(b)). Any calculation of underutilized contributions made before 2002 must include all plans subject to the contribution limits. This would include any contributions made to a 401(k) and/or 403(b). For example, contributions made to a 403(b) during that period reduces the underutilized amounts available for the 457 special catch-up.

Coordination of the pre-2002 contributions can become very complex. The final regulations regarding the pre-2002 calculation can be found in regulation 1.457-4(c)(3)(iv). Luckily, since overall contribution limits have grown significantly since 2001, it may not be necessary to calculate underutilized amounts prior to 2002.

According to federal regulations 1.457-4(c)(3)(i), the special catch-up provision can be used in one or more of the last 3 taxable years before attaining normal retirement age, and cannot be used at the same time as the age 50 catch-up.

"Normal retirement age" can be participant designated, but cannot be earlier than the earliest of age 65 or the age at which they have the right to retire and receive an immediate, unreduced retirement benefit under the basic defined benefit pension plan. However, it cannot be later than age 70 ½. For qualified public safety or firefighter participants, the normal retirement age can be earlier than a standard participant but cannot be lower than age 40. It is a plan's responsibility to establish a "normal retirement age" that meets these guidelines.

403(b) 15-Year Catch-Up

For individuals participating in a 403(b) plan an additional catch-up amount beyond the normal 402(g) limit and age 50 catch-up may be a possibility. In order to qualify, the participant in the 403(b) plan must have at least 15 years of service with the same public school system, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches (or associated organization). If the participant meets these criteria, they may increase their elective deferrals to the 403(b) plan by the lesser of:

1. $3,000,
2. $15,000, reduced by the sum of:
    a. The increases to the general limit they were allowed in earlier years because of this rule, plus
    b. The aggregate amount of designated Roth contributions for prior tax years, or
3. $5,000 times the number of years of service for the organization, minus the total elective deferrals made by their employer for earlier years.

These regulations can be found in IRS Publication 571 or section 1.403(b)-4(c)(3) of the treasury regulations. As noted above, there is a $15,000 lifetime limit on this catch-up, and a maximum of $3,000 per year is allowed. The 15-year catch-up can be used in addition to the age 50 catch-up. This means that for 2008, an eligible employee could potentially contribute $15,500 in regular elective deferrals, $5,000 in age 50 catch-up deferrals, and $3,000 in 15-year catch-up deferrals, bringing the total to $23,500.

It is important to note that the 15-year catch-up rule is always used before the age 50 catch-up. That means any amount deferred over the regular 402(g) limit would first be viewed as the 15-year catch-up rather than the age 50 catch-up. This can potentially be problematic because an employee may think they are using the age 50 catch-up while in fact they are using up their lifetime limit for the 15-year catch-up. For example: an employee that is eligible for both the 15-year catch-up maximum and also the age 50 catch-up contributes $18,500 for 2008. Because of the ordering rules the participant has just used $3,000 of their $15,000 lifetime limit for the 15-year catch-up. The problem comes when, in later years, the participant wants to contribute more and finds that they have already used some or all of their 15-year catch-up.

Individual Retirement Arrangements (IRA)

Contribution Limits and Age 50 Catch-Up

With the passing of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) employers may now offer Deemed Individual Retirement Arrangements (IRAs) as part of their retirement savings programs. These accounts also come with their own contribution limits and coordination requirements. The contribution limit for 2008 is $5,000, and may be indexed for inflation each year thereafter in increments of $500. Like the other savings plans, IRAs also enjoy an age 50+ catch-up provision. In 2008 those age 50 and older may contribute an additional $1,000 to their IRAs, bringing the total to $6,000.

Coordination

It is *not* necessary to coordinate contributions to an IRA with other employer sponsored plans, such as the 457, 401(k), and 403(b). However, the participant must coordinate contributions to all IRAs they own, which includes both traditional IRAs and Roth IRAs. Since they may have other IRAs with banks, credit unions, and brokerage houses, a participant can only contribute the limit between all IRAs they own.

For example, suppose I have a Deemed Roth IRA with my employer and a traditional IRA at a bank. The most I can contribute to the two IRAs combined is $5,000. However, if I also participate in my employer sponsored 457, I can contribute $15,500 to the 457 *and* $5,000 to my IRAs. Add a 403(b) to the mix and I get: $5,000 Roth IRA + $15,500 457 plan + $15,500 403(b) plan = $36,000 in the same year (and even more if I am over age 50)!

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