

M I L B E R G
C O N S U L T I N G L L C

Pension Reform Provides a Windfall of Planning Opportunities for Small Employers

In 2002, you can contribute up to \$50,000 to your Profit Sharing/401(k) Plan!

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA 2001) passed both houses of Congress on May 26, 2001. The following is an *abbreviated* overview to highlight the most significant pension provisions:

INCREASED DOLLAR LIMITS (future cost-of-living adjustments apply)

- § 401(k) elective deferral limit is \$11,000 in 2002 increasing to \$15,000 in 2006
- § The dollar limit for a defined contribution plan is \$40,000 for 2002 (*you aint heard nothing yet!*)
- § The dollar limit for the annual benefit payable in a defined benefit plan is \$160,000 for 2002
- § The compensation dollar limit under IRC §401(a)(17) is \$200,000 for 2002
- § The elective deferral limit for SIMPLE plans is \$7,000 for 2002 increasing to \$10,000 in 2005

INCREASED DEDUCTION LIMITS FOR EMPLOYERS (effective in 2002)

Changes ***dramatically increase*** the deduction limits for profit sharing plans:

- § The 15% limit is increased to 25% of aggregated participant compensation
- § 401(k) deferrals are *separately deductible* with regard to the 25% limit. *They do not offset against the 25% limit applicable to employer matching or profit sharing contributions (WOW!).*

CATCH-UP CONTRIBUTIONS FOR INDIVIDUALS AGE 50 AND OLDER IN 2002

Starting when you reach age 50 and subsequent years, a plan may allow the individual to make a "catch-up" additional 401(k) contribution of \$1,000 increasing to \$5,000 in 2006 (*Up to \$45,000 to your PS/401(k) Plan!*). The catch-up contribution for SIMPLE plans is \$500 increasing to \$2,500 in 2006. The catch-up contributions are not considered for the 401(k), SIMPLE or Profit Sharing limits or maximum contribution testing.

ELIMINATION OF 25% LIMIT FOR DEFINED CONTRIBUTION PLANS

The individual annual additions limit is increased from 25% to 100% of compensation. Therefore, starting in 2002, the annual additions limit is *100% of compensation for participants who earn less than \$40,000*, and the limit is \$40,000 for participants who earn \$40,000 or more (*This sounds too good to be true!*).

TAX CREDITS (IN 2002) AND USER FEE WAIVER FOR SMALL EMPLOYER PLANS

The new law allows small employers (100 or fewer employees) to claim a tax credit for up to 50% of the costs associated with the establishment and maintenance of a plan that covers at least one employee who is not highly compensated (*I think I'm going to faint now!*). Tax credits are also available for contributions made by individuals who are within certain income limits. Small employers are also exempt from paying user fees on obtaining a determination letter for a new plan as long as the determination letter is requested within the first 5 years of the plan.

QUALIFIED RETIREMENT PLANS FOR SMALL BUSINESSES

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PORTABILITY OF BENEFITS BETWEEN EMPLOYER-SPONSORED PLANS AND IRAS

The new law significantly expands the portability of benefits so distributions from qualified plans, 403(b) plans, and governmental 457 plans may be rolled into any of such plans, or into IRAs (e.g., a qualified plan distribution could be rolled over into a 403(b) custodial account, or vice versa *(Is that applause I hear from my friends who are stock brokers?)*).

LOANS ARE AVAILABLE TO ALL BUSINESS OWNERS IN 2002

The new law eliminates the current prohibition on making plan loans to certain participants who are owners of an unincorporated employer or an S corporation. Starting in 2002, these individuals may receive loans from their plans, without engaging in a prohibited transaction.

OTHER SIGNIFICANT CHANGES

Many other significant changes to the top-heavy rules, hardship withdrawals, the special non-discrimination test for 401(k) plans, certain notice requirements and funding requirements for defined benefit plans will ease the administration of plans. Other positive changes provide for increased IRA limits starting in 2002 and the availability of Roth 401(k)s starting in 2006.

The new law does not prescribe a special remedial amendment period for these new provisions. However, we do anticipate that IRS will provide an extended amendment period that may include an extension of the GUST remedial amendment period to conform to the amendment period for the EGTRRA 2001.

All kidding aside, these changes provide significant planning opportunities for us individually and our clients. They should be seriously considered in the overall planning process in both the establishment of new plans and the inevitable required amendment of all existing plans.

Please feel free to contact me if you require additional information on the pension provisions of the new law, or if I can be of assistance to you or your clients with these matters.

Very truly yours,

Barry R. Milberg

Due to the complex nature of the laws governing Qualified Retirement Plans, the information provided is for general use only. It should be relied upon only when coordinated with professional tax and financial advice.