

Actuarial Consultants, Inc.

ACI Action Item

Pension Reform Passes!

President Bush Expected to Sign Legislation Week of June 4th

After considerable wrangling, pension reform finally got through Congress on May 27 as part of the larger Economic Growth & Tax Relief Reconciliation Act of 2001. The President is expected to sign the bill upon his return to Washington.

The current bill is very similar to the Portman-Cardin bill (HR 10) that had been under consideration for some time. Most of the provisions of the bill are effective beginning in 2002. Some of the major provisions are:

- Increases the maximum 401(k) deferral limits from \$10,500 to \$11,000 in 2002, and by an additional \$1,000 annually, reaching \$15,000 in 2006.
- Allows catch-up contributions for those over 50. For qualified retirement plans (excluding 401(k) plans), the catch-ups increase in \$1,000 increments annually through 2005. For 401(k) plans, the catch-ups increase in \$500 increments through 2005. These amounts will not be subject to discrimination testing if offered to all plan participants.
- Increases the maximum annual benefits limit for a defined benefit plan from \$140,000 at Social Security Retirement age (65 to 67) in 2001 to \$160,000 at age 62 in 2002. This results in an increase of more than 50% in benefits at age 62.
- Increases the maximum individual contribution for defined contribution plans to the lesser of \$40,000 or 100% of compensation in 2002 (currently the lesser of \$35,000 or 25% of compensation). This quadruples the limit for those earning below \$40,000 and increases the limit for everyone earning under \$160,000 per year.
- Increases the limit on plan recognized compensation to \$200,000 in 2002 from \$170,000 in 2001. This will enable retirement plans to provide higher benefits for those earning over \$170,000 per year.
- Increases IRA deductions from \$2,000 to \$3,000 in 2002, graded to \$5,000 in 2008 plus additional amounts for those 50 or older.
- Increases the profit sharing plan deduction limit to 25% in 2002 (currently 15%).
- Allows 401(k) plan elective deferrals to be exempt from the 25% deduction limit and allows these deferrals to be counted as compensation when computing the new 25% deduction limit.

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- Permits plan loans for partners and Subchapter-S shareholders.
- Provides a tax credit for start-up costs associated with new retirement plans for small businesses (less than 100 participants). Tax credit is 50% of the first \$1,000 in administrative and education expenses for the first three plan years. Small plans will also be exempted from paying a user fee for IRS determination letters.
- Simplifies top-heavy rules, including elimination of a five-year “look back” period for determining top-heavy status.
- Frozen defined benefit plans no longer need to satisfy top-heavy minimum accrual rules.
- Deems the safe harbor 401(k) matching contribution to satisfy top-heavy requirements.
- Repeals the Multiple Use test for testing discrimination in 401(k) plans.
- Requires all 401(k) matching contributions to vest on either a three-year cliff schedule (0%/0%/100%) or six-year graded schedule (0%/20%/40%/60%/80%/100%). Most smaller 401(k) plans already incorporate one of these two schedules.
- Creates greater portability between retirement plans.

The July issue of *Action Items* will include a full analysis of the pension reform provisions to the Economic Growth & Tax Relief Reconciliation Act of 2001, including the practical implications of each major provision. These changes may influence plan design, and can be addressed as part of the required plan restatement process associated with several recent tax laws (GUST).

As always, feel free to contact an ACI consultant or plan administrator with any questions relating to this legislation.