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INFORMATION RELEASE

Exciting Pension Law Changes Will Benefit Many Businesses

June 2001

The Economic Growth and Tax Relief Reconciliation Act of 2001 was signed into law on June 7, 2001, and contains many provisions that will improve and simplify the laws applicable to qualified retirement plans. For example, the new law will:

- Permit larger contributions and benefits for participants
- Increase tax deduction limits for plan contributions
- Provide tax credits for small employers to encourage the establishment of new plans
- Permit older participants to make "catch up" contributions to their 401(k) plans
- Simplify 401(k) testing
- Permit sole proprietors and S-corporation shareholders to borrow from their plans

We will present a detailed explanation of this new law and its effect on retirement plans at our fall seminars on October 23 and 25 and November 8 and 13.

The following chart presents a simplified comparison of the prior law with the new law.

Issue	Current Law	New Law
401(k) Limit	401(k) limit of $10,500 per year.	401(k) limit of $11,000 in 2002; then increased $1,000 each year until $15,000 in 2006.
Compensation Limit	Annual compensation limited to $170,000.	Annual compensation limited to $200,000.
Defined Contribution Plan Limit	Maximum annual contribution to any participant under a defined contribution plan is the lesser of $35,000 or 25% of compensation.	Maximum annual contribution to any participant under a defined contribution plan is the lesser of $40,000 or 100% of compensation.
Defined Benefit Plan Limit	Maximum annual pension of $140,000, or less if pension begins prior to Social Security retirement age.	Maximum annual pension of $160,000, or less if pension begins prior to age 62.
Profit Sharing Plan Deduction Limit	Deductions of profit-sharing plan contributions are limited to 15% of aggregate participants' compensation. If the employer also maintains a money purchase pension plan, the combined contribution can be deductible up to 25% of compensation.	The deduction limit for profit-sharing plans is increased to 25% of aggregate participants' compensation. (There may be little need for money purchase plans in the future.)

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Issue	Current Law	New Law
Exclusion of 401(k) Deferrals from Deduction Limit	Employee 401(k) deferrals count against deduction limit.	401(k) deferrals will **not** count against the deduction limit.
Definition of Compensation for Determining Deduction Limits	Compensation does **not** include 401(k) deferrals in determining a company's tax-deductible limit.	Compensation **includes** 401(k) deferrals. So, deduction limits will increase.
Top Heavy 401(k) Plans	Top heavy plans must provide minimum contributions to all non-key employees if contributions are made on behalf of key employees. Matching contributions **cannot** be used to satisfy this requirement.	Matching contributions **will now count** toward satisfying the top-heavy minimum contribution requirement. With certain exceptions, a safe harbor 401(k) plan will be deemed to satisfy the top-heavy rules.
Tax Credits for New Small Employer Plans	None.	Beginning in 2002, businesses with 100 or fewer employees will be eligible for an annual tax credit. The amount of the credit will be 50% on up to $1,000 of administrative costs for the first three years of a new plan. The credit is available only if at least one non-highly compensated employee is participating in the plan.
Catch up Contributions for Older Workers	401(k) deferrals are limited to $10,500 per year per participant. There are no separate limits for older workers.	Beginning in 2002, individuals who are age 50 or older will be allowed to make an additional contribution to a 401(k), 403(b), or 457 plan equal to $1,000 in 2002, then increased by $1,000 each year until $5,000 in 2006. The amount of the catch-up contribution will **not** be subject to ADP testing provided all participating employees over age 50 are eligible to make a catch-up contribution. Also, the catch-up contribution will **not** count against the employer's deduction limit or against the individual's 415(c) dollar limit.
Faster Vesting of Employer Matching Contributions	Employer matching contributions must vest at least as rapidly as either the Cliff or Graded schedules below: **Service** / **Cliff** / **Graded** 1 / 0% / 0% 2 / 0% / 0% 3 / 0% / 20% 4 / 0% / 40% 5 / 100% / 60% 6 / 100% / 80% 7 / 100% / 100%	Employer matching contributions must vest at least as rapidly as either the Cliff or Graded schedules below: **Service** / **Cliff** / **Graded** 1 / 0% / 0% 2 / 0% / 20% 3 / 100% / 40% 4 / 100% / 60% 5 / 100% / 80% 6 / 100% / 100%

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Participant Loans for Sole Proprietors, Partners and S-Corporation Shareholders	Prohibited transaction rules prevent sole proprietors, 10% partners and 5% S-corporation shareholders from taking participant loans.	Sole proprietors, partners and S-corporation shareholders are permitted to borrow. The provision also applies prospectively to preexisting loans.
401(k) 12-Month Waiting Period Liberalized	Participants who take hardship withdrawals from 401(k) plans are generally prohibited from making additional 401(k) deferrals for a 12-month period following the date of the hardship withdrawal.	The 12-month period will be reduced to six months.
Repeal of "Same Desk Rule"	When a company is acquired, an employee who continues working for the acquiring company is considered as though he had not terminated employment. Thus, he is not entitled to any benefit distributions that would arise due to a termination of employment until a later date when an actual termination of employment occurs.	The same desk rule is eliminated. The provision applies to distributions after December 31, 2001, regardless of when the transfer of ownership occurred.
Plans May Disregard Rollovers for Purposes of Cash-Out Amounts	Plans may require a terminated participant to take a lump sum benefit if the nonforfeitable value of his benefit does not exceed $5,000.	A plan is permitted to ignore amounts attributable to rollover contributions when determining whether the value of the benefit exceeds $5,000.
Excise Tax on Nondeductible Contributions to Defined Benefit Plans	A 10% excise tax is imposed on employers who make nondeductible contributions to qualified plans.	The 10% excise tax on nondeductible contributions will no longer apply to any contributions to a defined benefit plan up to the accrued liability full funding limit.
401(k) Investment in Employer Stock and Employer Real Property	The Taxpayer Relief Act of 1997 placed limits on investment of employee 401(k) contributions in employer real property.	The provision in the Taxpayer Relief Act of 1997 is clarified as not applying to 401(k) deferrals invested in employer real property before January 1, 1999.
Repeal of the Multiple Use Test	401(k) plans that provide employer matching contributions must satisfy the restrictive "multiple use test".	The multiple use test is repealed. This will improve test results for many 401(k) plans that have employer matching contributions.
Automatic Rollovers of Certain Involuntary Distributions	A qualified plan may distribute a participant's vested accrued benefit that does not exceed $5,000 without the participant's consent. The participant may roll this distribution over to an IRA or an employer-sponsored plan.	An involuntary distribution in excess of $1,000 will have to be directly rolled over to an IRA designated by the employer unless the participant affirmatively elects to roll over the amount to another IRA or qualified plan or elects to receive the amount in cash. The Labor Department is directed to issue safe harbor rules under which designation of an IRA by the employer and selection of an investment will satisfy ERISA's fiduciary rules. The provision is not effective until such regulations are issued.

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Participant Notification of Reduction in Benefit Accruals	Participants must be notified 15 days in advance of a plan amendment significantly reducing future benefit accruals.	The notice is still required but must contain additional information. The notice will have to provide sufficient information to allow participants to understand the effect of the amendment on their individual benefits. For plans with 100 or fewer participants, the Treasury may provide for a simplified notice or exempt such plans from the expanded notice requirement.
Rollovers Among Various Types of Retirement Plans and IRAs	403(b) assets may not be rolled over into a 401(k) plan or vice versa. After-tax contributions cannot be rolled over. Rollovers must be made within 60 days, or they are treated as a taxable distribution.	Rollovers between the various types of defined contribution arrangements (i.e., 401(k), 403(b), and governmental 457 plans) can be made without restriction. Further, taxable IRA amounts can be rolled over to a qualified plan, 403(b) annuity, or governmental 457 plan. After-tax employee contributions can be included in an eligible rollover distribution to a qualified plan or an IRA. IRS is given authority to extend the 60-day rollover period where failure to comply is due to casualty, disaster or other events beyond the reasonable control of the individual.
Elimination of IRS User Fee for Determination Letters	Plan sponsors must pay a user fee to the IRS in order to obtain a determination letter certifying that their plan is qualified.	The IRS user fee for a determination letter will now be waived with respect to some retirement plans maintained by employers with 100 or fewer employees. Plans adopted prior to 1993 will **not** be eligible for the fee waiver.

We would like to express our appreciation to the American Society of Pension Actuaries for the research that they contributed to the development of this chart.

Louis Kravitz & Associates, Inc. is the largest independent firm of retirement consultants headquartered in Southern California. We specialize in the design, implementation and administration of virtually every type of retirement plan. Our consultants, actuaries and other specialists have the experience and ability to make certain your retirement plans are properly designed, meet your needs and operate to your satisfaction. We have been dedicated to providing high quality service since our firm was founded in 1977. One of our specialties is working with our clients to maximize benefits for their key executives.