

Publications

Catch-Up Contributions: IRS Guidance and Technical Corrections

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Author: Charles W. Sherman Jr.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”) added section 414(v) to the Internal Revenue Code. This section permits participants age 50 or older to make additional pre-tax contributions, i.e., “catch-up contributions,” beginning January 1, 2002. Catch-up contributions may be made under a 401(k) plan, a SIMPLE IRA (as defined in section 408(p)), a SEP (as defined in section 408(k)), a 403(b) arrangement, and an eligible governmental section 457 plan, as well as a traditional or Roth IRA.

The IRS has issued proposed regulations, as well as a notice, providing guidance on how this new provision is to work for retirement plans and contracts, other than IRAs. See Prop. Treas. Reg. _ 1.414(v)-1 and Notice 2002-4. Further “guidance” has come from the recently enacted Job Creation and Worker Assistance Act of 2002 (Pub. L. No. 107-147, March 9, 2002) (“JCWAA”), which included pension and other technical corrections to EGTRRA. Changes to section 414(v) were a significant part of the JCWAA pension technical corrections.

The concept of allowing employees nearing retirement to make extra contributions to retirement plans has been well received and, in general, employers are eager to add catch-up contributions to their plans. However, in their attempts to implement catch-up contributions, employers have discovered that the actual operation of catch-up contributions is not as straight forward as one might anticipate from such a relatively simple concept. The proposed regulations, notice, and JCWAA technical corrections clarify some issues, but there are still unanswered questions that need to be addressed in future guidance.

A. The Administration of Catch-Up Contributions

Catch-Up Eligible Participants. Only “catch-up eligible participants” may make catch-up contributions. In order to qualify as a catch-up eligible participant, a participant must meet two requirements. First, the participant must be otherwise eligible to make elective deferrals under the relevant plan or contract. For example, a participant in a defined benefit plan could not qualify as a catch-up eligible participant with respect to the defined benefit plan. Second, the participant must be at least age 50. Participants who would attain age 50 at any time during the calendar year are treated as having attained age 50 on January 1 of that year, so their catch-up contributions will not be affected if they terminate service before they actually reach age 50. See JCWAA _ 411(o)(7) and Prop. Reg. _ 1.414(v)-1(a)(2) and (4).

Catch-Up Contributions. Catch-up contributions are elective deferrals, or contributions to an eligible governmental section 457 plan, that exceed an otherwise “applicable limit.” See Prop. Reg. _ 1.414(v)-1(a)(3). There are three types of applicable limits —

Statutory limits, such as those described in sections 401(a)(30), 402(h), 403(b)(1)(E), 404(h), 408(k), 408(p), 415 and 457.

The ADP nondiscrimination test limit (or, in the case of a SARSEP, the limit described in section 408(k)(6)(A)(iii)).

Plan limits, established at the employer’s discretion for administrative or compliance (e.g., ADP test) reasons. For example, many plans state that participant contributions may not exceed a stated percentage of compensation. The regulations expressly provide that a plan limit must be stated in the plan document.

A Treasury official has stated informally that if a plan permits catch-up contributions, it must permit catch-up contributions with respect to any of the applicable limits; for example, it cannot treat as catch-up contributions only amounts in excess of the statutory limit.

Because catch-up contributions are treated as elective deferrals, a plan generally may account for them in the same manner as other elective deferrals. Separate accounting is not required, except to determine initially whether or not an elective deferral is a catch-up contribution. A Treasury official has informally indicated that their status as elective deferrals also means that they are subject to many of the provisions generally applicable to the particular type of elective deferrals (e.g., 401(k), 403(b), or 457 deferrals), including distribution restrictions and the requirement that they must be deferred before they are currently available.

Maximum Amount of Catch-Up Contributions. Catch-up contributions must be made out of current income. This means that an individual’s aggregate elective deferral contributions (including catch-up contributions) may not exceed the individual’s compensation. In addition, catch-up contributions may not exceed either of the following limits: