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New Legislation Changes Retirement Savings Rules

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On June 7, 2001, President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") into law. EGTRRA makes significant and complex changes to many of the tax and labor law rules governing retirement savings. In general, these changes go into effect on December 31, 2001, and will sunset after 2010; absent additional legislation, pre-EGTRRA laws will apply for 2011 and beyond.

Although it is likely that EGTRRA's provisions will be significantly changed before they become effective, you should be informed about these new rules governing retirement savings plans. Some of the most significant changes to the rules affect employer-sponsored IRA contributions, employer sponsored retirement plans, and Roth contribution programs.

Employer Sponsored IRAs

EGTRRA substantially increases the maximum dollar amount of annual contributions that an otherwise eligible individual may make to his or her traditional and Roth individual retirement accounts. In addition, beginning in 2003, employers may allow employees to make traditional or Roth IRA contributions to "separate accounts" under their existing retirement plans or to newly established plans. Employees will be subject to the same contribution and deduction limits as for traditional IRAs or Roth IRAs. In a change from prior law, employers may commingle IRA contributions in the same trust as other plan contributions. A separate IRA plan, or the portion of a plan consisting of IRA separate accounts, will be exempt from many ERISA employee benefit plan requirements.

Employer Plan Contribution and Benefit Limits

EGTRRA increases many of the dollar limits applicable to contributions and benefits under various types of employer sponsored retirement plans, as well as the compensation that may be used for computing those benefits or contributions.

EGTRRA also increases the 15% of compensation employer deduction limit for contributions to profit-sharing and stock bonus plans to 25% and excludes elective deferrals (401(k), 403(b), etc.) from that limit. Elective deferrals will now be included in the compensation base for the contribution limit in the same manner as they are for "annual additions" to each participant.

Top-heavy Simplification

Prior law required qualified plans that are "top-heavy," i.e., 60% or more of the plan's accrued benefits are those of "key employees," to provide certain minimum benefits for non-key employees and accelerated vesting for all participants. EGTRRA continues those top-heavy plan requirements, but substantially simplifies and liberalizes their application. First, the definition of who is a "key employee" would be both narrowed and simplified. Many individuals with lower levels of compensation or ownership will no longer be key employees and an employee will be a key employee only if he or she meets one of the criteria for the current year, not also any one of

the prior four years considered under prior law. EGTRRA also reduces the inclusion period for accrued benefits, allows matching contributions to satisfy the minimum contribution level for non-key employees, and exempts safe harbor 401(k) plans and frozen defined benefit plans.

Roth Contribution Programs

Beginning in 2006, employers may add "Roth contribution programs" to their qualified retirement plans or 403(b) annuity programs. Under a Roth contribution program, individual employees will elect whether all or a part of their elective deferral contributions to the plan will be included in their gross income. The advantage to an employee in making a gross income inclusion election will be that all qualified distributions from the portion of the plan attributable to the Roth contribution program will be excluded from the employee's gross income; i.e., the investment earnings will never be taxed.

EGTRRA provides extra incentives for smaller employers to establish retirement plans and for lower income individuals to contribute. Employers with fewer than 100 employees are allowed a credit of the lesser of \$500 or one-half of the costs of establishing a plan and IRS determination letter user fees are eliminated for such employers.

Conclusion

EGTRRA contains a myriad of additional retirement savings provisions, including a liberalization of the rules for rollovers between different types of retirement plans for both participants and spouse beneficiaries, changes to the matching contribution vesting rules, and changes to the rollover rules. Make sure you review how these rule changes will effect your business before the new rules go into effect at the end of the year!

For a more detailed article reviewing the EGTRRA rules, please contact [Tom Foster](#).

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