How Catch-up Contributions Work in Multi-Plan Environments

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Introduction

For many years, plans governed under Sections 457 and 403(b) of the Internal Revenue Code have permitted eligible participants who did not defer their maximum amounts in past years to "catch up" - by making additional contributions later on.

Participants who did not defer the maximum they could in any given year have "underutilized deferral amounts" which may be eligible for "catch-up." Eligible participants who maximized their deferrals during their careers will not have any underutilized or unused deferrals that may be used for the traditional forms of "catch up."

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expanded the "catch-up" concept by adding the Age 50+ Catch-up, and making it available to 401(k), 403(b) and governmental 457(b) participants. Unlike the traditional forms of 403(b) and 457 Catch-up, the Age 50+ Catch-up based on age and not on past deferrals. Depending on plan type, the Age 50+ Catch-up may or may not be used with other forms of Catch-up.

There are three types of employer-sponsored retirement catch-up contributions available:

- Special 457 Catch-up
- 403(b) "Long Service" Catch-up
- Age 50+ Catch-up

Special 457 Plan Catch-up Option

Section 457 plans <u>may offer</u> participants the Special 457 Catch-up Option. This provision allows participants who did not defer the maximum amounts in prior years, the opportunity to contribute these unused or underutilized deferral amounts in any one or **all three calendar years ending prior to the calendar year of the plan's stated Normal Retirement Age (NRA).** The Plan Document must provide for this option and specify the plan's Normal Retirement Age (NRA).

The final 457 regulations permit NRA on or after the earlier of:

- Age 65 or
- The age at which participants have the right to retire and receive an unreduced immediate retirement benefit under the basic defined benefit plan of the State (or money purchase plan if the participant is not eligible to participate in a defined benefit plan) before age 70½.

Alternatively, a plan may specify another method that permits participants to select his/her own Normal Retirement Age (NRA) within a range of these ages but no later than age 70½. An employer cannot permit a participant to have more than one Normal Retirement Age regardless of the number of 457 plans the employer sponsors. However, individuals who participate in 457 plans of different employers may have different Normal Retirement Ages.

Because of the unique retirement situations within the ranks of police and firefighters, 457 plans have the option of setting the plan's Normal Retirement Age for them as low as 40 or allow qualified participants to choose a Normal Retirement Age between 40 and 70½.

The maximum amount a participant may contribute in any year using the Special 457 Catch-up limit is the smaller of two times the deferral limit in effect for the year catch-up contributions are being made or the annual limit plus any unused deferrals from previous years. The maximum annual 457 deferral limits adjusted for maximum Special 457 Catch-up contribution are:

- $26,000 - 2004
- $28,000 - 2005
- $30,000 - 2006

The following examples are based on the 457 final regulations.

Example 1
John will retire in 2007 when he reaches the plan's NRA of 65. The only deferral plan he has participated in is his employer's 457 plan, which permits eligible participants to make catch-up contributions in any or all three of the calendar years before reaching the plan's NRA. Because John did not contribute the maximum amounts he could have contributed to his 457 plan and he is in the period prior to the year he will reach his NRA, he is eligible to make catch-up contributions in 2004, 2005 and 2006 based on past underutilized deferrals. He may not make special 457 catch-up contributions in 2007.

Example 2
Sam turns 61 later in 2006 and wants to defer the maximum amount possible and has sufficient compensation to do so. The plan's NRA is 65. The annual deferral limit for 2006 is $15,000. Even though he has underutilized deferrals from prior years, he is not eligible for the Special 457 Catch-up Option in 2006 because he is not in one of the last three years **prior to** reaching the plan's NRA. He may, if the plan permits, use the Age 50+ catch-up and contribute an additional $5,000 for a total of $20,000 in 2006.

Calculating Underutilized Deferral Amounts
Unused or underutilized deferral amounts for each prior year the participant was eligible to contribute in a 457 plan are determined by subtracting the actual 457 deferrals for the year from the maximum amount the participant could have deferred for that year. Unused deferrals for all prior years are then added together to determine the total amount of underutilzed deferrals available for contribution during the Special 457 Catch-up period.

Each prior year the employee was eligible to participate in the 457 plan is used to calculate underutilized or unused deferral amounts, based on the rules that were in effect for the year being calculated. For years before 2002, elective deferrals made to other elective deferral plans regardless of employer including 403(b), 401(k) SARSEP and SIMPLE plans were treated as if they had been made to the 457 plan and reduced and in some cases, eliminated a participant's opportunity to make contributions to the employer's 457 plan. To calculate unused deferral amounts for 2002 and later years, participants no longer have to reduce 457 deferral limits by deferrals to non-457 plans.

Example
Daniel has been eligible to participate in his employer's 457 and 401(k) plan since 1997. From 1997 to 2001, he earned $50,000 each year. Every year he deferred the maximum to the 401(k) plan, which equaled or exceeded the maximum amount he could have contributed to the 457 plans. He made no contributions to his 457 plans. His plan permits eligible participants to use the Special 457 Catch-up Option. In 2002, Daniel is in the three-year period prior to the year he will reach the plan's Normal Retirement Age and wants to defer the maximum to the 457 plan using the Special 457 Catch-up Option.

	1997	1998	1999	2000	2001
457 limit	$7,500	$8,000	$8,000	$8,000	$8,500
401(k) contributions	$8,000	$8,000	$8,000	$10,500	$10,500
401(k) contributions	$8,000	$8,000	$8,000	$10,500	$10,500
Underutilized 457 deferral amounts available for Special 457 Catch-up	$0	$0	$0	$0	$0

Daniel cannot use the Special 457 Catch-up because he had no unused 457 deferrals amounts. In each of the years prior to 2002, his deferrals to the 401(k) equaled or exceeded the deferral limit permitted under 457(b).

Beginning in 2002 and after, 457 participants no longer have to offset their 457 deferrals by deferrals to non-457 plans. In 2004, a public employee who participates in both a 457 and 401(k) plan could defer up to $13,000 to each plan.

Interaction of the Age 50+ Catch-up and the Special 457 Catch-up
Generally, employers who offer the Age 50+ Catch-up are required to make this option universally available to plan participants in all plans they sponsor. If the employer offers the Age 50+ Catch-up in one 457 plan, the option must be offered in all 457 plans it sponsors.

Employers who sponsor a 40l(k) and/or 403(b) plan in addition to a 457 plan may - but are not required to - offer the Age 50+ Catch-up for these plans if they offer it in the 457 plan. Conversely, if they offer it in their non-457 deferral plans, they do not have to offer it in their 457 plans. Age 50+ Catch-up amounts are not used to calculate prior year unused deferrals for the Special 457 Catch-up and do not affect other 457 limits.

The maximum Age 50+ Catch-up amounts are:

- $3,000 - 2004
- $4,000 - 2005
- $5,000 - 2006

After 2006, Age 50+ Catch-up limit will reflect increases in the cost of living. For governmental 457(b) plans, the Age 50+ Catch up option may be used:

- Once the plan's annual or statutory deferral limit has been reached;
- In any calendar year the participant becomes age 50 or older, provided the participant is not using the Special 457 Catch-up option for that year;
- If the Age 50+ Catch-up produces a greater amount. It may be used instead of the Special 457 Catch-up Option in any or all of the three calendar years prior to the year of retirement.

403(b) Long Service Catch-up
Section 403(b) plans offer a Long Service Catch-up Option for eligible participants who did not defer maximum amounts in past years. This option gives participants with at least 15 years of service with the same employer (for example, the same school district or the same hospital; not 15 years in the state retirement system) the chance to contribute an additional amount of up to $3,000 per year above the plan's annual deferral limit. Long Service Catch-up has a $15,000 lifetime cap

and can be used at the same time as the Age 50+ Catch-up if certain ordering rules are followed.

Interaction Between the Long Service Catch-up and Age 50+ Catch-up
The ordering rules for 403(b) Catch-up require all the maximum annual deferrals including the maximum Long Service Catch-up amount for the year be contributed to the plan before making the year's Age 50+ Catch-up contribution.

Many 403(b) participants unwittingly make the Age 50+ without realizing that they must first contribute their maximum available annual deferral and Long Service Catch-up amounts before making the Age 50+ Catch-up. In these situations, the Age 50+ Catch-up counts as a Long Service Catch-up contribution and reduces the $15,000 lifetime cap. Misapplication of the Age 50+ Catch-up could cause excess deferrals because the participant has used up the $15,000 lifetime cap and is no longer eligible to make contributions. Properly applied, Age 50+ Catch-up will not reduce the lifetime cap for Long Service Catch-up.

Example 1
Jane, age 51, has worked for the same school district for 20 years and has participated in the State Teachers Retirement System for 25 years. The school district sponsors a 403(b) plan that allows teachers to make salary reduction contribution to various 403(b) annuity and custodial accounts selected by the school district. In prior years, Jane was unable to contribute her maximum permitted amounts to her 403(b) plan resulting in a number of years of underutilized deferrals. She now wants to contribute the maximum amount possible and is eligible for both the Long Service and the Age 50+ catch-up contributions.

Her current salary from the school district is $45,000. In 2004, she will be able to contribute:

Her annual deferral limit of $13,000	$13,000
$3,000 in Long Service Catch-up contributions	$3,000
Age 50+ Catch-up contribution of $3,000	+ $3,000
TOTAL CONTRIBUTION	**$19,000**

Example 2
Same as above except Jane makes the annual maximum deferral amount of $13,000 in 2004, decides not to make the maximum Long Service Catch-up ($3,000 contribution for the year) assuming she can make the Age 50+ contribution of $3,000 anyway. She is unaware that her Age 50+ catch-up contribution will now be treated as a Long Service Catch-up contribution reducing her lifetime cap from $15,000 to $12,000.

Because she made her Age 50+ contributions before making her maximum Long Service Catch-up, she runs the risk of making excess deferrals at some point in the future. Correctly applied, the Age 50+ catch-up will not reduce other 403(b) limits.

401(k) Plan Age 50+ Catch-up
Section 401(k) plans may offer the Age 50+ Catch-up, but it is available only after the participant has met the plan's maximum deferral limit or the statutory deferral limit for the year. The Age 50+ Catch-up does not count toward other 401(k) plan contribution limits.

There is a one-time Age 50+ Catch-up limit per employer except if the employer also sponsors a

457 plan. In that case, there are two separate Age 50+ Catch-up limits and no coordination or reduction between the two limits.

Example 1
Max, age 55, participates in a 401(k) plan that caps deferrals at 15% of compensation. His eligible compensation for the year is $40,000 and he defers the maximum amount permitted by the plan - $6,000 (.15 X $40,000).

Because his employer's plan also provides for the Age 50+ Catch-up option and he has reached the plan's stated maximum deferral limit, he can defer more than the $6,000 plan limit.

Example 2
Same as above except that Max's 401(k) plan has been amended and now caps deferrals at the statutory limit of 100% of compensation up to the annual statutory limit of $13,000 for 2004. Max does not meet the statutory limit (which is now the plan's limit) and may not make additional contributions using the Age 50+ provision in his plan.

Example 3
In 2006 Sam, age 53, takes a job with an employer that sponsors both a 457 plan and 401(k) plan. Both plans offer the Age 50+ Catch-up option. He has sufficient compensation to defer the following:

457 annual deferral limit of $15,000	$15,000
457 Age 50+ Catch-up contributions	$5,000
401(k) annual deferral limit of $15,000	$15,000
401(k) Age 50+ Catch-up contributions	+ $5,000
TOTAL CONTRIBUTION	**$40,000**

In 2006, an employee who participates in a 401(k), 457, and 403(b) plan who is eligible for Special 457 Catch-up, 403(b) Long Service Catch-up, and 403(b)/401(k) Age 50+ catch-up, could defer a total of $53,000 to these plans, as summarized below:

457 annual deferral limit of $15,000	$15,000
Special 457 Catch-up contributions	$15,000
403(b)/401(k) combined annual deferral limit of $15,000	$15,000
403(b) Long Service Catch-up contributions $3,000	$3,000
403(b)/401(k) combined Age 50+ Catch-up contributions	+ $5,000
TOTAL CONTRIBUTION	**$53,000**

The more traditional forms of catch-up and the new Age 50+ Catch-up contributions - if applied correctly - provide participants with opportunities to make significant contributions to their various deferral plans to save for their retirement.

Sources used for this article:
457 Final Regulations
401(k) Proposed Regulations
Final Age 50 Catch-up Regulations
ERISA Outline Book 2003 Edition, Sal A. Tripodi, J.D. LL.M

About the author:
A Plan Technical Consultant with Nationwide Retirement Solutions, Joann Albrecht, CPC, QPA, is our "go-to" person on legislative and regulatory issues that may affect the deferred compensation plans Nationwide administers.

Joann has extensive experience with both the private and public sector retirement plans including qualified plans, 403(b), and 457 plans. She is a credentialed member of the American Society of Pension Actuaries (ASPA), and serves on several ASPA committees including its Tax Exempt and Government Plans Committee and has been a speaker at several ASPA benefit conferences.