

# TAX LAW FOCUS

## SUPPLEMENT

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### TAX-QUALIFIED RETIREMENT PLANS

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("*2001 Act*") contains a number of provisions that will affect tax-qualified retirement plans. Although many of these provisions will be beneficial, none of them is effective this year. Most changes take effect for years beginning in 2002.

The table below provides a summary of some of the more significant changes made by the 2001 Act. Most of the changes will require plan amendments, even where a requirement has been entirely eliminated. At this early stage, however, it is not entirely clear how the changes are to be implemented, nor when document changes can or must be made in order to utilize the new features.

Please feel free to call any of the employee benefit attorneys listed at the end of this summary to discuss these changes and how they may specifically affect your tax-qualified retirement plans.

DESCRIPTION OF PROVISION	EFFECTIVE DATE
<b>Benefit Portability</b>	
Plans may be amended to accept rollovers from all IRAs, as well as from Section 457 plans and 403(b) annuity plans.	Distributions made after December 31, 2001
Rollovers to 403(b) annuity plans and 457 plans (if separate accounting) may be made, and plans can be amended to provide for direct rollovers to such plans.	Distributions made after December 31, 2001
The Special Tax Notice describing rollover rules and withholding must include an explanation of possibly different restrictions under transferee plans.	Distributions made after December 31, 2001
Plans may be amended to accept rollovers consisting of after-tax employee contributions.	Distributions made after December 31, 2001
IRS has been given the authority to waive the 60-day period during which rollovers must be made in the event the recipient experiences a casualty, disaster, or other event beyond his/her reasonable control.	Distributions made after December 31, 2001
Plans must provide that small benefits (over \$1,000 but not more than \$5,000) which are mandatorily distributed will be automatically transferred directly into an IRA for the affected participant, unless the participant elects otherwise; the Department of Labor must issue regulations concerning investment of the transferred funds and for designating appropriate recipient institutions.	Distributions made after final regulations are issued
Plans may include a provision to treat elective deferrals as after-tax Roth IRA contributions.	Taxable years beginning after December 31, 2005

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<p>“Deemed IRAs” will be permitted within tax-qualified retirement plans. Plans may be amended to allow voluntary employee contributions which participants may designate to be treated as if they were a regular or Roth IRA. This portion of the retirement plan would not be treated as part of the plan for ERISA and certain other purposes.</p>	<p>Plan years beginning after December 31, 2002</p>
<p><b>Changes Affecting Limits and Testing</b></p>	
<p>The defined contribution plan Section 415 limit is raised to the lesser of \$40,000 or 100% (up from 25%) of compensation. COLA will now round down to the next \$1,000 (rather than \$5,000) increment.</p>	<p>Years beginning after December 31, 2001</p>
<p>The defined benefit plan Section 415 annual benefit limit is increased to \$160,000. Decreases in the limit for early benefit commencement apply before age 62; increases in the limit for late commencement apply after age 65 (rather than the Social Security retirement age).</p>	<p>Years ending after December 31, 2001</p>
<p>The \$170,000 compensation limit will rise to \$200,000. COLA rounding will now be in \$5,000 (rather than \$10,000) increments.</p>	<p>Years beginning after December 31, 2001</p>
<p>Elective deferral limits (for 401(k) and certain other plans) will increase.</p>	<p>For taxable years beginning in:</p> <ul style="list-style-type: none"> <li>2002 - \$11,000</li> <li>2003 - \$12,000</li> <li>2004 - \$13,000</li> <li>2005 - \$14,000</li> <li>2006 and thereafter \$15,000 (plus COLA)</li> </ul>
<p>401(k) plans may provide that participants who are at least age 50 may contribute catch-up contributions. Catch-up contributions will not count in ADP testing.</p>	<p>Contributions in taxable years beginning after December 31, 2001 The catch-up amount is (for taxable years beginning in):</p> <ul style="list-style-type: none"> <li>For plans other than SIMPLE 401(k) plans: <ul style="list-style-type: none"> <li>2002 - \$1,000</li> <li>2003 - \$2,000</li> <li>2004 - \$3,000</li> <li>2005 - \$4,000</li> <li>2006 - and thereafter \$5,000 (plus COLA);</li> </ul> </li> <li>For SIMPLE 401(k) plans: <ul style="list-style-type: none"> <li>2002 - \$500</li> <li>2003 - \$1,000</li> <li>2004 - \$1,500</li> <li>2005 - \$2,000</li> <li>2006 - and thereafter \$2,500 (plus COLA)</li> </ul> </li> </ul>
<p>The multiple use test that applies in testing 401(k) plan matching contributions is eliminated.</p>	<p>Years beginning after December 31, 2001</p>
<p><b>Top Heavy Changes</b></p>	
<p>The definition of “key employee” (for top heavy purposes) (1) no longer uses the look back rule (<i>e.g.</i>, if key employee status occurred in any of the four prior plan years), (2) no longer includes the top 10 paid employees, and (3) counts officers only if compensation exceeds \$130,000.</p>	<p>Years beginning after December 31, 2001</p>

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<b>DESCRIPTION OF PROVISION</b>	<b>EFFECTIVE DATE</b>
The value of distributions previously received are counted for purposes of determining a plan's top heavy status only if made in the preceding year or, in the case of in-service distributions, in the preceding five years.	Years beginning after December 31, 2001
Matching contributions now count as top heavy minimum contributions.	Years beginning after December 31, 2001
Safe harbor and SIMPLE 401(k) plans will not be considered top heavy.	Years beginning after December 31, 2001
Certain frozen defined benefit plans may be exempt from providing top heavy minimum benefits.	Years beginning after December 31, 2001
<b>Deductions, Credits, Fees, and Funding</b>	
In determining an employer's maximum deductible contribution to a tax-qualified retirement plan, elective deferrals will not count as employer contributions.	Years beginning after December 31, 2001
An employer's maximum deductible contribution to stock bonus or profit sharing plan is increased from 15% to 25% of the compensation paid or accrued to plan beneficiaries. Compensation for this purpose will now include elective deferrals as well as any compensation imputed to a disabled participant.	Years beginning after December 31, 2001
Small employers (no more than 100 employees making over \$5,000 annually) may receive tax credits for expenses incurred in starting up and administering new retirement plans.	Costs paid or incurred in taxable years beginning after December 31, 2001, with respect to qualified plans established after December 31, 2001
Certain small employers may have relief from IRS user fees when applying for determination letters for the plan's first five years.	Determination letter requests made after December 31, 2001
Low-income employees can take a partial tax credit for up to \$2,000 for elective deferrals.	Taxable years beginning after December 31, 2001
For defined benefit plans, the 160% of current liability funding limit has been repealed and the maximum contribution deduction rules have been eased.	Plan years beginning after December 31, 2001
The rules applying an excise tax to nondeductible contributions to a defined benefit plan are modified. Sponsors of defined benefit plans who also maintain defined contribution plans may now make an election not to count defined benefit plan contributions, except to the extent they exceed the full funding limit.	Years beginning after December 31, 2001
Companies that sponsor ESOPs may take a deduction for dividends paid to an ESOP even if those dividends are reinvested in employer securities at the election of the participant (rather than only if paid out to participants).	Taxable years beginning after December 31, 2001
<b>Vesting and Hardship Changes</b>	
Plans will be required to accelerate vesting for matching contributions using either a three-year/100% or a two to six year graded vesting schedule (20% per year).	Contributions for plan years beginning after December 31, 2001 (with special delayed effective date for collective bargaining agreements)
A participant who receives a hardship distribution under a 401(k) plan will be prohibited from making elective deferrals for only six months, rather than 12 months, after receiving the hardship distribution.	Years beginning after December 31, 2001
All hardship distributions from any type of plan will be ineligible for rollover.	Distributions made after December 31, 2001

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<b>Changes Affecting Distributions</b>	
The Secretary of the Treasury must modify the life expectancy tables used in determining minimum required distributions in order to reflect current life expectancies.	When regulations are issued
Defined contribution plans will have relief from the requirements to continue to provide certain optional forms of benefits following asset transfers, plan mergers, and consolidations.	Years beginning after December 31, 2001
The Secretary of the Treasury must issue regulations that make the anti-cutback rules inapplicable to any plan amendment that reduces or eliminates benefits or subsidies which create significant burdens or complexities for plans or participants.	Regulations to apply to plan years beginning after December 31, 2003 (or earlier as specified in any regulations)
The "same desk rule" is eliminated so that distributions may be made on any "severance from employment" (some terminations may still not be a "severance" for this purpose).	Distributions made after December 31, 2001
Plans using the small benefit cash out rules (forcing distributions less than \$5,000 to be paid immediately to terminated participants) may disregard rollover amounts in determining whether an account is less than \$5,000.	Distributions made after December 31, 2001
<b>Miscellaneous Changes</b>	
It will no longer be a prohibited transaction for a Subchapter S corporation shareholder, a 10% or more partner, or a sole proprietor to obtain a participant loan from a plan providing for loans.	Years beginning after December 31, 2001
A new excise tax will apply to pension plans that do not timely and properly notify participants about reductions in future benefit accruals. The penalty is generally \$100 per affected participant and alternate payee for each day of noncompliance. The amendment will take effect, however, unless the failure to provide the notice was "egregious." (Under current law, the amendment is ineffective unless proper notice is given.)	Amendments taking effect on or after the date of enactment
The Secretary of the Treasury must modify the coverage regulations that apply to tax exempt entities so that employees eligible to make contributions under 403(b) annuity plans are treated as excludable employees for purposes of a related entity's 401(k) or 401(m) coverage testing.	When regulations are issued, retroactive to the plan year beginning in 1997
Employer-provided retirement advice will now be treated as a fringe benefit, the value which is excludable from employees' incomes, so long as the advice is provided on a nondiscriminatory basis.	Years beginning after December 31, 2001
S Corporation ESOP allocations will no longer be permitted to those who are deemed to own 20% or more of the sponsor's stock.	Plan years beginning after December 31, 2004, for existing ESOPs, or, for ESOPs established or S elections made after March 14, 2001, plan years ending after that date

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