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EGTRRA Spells Extra Tax Relief for Colleges and Universities

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The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), signed into law on June 7, includes a substantial array of reforms related to retirement savings—66 separate provisions in all. The benefits of these reforms to academic faculty and staff will improve over the 10-year life of the law, as contribution limits and other ceilings increase.

The retirement plan provisions described in this article are scheduled to go into effect on or after January 1, 2002. During the next six months, human resource professionals need to become familiar with EGTRRA so they can make any changes necessary to comply with the new law before it takes effect, and introduce innovations to their retirement programs that will capture the full benefits of the new law for faculty and staff.

Greater Simplicity, Improved Savings Opportunities

Beginning January 1, 2002, the act repeals two major requirements applicable to 403(b) plans maintained by colleges, universities, other nonprofit organizations, and governments: the 3-step Maximum Exclusion Allowance (MEA) under IRC Section 403(b)(2), which is cumbersome to calculate and difficult to explain to faculty and staff; and Alternative Limits A, B, and C under IRC Section 415(c)(4), currently available to educational institutions, hospitals, home health service agencies, certain churches, and health and welfare organizations. The amounts that may be contributed to 403(b) plans will now generally become subject to the same limitations as 401(k) plans, which will reduce the regulatory burden on 403(b) plan administrators. Several other amendments are worth noting:

- **Current statute:** IRC Section 401(a)(17) limits the amount of compensation that may be taken into account to determine how much can be contributed under qualified plans.
 - **What has changed:** EGTRRA increases the limit by 18 percent beginning January 1, 2002, from \$170,000 to \$200,000. This limit will be indexed in \$5,000 increments, rather than \$10,000 as under the current law. The raising of this limit is good news for many colleges and universities where senior administrators and faculty have been restricted in the amount that could be contributed to their plans, ever since the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) lowered the maximum eligible compensation that could be taken into consideration for such contributions.

- **Current statute:** IRC Section 415 (c)(1) limits the amount of permissible contributions to defined contribution plans.
 - **What has changed:** EGTRRA increases the limit beginning January 1, 2002, from the lesser of \$35,000 or 25 percent of the participant's compensation to the lesser of \$40,000 or 100 percent of the participant's compensation. The dollar limit is subject to indexing in \$1,000 increments rather than \$5,000 as under the current law. The increase of the limit from 25 percent of compensation to 100 percent simplifies administration and communication to faculty and staff. That change, combined with the increase of the dollar limit, may encourage additional retirement savings.
- **Current statute:** IRC Section 402(g) limits the amount that may be contributed through salary reduction (pretax basis).
 - **What has changed:** EGTRRA increases the limit beginning January 1, 2002, from \$10,500 to \$11,000. This limit will increase \$1,000 each year until it reaches \$15,000 in 2006. It will then be indexed in \$500 increments. With the elimination of the MEA calculation, plan sponsors will now need to comply with only two limits on the amount that a faculty or staff member may contribute on a pretax basis (salary reduction).

EGTRRA adds two new sections to the Internal Revenue Code that apply to 403(b) plans, 401(k) plans, and 457 plans:

- IRC Section 414(v), a new section of the code, permits individuals who have attained age 50 by the end of the plan year to make a catch-up elective deferral in excess of all other applicable limits and without regard to nondiscrimination requirements (if made available to all eligible participants).
 - EGTRRA sets the catch-up amount at \$1,000 in 2002, with annual increases of \$1,000 until 2006. It will then be indexed in \$500 increments. It is very important to note, however, that the legislation let stand the IRC Section 402(g)(8) alternative limit, also known as the "15-year rule." That alternative was first made available under the Tax Reform Act of 1986 (TRA '86) to educational institutions, hospitals, home health service agencies, certain churches, and health and welfare organizations. The "15-year rule" under Section 402(g)(8) may be more beneficial for faculty or staff who have completed 15 or more years of service with your organization than the new catch-up provisions under IRC Section 414(v).
- IRC Section 25B, a new section of the code, attempts to expand retirement plan coverage by providing a nonrefundable tax credit for years 2002 through 2006 to certain taxpayers with incomes at or below specified levels. The credit is not available except to the extent that the taxpayer is required to pay income tax (has a tax liability).
 - EGTRRA sets the amount of the tax credit at 10 percent, 20 percent, or 50 percent on up to \$2,000 in elective deferrals and voluntary after-tax contributions to an IRA, 401(k), 403(b), or eligible 457(b)

governmental plans. The amount of the tax credit is based on the individual's adjusted gross income (AGI) and tax filing status. Colleges and universities traditionally have struggled to attract new employees and low- and moderate-income staff and faculty to participate in their tax-deferred annuity plans. This new provision should be communicated to encourage these individuals to participate in the plan even though the tax credit is requested by the taxpayer, not by the plan sponsor.

EGTTRA also amended IRC Section 132 to exclude from taxable income the value of retirement planning or advice provided in a nondiscriminatory manner to faculty and staff and their spouses in regard to IRC Section 401(a), 403(a), 403(b), nonqualified plans, and employer-sponsored IRA plans. More and more institutions have added financial planning programs to their array of benefit programs or are contemplating the addition of such a program. This new provision adds value to this type of benefits program because the value of the services provided is not considered a taxable benefit.

Action Steps to Prepare for 2002

Plan Administration

The changes described in this article will ultimately simplify retirement plan administration. In the short term, colleges and universities need to take several steps to comply with EGTRRA:

- contact your institution's legal counsel and consultants from your retirement plan service providers to discuss how EGTRAA will affect your institution's retirement plan.
- formulate new procedures.
- revise enrollment/election forms.
- implement necessary changes to your Human Resources Management System (HRMS).
- adjust the projected benefits pool.
- update plan documents, summary plan descriptions (SPDs) and other communication materials (i.e., Web site, and brochures) in a timely manner to assure consistency in content.
- coordinate new processes/procedures with your retirement plan service providers.
- review your policy regarding contributions on earnings in excess of the 401(a)(17) limit on compensation. After the passage of OBRA '93, many organizations put into place Section 457 plans or provided faculty and staff with cash equal to the amount that would have been contributed to the plan. If that is the policy at your institution, is it still designed to meet the needs of the institution in recruiting, retaining, and retiring key employees?
- maintain records of prior employee elective deferrals to the 403(b) plan that are necessary to complete the 402(g)(8) "15-year rule" calculations, as well as records pertaining to contributions made by employees under this alternative limit.

Communication and Education

Now is the time for institutions to take advantage of the widespread media coverage of the largest tax reduction legislation in 20 years. As soon as possible, faculty and staff need to be apprised of the new provisions and how the changes can make retirement savings even more attractive. The following four steps offer a starting point for beginning to educate employees about their retirement plan options and incentives under the new law:

1. Develop and offer pre-retirement planning seminars explaining the implications of the new tax law for pension plans.
2. Emphasize the provisions that affect your retirement plan and how the law increases the amount employees can save for retirement.
3. Make sure that faculty and staff in the baby boom generation (50 or older) are aware of the new opportunity permitted under the statute to increase their contributions to your tax-deferred annuity plan over and above the previous applicable IRC limits. Section 402(g)(8)—the 15-year rule—presents an opportunity to highlight a unique feature of some 403(b) plans not found in 401(k) plans. This provision can be more favorable for faculty and staff who have completed 15 or more years with your organization (until the year 2004) than the new catch-up provisions under IRC Section 414(v.)
4. Make special efforts to reach out to low- and moderate-income individuals working at your institution, and make them aware of the new tax credit under IRC Section 25B.

A Look to the Future

Beyond the short-term benefits of EGTRAA lies an important opportunity beginning in the year 2006. Beginning that year, organizations may establish a Roth 403(b) plan for faculty and staff. Plan participants will be able to make after-tax contributions to the plan and the contributions can grow without incurring federal income tax. Over the next few years, as recruitment, retention, and retirement patterns and needs continue to change at colleges and universities, plan sponsors will need to evaluate whether to add a Roth 403(b) plan as a supplement to their traditional retirement plan.