PROVISIONS & UPDATES OF THE ECONOMIC GROWTH AND TAX RECONCILIATION RELIEF ACT (EGTRRA)

Provided below is a brief summary of key EGTRRA provisions related to retirement plans available to CSU employees. These provisions were effective January 1, 2002, prior to the passage of California conforming legislation. All provisions of EGTRRA will "sunset," or not apply in years beginning after December 31, 2010.

Campuses are advised to refer employees to their tax advisors, or financial planners for assistance in understanding these tax laws.

Questions regarding the 401(k) and 457 plans should be directed to the Savings Plus Program office at (866) 566-4777, or via the Department of Personnel Administration's web site at http://www.dpa.ca.gov.

1. Elective Deferral Limits Increased

The Internal Revenue Code (IRC) establishes specific limits that govern the amounts an individual can contribute to pre-tax salary reduction retirement plans, such as 403(b), 401(k), and 457 plans. For tax years beginning after December 31, 2001, only two limits will apply: the IRC Section 402(g) "elective deferral limit" and the IRC Section 415(c) "percentage of compensation" limit. For 2002, the limits will increase as follows:

Plan Type	Limit
403(b), 401(k) and 457	100% of compensation, or maximum $11,000 per year.

Additionally, contributions to a 457 plan no longer have to be offset by contributions to a 403(b), or 401(k) plan. For example, for tax year 2002, a participant could elect to contribute up to $11,000 to a 403(b), or 401(k) plan AND up to $11,000 to a 457 plan, for a total contribution of up to $22,000.

The maximum elective deferral limit will increase incrementally over the next five years, as follows:

Tax Year	Limit
2002	$11,000
2003	$12,000
2004	$13,000
2005	$14,000
2006 and thereafter	$15,000

For tax years beginning after December 31, 2006, the elective deferral limit will be adjusted for inflation in $500 increments.

Note: The IRC Section 402(g)(8) "catch-up" provision is retained.

2. 457 Plan Changes

EGTRRA includes a number of provisions unique to 457 plans. As stated above, elective deferrals to a 403(b) or 401(k) plan will not count against the 457 plan dollar limit, and the percentage of compensation limit on elective deferrals is increased to 100% of compensation. Additional changes include:

► Expanded Catch-up Provision. The 457 plan has a special provision that allows eligible participants to "catch-up," or exceed the annual elective deferral limit during the last three years ending before the plan's normal retirement age. EGTRRA changes the 457 catch-up limit to an amount equal to up to twice the regular elective deferral limit during each of the three years of the catch-up period as follows:

$22,000 in 2002
$24,000 in 2003
$26,000 in 2004
$28,000 in 2005
$30,000 in 2006 - thereafter indexed for inflation.

The 457 catch-up limit is offset by the current and prior years' deferrals to the 457 plan made since the employee began participation.

► Minimum Distribution Rules. The special minimum distribution rules applicable only to 457 plans have been repealed. This provision makes distribution of funds more flexible. The doctrine of "constructive receipt" has been repealed. 457 plans are now subject to the minimum distribution rules applicable to qualified plans. Distributions will now be taxed only as paid. The new law allows for payout upon retirement or separation from service, with no age requirement and no tax penalty. It eliminates the irrevocable election requirement of 457 plan distributions. Under certain conditions, individuals currently receiving 457 distributions may be able to change their election and roll over funds to other plans. Under the new law, the "made available" rule would no longer apply to governmental 457 plans (but would continue to apply to 457 plans of tax-exempt employers) after 2001.

Please Note: the 457 plan offered by the Department of Personnel Administration's Savings Plus Program is a governmental 457 plan, thus, guidelines for tax-exempt 457 plans do not apply.

► Division of 457 Plan Benefits Upon Divorce. Previously, the IRC did not address how benefits under 457 plans were taxed upon divorce. EGTRRA clarifies and simplifies rules for splitting, or transferring a 457 account in the event of divorce. Effective for transfers, distributions and payments after December 31, 2001, the qualified plan tax rules for Qualified Domestic Relations Orders (QDROs) will apply to 457 plan divorce distributions. In the case of qualified plans, payments to a former

spouse under a QDRO may be made before the participant is entitled to a distribution. The account can be divided and distributions to an ex-spouse would be available immediately. Only the recipient of the funds would be taxed, and only on the amounts received.

3. 403(b) Plan Change

The Maximum Exclusion Allowance (MEA) is part of a complex set of rules used to determine the maximum amount a participant can contribute in any given year to a 403(b) account. Effective January 1, 2002, the MEA calculation has been eliminated and replaced with new contribution limits similar to those for 401(k) and 457 plans. Alternatives A, B and C limits have also been repealed. Effective January 1, 2002, 403(b) plan participants will be subject to only the 402(g) elective deferrals limit ($11,000 for 2002), and the overall IRC Section 415(c) limit (100% of adjusted gross income).

4. Additional Catch-up Contributions – 403(b), 401(k) and 457 Plans

►15 Year Catch-Up Election For 403(b) Plans. IRC Section 402(g)(8) provides for a "catch-up" election, which permits certain long-term employees to increase their elective deferrals over the 402(g) limit. Under this catch-up election, employees with 15 or more years of service with the same employer may be eligible to contribute up to an additional $3,000 per year, beyond the IRC Section 402(g) limit, for up to 5 years, or a lifetime maximum of $15,000.

The "15-year" catch-up election is directly tied to the 402(g) limit, and is the lesser of the 402(g) limit plus $3,000, or $15,000 minus all prior years' catch-up amounts. Employees who have deferred more than $5,000 per year (i.e., at least $75,000 over their 15 years of service) are not eligible for this catch-up election. Contributions under this catch-up election cannot exceed $14,000 for 2002 ($11,000 402(g) limit plus $3,000). This provision will still be available to eligible employees.

►Over Age 50 Catch-Up Election. IRC Section 414(v), added under EGTRRA, creates a new catch-up provision available to individuals age 50 and older before the end of the plan year, and allows them to make additional pre-tax elective deferrals to a 403(b), 401(k), or 457 plan over and above the regular contribution limits, without regard to previous contributions. This new catch-up provision does not require a calculation worksheet.

EGTRRA makes this new catch-up an optional provision and is applicable for eligible participants in the CSU 403(b) plan and the State's 401(k) and 457 plans. These catch-up contributions do not count toward any dollar limitation, and qualified plan discrimination tests, except that the total of all elective deferrals cannot exceed 100 percent of an employee's total compensation (including deferrals).

The maximum amount of these additional contributions is phased-in from 2002

through 2006 in $1,000 increments until it reaches $5,000. In 2002, a participant can defer $1,000 to the 403(b) or 401(k) and an additional $1,000 to a governmental 457(b) plan. In other words, the age-50 catch-up amount for a governmental 457(b) plan is separate from the age-50 catch-up amounts to 403(b) and 401(k) plans. Thereafter, it will be indexed to inflation in $500 increments for later years. Unlike the 402(g)(8) "15-year" catch-up provision for 403(b) plans, the new catch-up provision is available to all individuals over the age of 50 by the end of the plan year, who meet the criteria, regardless of whether they qualified for the IRC Section 402(g)(8) catch-up exceptions under the old law.

To qualify for this new catch-up provision, individuals must first maximize the elective deferral limit allowed under the plan, or law for that year. Additional catch-up contributions are limited as follows:

$1,000 beginning in 2002
$2,000 for 2003
$3,000 for 2004
$4,000 for 2005
$5,000 for 2006 and thereafter.

Please note: Previously, EGTRRA had a non-duplication rule preventing 457 plan participants from combining the IRC Section 414(v) "age-50" catch-up with the IRC Section 457(b) "times two elective deferral" catch-up during the last three years before retirement. In accordance with the Job Creation and Worker Assistance Act of 2002, this rule has been modified and 457 participants are now entitled to make catch-up contributions up to an amount equal to the greater of (i) the age-50 catch-up limit or (ii) the 3-year catch-up limit.

5. Tax Credit for Low-Income Contributors - IRC Section 25B

Under EGTRRA, low to moderate income individuals (defined as those making up to $50,000 in the case of a joint return) will receive a temporary "nonrefundable" federal income tax credit of up to $2,000 to match their salary reduction contributions to 403(b), 401(k) and 457 plans and Individual Retirement Accounts (traditional, Roth, or SIMPLE). The tax credit, designed to encourage lower-income and middle-income individuals to begin saving for their retirement, only reduces taxes otherwise owed and does not cause a refund. Qualified individuals may use the credit in tax years 2002 through 2006.

The tax credit will range from 10 percent to 50 percent of the amount contributed, up to a maximum of $2,000, depending on adjusted gross income (AGI). The credit is in addition to any deduction or exclusion, and does not change the otherwise applicable tax treatment of elective deferrals and contributions. The amount of the credit decreases as an individual's income increases and will be available in three tiers as follows:

Joint Tax Filers		Single/Married Filing Separately		Head of Household Tax Filers	
AGI	Percent	AGI	Percent	AGI	Percent
Up To $30,000	50%	Up to $15,000	50%	Up to $22,500	50%
$30,001 - $32,500	20%	$15,001 $16,250	20%	$22,501 - $24,375	20%
$32,501-$50,000	10%	$16,251 - $25,000	10%	$24,376 - $37,500	10%
Over $50,000	0%	Over $25,000	0%	Over $37,500	0%

Certain individuals, including full-time students, are not eligible. Employees should be referred to their tax or financial advisors for advice about calculating and claiming the credit.

6. Hardship Withdrawals For 403(b), 401(k) and 457 Plans

In cases of extreme financial need, employees may be permitted to access some or all of their elective deferrals. A withdrawal qualifies as a hardship distribution under the federal rules if it meets two conditions. First, the participant must have an "immediate and heavy financial need." Second, the withdrawal must be necessary to satisfy the need. Under a regulatory "safe harbor," an individual who obtains a hardship distribution of elective deferrals generally must be suspended from participation in the plan(s) for 12 months after receipt of the hardship distribution. Effective for years beginning after December 31, 2001, Treasury regulations reduce from 12 months to six months the period during which an employee must be prohibited from making elective contributions. For hardship withdrawals taken during 2002, the penalty suspension period would expire six months following. For example, a participant who takes a hardship withdrawal in May 2002 would be restricted from participating until November 2002.

Upon notification of a hardship withdrawal, campuses are required to cancel salary reduction agreements for the specified penalty period. All hardship distributions, including amounts attributable to salary reduction contributions, and non-elective contributions, are ineligible for rollover.

7. Purchase of Service Credit

Effective 2002, employees who are eligible to purchase additional service credit in their defined benefit pension plan (e.g., CalPERS retirement system) may do so using funds from a 403(b), or 457 plan. Under this provision, funds can be transferred to purchase service credit, or to repay the defined benefit plan for a prior refund of employee contributions, effective for trustee-to-trustee transfers made after 2001. Employees should be referred to CalPERS, or their financial advisor to determine whether this option will be beneficial.

8. Defined Benefit Plan Limit Increased – IRC §415(b)

Section 415 of the Internal Revenue Code (IRC) places a dollar limit on the annual benefit an individual can receive from a tax-qualified pension plan, such as CalPERS. The current annual benefit under defined benefit plans is limited to the lesser of

$140,000, or 100% of average compensation over the highest three years of employment. Special rules generally require actuarial reduction of the 415(b) dollar limit for benefits payable prior to normal Social Security Retirement Age.

Effective for years ending after December 31, 2001, the maximum pension benefit a retiree can receive under a defined benefit plan will increase to $160,000. This limit will be indexed in $5,000 increments for inflation. The "early retirement" age will be lowered to 62, and the normal Social Security retirement age, for purposes of applying the limit, will be 65. Actuarial reduction will be required only for benefit commencement prior to age 62. The "100% over three years" limit is eliminated.

CalPERS has adopted a "Replacement Benefits Plan," applicable to eligible CSU employees, which will, to the extent allowed by federal and state laws, replace any benefits that exceed IRC Section 415(b) limits. This CalPERS-paid benefit is a manual payment process that is made on a quarterly basis.

9. Compensation Limit Increased Code – IRC §401(a)(17)

Previously, under IRC Section 401(a)(17), the annual compensation that may be taken into account for determining contributions and benefits under a retirement plan, applying the deduction rules and for nondiscrimination testing purposes, was limited to $170,000, indexed in $10,000 increments for 2001. Beginning in 2002, the limit will increase to $200,000, indexed in $5,000 increments in subsequent years. However, CSU employees who first became members of CalPERS prior to July 1, 1996, are exempted from any compensation limit.

10. Rollovers

Previously, 403(b) funds could only be transferred directly to another 403(b) plan, or an IRA. EGTRRA provides more asset portability. Under EGTRRA, employees are able to roll over distributions from a 403(b) to an IRA, or to/from another 403(b), 401(a) or governmental 457(b) plan. For distributions made after December 31, 2001, eligible rollover distributions from a qualified retirement plan, 403(b) annuity, IRA and governmental 457(b) plan can generally be rolled over to any of these plans. The direct rollover and withholding rules will apply to distributions from a governmental 457 plan, not a tax-exempt 457 plan.

Similarly, employee after-tax distributions from an IRA generally can be rolled over into a 403(b), 401(k) or governmental 457(b) (defined contribution plans). This provision does not require plans to accept rollovers of after-tax contributions unless the plan provides separate accounting for such contributions (and earnings thereon). Not all plans will have the ability to offer this feature. Employees should be encouraged to contact their investment companies with questions regarding this provision.

Additional provisions include:

► Waiver of 60-Day Rule. Under previous law, unless a rollover was done directly from one plan to another, a participant had 60 days from the date of receiving a distribution to roll it over. If the rollover was not done within the 60-day limit, the distribution was subject to taxation. There are two exceptions that apply: the participant is on military service in a combat zone, or the President has declared a disaster. For distributions made on or after January 1, 2002, the new law permits the Secretary of the Treasury to waive the 60-day limit if its application "would be against equity, or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to the requirement."

11. CIRS COMPENDIUM REPORTS FOR CONTRIBUTION TRACKING

Human Resources Administration staff is working with HR-ISA to revise existing CIRS Compendium reports (PDC5209-1 (G92) and PDC5214-2 (G9)) to help campuses track contribution limits. Tracking requirements include: $11,000 maximum elective deferral, $22,000 deferral limit, and additional deferrals from all sources (i.e., new "age 50" catch-up and current "15-year" catch-up). A complete listing of the revised CIRS tracking reports, and samples of each, will be distributed in an upcoming Technical Letter. The CSU 403(b) Tax Sheltered Annuity brochure will be revised and distributed to campuses under separate cover. Internal Revenue Service (IRS) Publication 553 highlights the changes of EGTRRA and is currently available on IRS' web site address at: http://www.irs.ustreas.gov.