



Advantages to SEPs, SIMPLE IRA plans, and 401(k) plans of allowing “catch-up contributions” by individuals who have reached age 50

We would like to bring to your attention the potential advantages of amending your business's 401(k) plan, SEP, or SIMPLE IRA plan, to allow employees who will have reached age 50 by the end of a year to make “catch-up contributions” in that year.

The opportunity for an employee to make “elective deferrals,” i.e., to contribute a portion of his compensation, on a tax-deferred basis, to a 401(k) plan, SIMPLE IRA plan, simplified employee pension (SEP), 403(b) plan, and/or governmental section 457 eligible deferred compensation plan, is one of the most attractive means of saving for retirement. But the Code specifically provides annual limits on the amount of elective deferrals, and indirectly limits elective deferrals through nondiscrimination rules and overall limits on contributions. In addition, many plans provide a cap, usually as a percentage of compensation, on the amount that an employee can contribute to the plan on a tax-deferred basis.

Under recent legislation, plans providing for elective deferrals may allow employees who will be age 50 by the end of a year to make additional “catch-up contributions” in that year, regardless of otherwise applicable limits.

The maximum annual catch-up contribution for plans *other than* SIMPLE 401(k) plans or SIMPLE IRA plans is \$5,500 for 2009. This amount will be adjusted for inflation in later years. The maximum annual catch-up contribution for SIMPLE 401(k) plans and SIMPLE IRA plans is \$2,500 for 2009. This amount also will be adjusted for inflation in later years.

Catch-up contributions provide a significant tax deferral opportunity to employees over age 50—even if the over-age-50 employees are mostly highly compensated. That is, catch-up contributions are *not* taken into account in applying most of the nondiscrimination rules that otherwise apply to 401(k) plans, SEPs, and SIMPLE IRAs. Thus, an eligible employee would be able to defer compensation up to the catch-up contribution maximum amount, in addition to the amount that the employee would otherwise have been able to defer without the catch-up provision.

The right to make the same catch-up contribution election *does* have to be *available* to all eligible employees, if the employer provides for catch-up contributions under any of its plans. But again, there are no adverse tax consequences if the employees that actually elect to make catch-up contributions are mostly highly compensated employees.

Unlike catch-up contributions, any contributions that an employer makes to *match* catch-up contributions must still meet all the nondiscrimination rules that otherwise would apply. Also, catch-up contributions for *prior years* are taken into account in applying the top heavy rules and minimum coverage rules, for plans subject to these rules, e.g., 401(k) plans.

Please contact our office if you would like to discuss how these changes in the law can benefit you.

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