Annual Limit on Elective Deferrals

Part I of this Fact Sheet describes the Internal Revenue Service (IRS) annual limit on elective deferrals and explains how this limit may affect Thrift Savings Plan (TSP) contributions made to the accounts of certain highly paid FERS employees. Part II explains how this limit may affect employees covered by either FERS or CSRS* who are contributing to the TSP and another tax-deferred retirement plan.

Part I: Limits on Contributions to Your TSP Account

What are elective deferrals?

Elective deferrals are tax-deferred amounts that you choose to contribute to a plan instead of receiving these amounts as pay. Because these contributions are tax-deferred, they are not included in your taxable gross income for the year in which they are contributed. Your employer makes these contributions on your behalf under a qualified cash or deferred arrangement (as defined in section 401(k) of the Internal Revenue Code (Tax Code)).

For TSP participants, Employee Contributions are considered to be elective deferrals. Elective deferrals do not include Agency Automatic (1%) or Agency Matching Contributions because these contributions are not considered part of your pay.

What is the annual limit on elective deferrals?

Section 402 of the Tax Code limits the amount of income that you may elect to defer under all cash or deferred arrangements during a tax year. (For most employees a tax year is January 1 through December 31.) This limit is indexed to the annual cost-of-living adjustments referred to in the Tax Code and may change from year to year. The IRS announces the annual limit on elective deferrals each year. Information on the IRS elective deferral limit is available from your personnel office.

What happens to my Employee Contributions when the annual limit is reached?

When the annual limit is reached, your Employee Contributions must be suspended for the remainder of the tax year. The TSP System will not allow any Employee Contribution to be processed that will cause the total amount of Employee Contributions for the year to exceed the annual limit. Your agency payroll office must ensure that your Employee Contributions automatically resume during the first pay period paid in the following tax year.

---

* FERS refers to the Federal Employees' Retirement System, the Foreign Service Pension System, and other equivalent Government retirement plans. CSRS refers to the Civil Service Retirement System, including CSRS Offset, the Foreign Service Retirement and Disability System, and other equivalent Government retirement plans.

WEB 1.0 10/4/96 OC 91-13 (Revised 1/95)

What happens to my Agency Matching Contributions when Employee Contributions are suspended because the annual limit has been reached?

Your Agency Matching Contributions are also suspended when the annual limit on elective deferrals has been reached. Agency Matching Contributions are based upon the amount of Employee Contributions that you make each pay period. Thus, if there are no Employee Contributions in a pay period, there can be no Agency Matching Contributions.

What happens to my Agency Automatic (1%) Contributions when my Employee and Agency Matching Contributions are suspended?

Your agency must continue to submit Agency Automatic (1%) Contributions even though your Employee and Agency Matching Contributions are suspended. As a FERS employee, you are entitled to receive Agency Automatic (1%) Contributions whether or not you make Employee Contributions.

What if I have made retroactive Employee Contributions during this tax year?

The total amount of your Employee Contributions during a tax year cannot exceed the annual limit on elective deferrals. This total includes all retroactive or makeup contributions that may have been deducted from your pay during the current tax year, even though they should have been deducted from your pay in a prior tax year.

Does it make a difference if I reach the annual limit before the end of the year?

Yes. If you are a high-salaried employee, you should keep the annual contribution limit in mind when deciding how much you will contribute to your TSP account each pay period. If you reach the annual maximum too quickly, you could lose the opportunity to receive some Agency Matching Contributions because you only receive Agency Matching Contributions on the first 5 percent of your basic pay that you contribute **each pay period**. If you reach the annual limit before the end of the year, your contributions (and consequently your Agency Matching Contributions) will stop. (The amount you could lose in Agency Matching Contributions would, in all likelihood, be far greater than the value of the added earnings you might receive by making Employee Contributions sooner.) The example on Page 3 illustrates how an employee can lose matching money if the limit is reached before the end of the year.

How can I make the maximum Employee Contribution and still receive the maximum Agency Matching Contribution each year?

In order to receive the maximum Agency Matching Contribution, you must contribute at least 5 percent of the basic pay you earn **each pay period** during the tax year. (The first 5 percent of your basic pay each pay period is matched — dollar for dollar on the first 3 percent and 50 cents on the dollar for the next 2 percent.)

Once you ensure that you are contributing at least 5 percent each pay period, you can contribute additional amounts in one of two ways. You can divide the additional amount evenly over the remaining pay periods in the year. Or, you can contribute up to 10 percent in the first half of the year (so that more of your money can be in your account gaining earnings over the remainder of the year) and then adjust your contributions during the July TSP election period. In July, you would elect to contribute a specific dollar amount that allows you to contribute the maximum amount to your account and also receive the maximum amount of Agency Matching Contributions. You can adjust your TSP contributions during either of the TSP Open Seasons.

The worksheets on Pages 4, 5, and 6 can help you figure out how to maximize your Agency Matching Contributions and determine the specific dollar amount you could contribute using either option.

Example

For tax year 1995, the annual limit on elective deferrals was set at $9,240. This example shows 1995 TSP contributions for two employees. Employee A contributes 10 percent each pay period and reaches the annual limit in 20 pay periods. Employee B uses a strategy of electing a whole dollar amount to spread out contributions and receive matching money in every pay period. The example was computed using an annual pay rate of $120,000 for the first two pay periods of 1995 and an annual pay rate of $123,000 for the last 24 pay periods of 1995. (For these two employees, the pay raise that is effective the first full pay period in January was not actually paid until February 1, 1995, which is the third pay date in 1995.) The salary per pay period is computed by dividing the annual salary by 2,087 (standard hours in a year), rounding the result to the nearest cent, and multiplying it by 80 (standard hours in a pay period).

	Employee A	Employee B
Salary per pay period		
2 pay periods based on $120,000/yr	$4,600.00	$4,600.00
24 pay periods based on $123,000/yr	$4,715.20	$4,715.20
Maximum possible Employee Contribution per pay period		
2 pay periods based on $120,000/yr	$460.00	$460.00
24 pay periods based on $123,000/yr	$471.52	$471.52
Maximum possible Agency Matching Contribution per pay period		
2 pay periods based on $120,000/yr	$184.00	$184.00
24 pay periods based on $123,000/yr	$188.61	$188.61
Employee Contribution actually elected		
2 pay periods based on 1994 election	2 @ 10% = $460.00	2 @ 10% = $460.00
balance based on January 1995 election	18 @ 10% = $471.52	24 @ whole dollar amount = $347.00
Number of pay periods until $9,240 limit is reached	20*	26**
Total Employee Contributions made in 1995	**$9,240.00**	**$9,240.00**
Total Agency Matching Contributions received in 1995	**$3,762.98**	**$4,894.64**

Thus, Employee B, who changed the TSP election during the November 1994 – January 1995 Open Season to **a whole dollar amount** for the rest of 1995, would receive **$1,131.66 more** Agency Matching Contributions than Employee A, who did not change the TSP election during the Open Season and continued to contribute 10 percent of basic pay each pay period until the annual limit was reached.

Note: You may choose to contribute a higher amount during the first half of the year in order to get more of your money at work sooner in the TSP. But some employees who contribute a higher amount during the first half of the year may not be able to contribute enough each pay period during the second half of the year to receive full Agency Matching Contributions each pay period. (See the attached worksheets.)

---

* Employee Contribution for the 20th pay period of the pay year must be reduced to $304.16. (This is equivalent to more than 6 percent of basic pay; thus, the employee receives the maximum Agency Matching Contribution for the pay period.)

** Employee Contribution for the 26th pay period of the pay year must be reduced to $339.00. (This is equivalent to more than 7 percent of basic pay; thus, the employee receives the maximum Agency Matching Contribution for the pay period.)

Worksheets to Maximize the Amount of Agency Matching Contributions

In order to receive the maximum amount of Agency Matching Contributions every pay period throughout the pay year, you must contribute at least 5 percent of your basic pay **each pay period**. Certain high-salaried employees may have to adjust the level of their contributions during both TSP Open Seasons to ensure that at least 5 percent of basic pay is contributed each pay period throughout the entire year.

Consequently, you will need to determine the maximum Employee Contribution you can make each pay period to receive the maximum Agency Matching Contributions (see Worksheet A). You may decide to spread your Employee Contributions evenly over the remaining number of pay periods in the current year (as illustrated by the calculations in Worksheet B) or you may decide to make more Employee Contributions earlier in the year (as illustrated by the calculations in Worksheet C).

Worksheet A – Calculating your contribution limit

Example. A high-salaried employee wants to maximize the amount of Agency Matching Contributions for 1995. The employee's salary was $120,000 during the first two pay periods in 1995 and $123,000 during the rest of the year. The employee's election for the first two pay periods in 1995 was 10 percent, based on her 1994 election. A new election will become effective the first full pay period in January 1995 (pay period number 3 with a pay date of February 1, 1995).

Your estimate. Enter the IRS limit on Employee Contributions for the year in which your new election will be effective.

Using your most recent Earnings and Leave Statement, find the total amount of your year-to-date TSP Employee Contributions. Add to that the amount of Employee Contributions that will be deducted each pay period until the pay date that your new TSP election will become effective. (Take anticipated salary increases in the year into account.)

Elections made before the election periods (January and July of each year) do not become effective until the pay date following the first full pay period in the election period. For example, if you change the amount of your TSP contribution on May 15, that election does not become effective until the pay date for the first full pay period in July (generally, this is a pay date in late July or early August). You will need to keep these effective dates in mind when estimating the amount that will be contributed.

Worksheets (Continued)

		Example	Your Estimate
A-1.	Enter the IRS elective deferral limit for the year (e.g., 1995):	$ 9,240.00	$ ______
A-2.	Enter all Employee Contributions made during the year prior to the effective date of your new election (e.g., two pay periods):	$ 920.00	$ ______
A-3.	Subtract Line A-2 from Line A-1:	$ 8,320.00	$ ______

Complete:

- Worksheet B – to spread your contributions evenly over the remaining pay periods in the current year.

  OR

- Worksheet C – to maximize your contributions in the early part of the year.

Worksheet B – Spreading your contributions evenly over the remaining pay periods in the current year

Complete this worksheet if you are making an election in the January election period and want to be certain that you can make full Employee Contributions for the year and receive full Agency Matching Contributions without having to make another election in July. Also, use this worksheet if you are making an election in the July election period to adjust your contributions for the remainder of the year.

		Example	Your Estimate
B-1.	Enter the result from Line A-3:	$ 8,320.00	$ ______
B-2.	Enter the number of salary payments remaining in the year for which your new election will be effective:	24	______
B-3.	Divide Line B-1 by Line B-2:	$ 346.67	$ ______
B-4.	Round up the result in Line B-3 to the next dollar to determine the whole dollar amount you should contribute each pay period for the rest of the year (this is the amount that you will enter on your Form TSP-1):	$ 347.00*	$ ______

* In this example, the last contribution of the year will be reduced to $331.00 by the employee's agency to avoid exceeding the IRS limit for the year.

Worksheet C – Maximizing your contributions in the early part of the year

Complete this worksheet if you want to make Employee Contributions of at least 5 percent each pay period and receive full Agency Matching Contributions, but you also want to make your Employee Contributions as soon as possible in the year. This will enable you to invest a greater amount of your contributions earlier in the year; these contributions will be included in your account balance that receives earnings each month. Thus, not only will you receive the maximum amount of Agency Matching Contributions, you will also receive the maximum amount of earnings on your Employee Contributions.

Using this strategy, you will need to change your percentage contribution during the January election period and then change your contribution to a whole dollar amount during the July election period. The following example is based on the same employee as in the preceding example. It assumes that for the January election period the employee elects to contribute 9 percent of her salary. (Depending on the amount of your salary, you may need to choose a lower percentage than you otherwise would have elected — but not below 5 percent — to ensure that you are able to contribute the equivalent of at least 5 percent of your basic pay each pay period after the July election period, as below.)

		Example	Your Estimate
C-1.	Enter the result from A-3:	$ 8,320.00	$ ______
C-2.	Enter the number of salary payments in this year for which the election you make in **January** will be effective:	13	______
C-3.	Enter your salary per pay period during the period the **January** election will be effective:	$ 4,715.20*	$ ______
C-4.	Multiply Line C-3 by .09 to contribute 9% of your salary per pay period:	$ 424.37	$ ______
C-5.	Multiply Line C-4 by Line C-2:	$ 5,516.81	$ ______
C-6.	Subtract Line C-5 from Line C-1:	$ 2,803.19	$ ______
C-7.	Enter the number of salary payments in this year for which the election you make in **July** will be effective:	11	______
C-8.	Divide Line C-6 by Line C-7:	$ 254.84	$ ______
C-9.	Round up the result in Line C-8 to the nearest dollar to determine your whole dollar amount election for the **July** election period (this is the amount that you will enter on your Form TSP-1 for the July election period; it should equal at least 5% of Line C-3):	$ 255.00**	$ ______

* The salary per pay period is computed by dividing the annual salary by 2,087, rounding the result to the nearest cent, and multiplying it by 80.

** In this example, the last contribution for the year will be reduced to $253.19 by the employee's agency to avoid exceeding the IRS limit for the year.

Part II: Participating in the TSP and Another Tax-Deferred Retirement Plan

The following questions relate to excess deferrals made to both the TSP and another qualified employer plan as described under sections 401(k), 403(b), 408(k), 457, or 501(c)(18) of the Internal Revenue Code.* Certain Federal employees can participate in other tax-deferred retirement plans in addition to the TSP (e.g., a Federal employee who contributes to the TSP may also be a professor at a college or university and may contribute to its tax-deferred retirement plan).

What is an excess deferral?

An excess deferral is the amount that exceeds the relevant annual limit on elective deferrals.

What if I am contributing to more than one plan and my combined contributions exceed the annual limit?

You may request a refund of any excess deferrals from one or more of the plans in which you participate. Each plan then has the option of returning these excess deferrals plus associated earnings by April 15th of the year following the year in which the deferrals were made.

If you notify the TSP Service Office in a timely manner that you wish to have the excess deferrals refunded from the TSP, the TSP will return the excess deferrals and associated earnings to you.

How does this process work?

If you wish to have the excess deferrals returned to you from the TSP, contact the TSP Service Office, National Finance Center, P.O. Box 61500, New Orleans, LA 70161-1500 (telephone (504) 255-6000). Ask for the form to request a refund of excess deferrals and associated earnings. You must complete this form and return it to the TSP Service Office by **February 20 of the year after the excess deferrals were made**. The TSP Service Office will process the refund; these amounts will be paid to you prior to April 15. Forms received after February 20 will not be processed.

What are the tax consequences if I contribute more than the annual limit in any tax year?

Excess deferrals are treated as income in the year in which you made the contributions, whether or not they are refunded to you. The total amount of deferred income is reported by each employer in Box 13 on your IRS Form W-2. If you have made excess deferrals, you must report the total amount of the excess on your individual income tax return as taxable wages for the year in which you made the excess deferrals.

If you elect to receive excess deferrals as a refund from the TSP, you will receive IRS Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., indicating the amount of the excess that was refunded to you. This distribution will also be reported to the IRS. If you have already filed your individual tax return for the year in which the excess was contributed, and this amount was not included as taxable wages, you will need to file an amended tax return.

---

* The elective deferral limit (e.g., $9,240 in 1995) applies to all qualified cash or deferred arrangements, including the TSP. However, special limits apply in two situations: (1) if you participate in a Section 403(b) plan as well as the TSP, the 1995 limit is $9,500, of which only $9,240 can be contributed to the TSP; and (2) if you participate in a Section 457 plan, your contributions to all plans (including the TSP) may be limited to $7,500 in 1995. You should consult with your 457 plan administrator concerning any limitation on the amount you can contribute to your TSP account.

How are the earnings on excess deferrals treated for tax purposes?

Earnings distributed with excess deferrals are considered taxable income **in the year in which they are distributed** (unlike the excess deferrals, which are considered taxable income **in the year in which they are contributed**). You will receive a separate IRS Form 1099-R indicating the amount of the earnings. You must report this amount as income in the year in which the distribution is made. This distribution will also be reported to the IRS.

What happens to the Agency Matching Contributions that were associated with excess deferrals returned to me?

Your agency will be notified that you have requested to have your excess deferrals and associated earnings returned to you. Your agency is then required to remove the Agency Matching Contributions associated with these excess deferrals. If your agency fails to remove the Agency Matching Contributions within one year of the date the contributions were made to your account, these contributions will not be returned to your agency; instead they will be removed from your account and used to offset TSP administrative expenses. In either case, the earnings associated with these Agency Matching Contributions will be removed from your account and used to offset TSP administrative expenses.

Is a distribution of excess deferrals considered an early withdrawal and thus subject to the IRS tax penalty?

If the distribution is made by April 15 of the tax year following the year in which the excess deferral was made, it will not be considered an early withdrawal.

What happens if the distribution is not made by April 15 of the following tax year?

You cannot request to have the excess amount refunded later. Instead, you will be taxed twice on this amount; once in the year the excess deferral is made and then again when you separate and withdraw your account. (If the withdrawal is premature, the IRS early withdrawal penalty may also apply.) Earnings on the excess deferrals are only taxed once, when you withdraw the account.

Please note: As stated above, if the TSP does not receive your request by February 20, it will not be processed; accordingly, you will not receive a distribution from the TSP of your excess deferrals.