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IRS Fact Sheet

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2002 TAX CHANGES: IRAS / RETIREMENT PLANS

Taxpayers will find many changes affecting their retirement planning as a result of the Economic Growth and Tax Relief Reconciliation Act of 2001 and regulations issued during 2002. They may be able to contribute more to retirement plans, get larger tax benefits for doing so and have more options for handling plan distributions.

Higher Contribution Limits for IRAs, Employer Plans

Taxpayers may contribute up to $3,000 in 2002 to either traditional or Roth IRAs. The elective deferral limit for 401(k) plans, 403(b) annuities (for employees of public schools and 501(c)(3) organizations), 457 plans (for employees of state or local governments or tax-exempt organizations) and salary reduction SEPs (Simplified Employee Pensions) is generally $11,000. For SIMPLE plans, the salary reduction limit is $7,000.

Employers' plans may better provide for the needs of retirees. For defined contribution plans, the annual addition may be up to 100% of an employee's compensation, but not more than $40,000. For defined benefit plans, the annual benefit limit for 2002 is the lesser of $160,000 or 100% of the employee's average compensation for his or her highest three consecutive calendar years.

Higher Contribution Limits for Taxpayers Age 50 and Over

Taxpayers who are at least 50 years old may contribute more to certain retirement plans – how much depends on the type of plan. For IRAs and elective deferrals in SIMPLE plans, the extra amount for 2002 is $500, giving a total taxpayer contribution limit of $3,500 for IRAs and $7,500 for SIMPLE plans. For other elective deferral plans – including 401(k), 403(b), governmental 457, and salary reduction SEP plans – the extra amount is $1,000, giving a total contribution limit of $12,000.

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Retirement Savings Contributions Credit

Generally, this credit is based on the first $2,000 of IRA contributions, elective deferrals to 401(k) and various other plans, and certain contributions to other retirement plans. It is available for most individuals with an adjusted gross income (AGI) up to $25,000 ($37,500 for a head of household) and married couples filing jointly with AGI up to $50,000. The taxpayer must also be at least age 18, not a full-time student, and not claimed as a dependent on another person's return.

The credit is a percentage of the eligible contribution and deferral amounts, with the highest rate for taxpayers with the least income, as shown in this table:

	==================== *AGI*	====================	
Credit Rate	*Joint Return*	*Head of Household*	*Others*
50%	up to $30,000	up to $22,500	up to $15,000
20%	$30,000+ to $32,500	$22,500+ to $24,375	$15,000+ to $16,250
10%	$32,500+ to $50,000	$24,375+ to $37,500	$16,250+ to $25,000

When figuring the Retirement Savings Contributions Credit, taxpayers who have received distributions from their retirement plans generally must subtract these amounts from their contributions. This rule applies for distributions starting two years before the year the credit is claimed and ending the day before the filing deadline (including extensions) for that tax return. For 2002, subtract distributions received after 1999 and before Apr. 15, 2003, (or the extended filing deadline) from the total 2002 eligible contributions and deferrals, then multiply the result (but not more than $2,000 per taxpayer) by the credit rate applicable for the taxpayer's filing status and income level.

The subtraction rule does not apply to distributions which are rolled over into another plan, loans treated as distributions, trustee-to-trustee transfers, or withdrawals of excess contributions or deferrals (and income allocable to such excess amounts).

This credit is in addition to whatever other tax benefits may result from the retirement contributions. For example, most workers at these income levels may deduct all or part of their contributions to a traditional IRA. Also, contributions to a 401(k) plan are not subject to income tax until withdrawn from the plan.

Required Distributions from Retirement Plans

New life expectancy tables generally provide for smaller annual distributions, so participants may keep more funds in their tax-deferred plans. Taxpayers using a fixed annuity method to avoid an early-withdrawal penalty may make a one-time switch to a variable amount method based on the account's value. This will help taxpayers preserve more of their retirement savings when the account value drops.

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Faster Vesting for Matching Contributions from Employers

Employees now gain a nonforfeitable right to an employer's matching contributions to their defined contribution plan more quickly. The plan has the option of fully vesting employees after three years of service (down from five), or granting employees gradual vesting rights of 20% each year, beginning after two years of service and resulting in full vesting after six years. (The old schedule went from three to seven years.) The new vesting schedule is for employer matches in plan years starting after 2001, except for plans covered under a collective bargaining agreement. The new schedule does not apply to employee vesting in other types of contributions.

Permissible Rollovers

Employees have greater freedom to make a tax-free rollover of distributions from one type of retirement plan to another. This is important for a person who changes jobs and wants to move retirement assets from one employer's plan to another. Some plans have been limited to rollovers to or from the same type of plan. Beginning in 2002, qualified employer plans, 403(b) annuities, governmental 457 plans and IRAs may accept rollovers from another plan, even if they are different types. For example, workers switching from a government agency to a public school might roll over their 457 plan assets to a 403(b) annuity. Although plans may accept rollovers, they are not required to do so.

A surviving spouse may roll over the decedent's distributions from an employer plan into the survivor's employer plan. Before 2002, a surviving spouse could roll over such distributions only into an IRA.

IRA assets may be rolled over to employer plans even if they did not come from another employer plan. Employees who roll over employer plan distributions into an IRA no longer have to keep that IRA separate – a "conduit IRA" – in order to do a future rollover to another employer's plan. However, taxpayers born before Jan. 2, 1936, who want to keep special capital gains and ten-year averaging benefits will need a conduit IRA to move assets from one employer plan to another.

Rollovers from IRAs to employer plans may not include any after-tax contributions. Distributions are considered to consist first of the taxable IRA portion, thus maximizing the amount eligible for rollover. Rollovers from employer plans may include after-tax contributions to those plans if the rollover is a direct trustee-to-trustee transfer. A receiving employer plan – but not an IRA trustee – must separately track such contributions and related earnings.

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