

The California State University
Office of the Chancellor
401 Golden Shore
Long Beach, CA 90802-4210
(562) 951-4410

Date: January 8, 2002

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HR/BENEFITS 2002-01

Reference: Technical Letter
HR/Benefits 2001-22

To: Human Resources Directors
Benefit Officers

From: Cathy Robinson, Senior Director
Human Resources Administration



Subject: **FEDERAL TAX LAW CHANGES AFFECTING 403(b), 401(k) and 457 PLANS**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) significantly revised federal laws relating to retirement benefit programs as we communicated in Benefits Technical Letter 2001-22 (available at <http://www.calstate.edu/HRAdm/pdf2001/TL-BEN2001-22.pdf>).

I am writing to inform you of recent events related to EGTRRA and California State law. It has been established California tradition that State law is amended to conform to federal law when retirement legislation is enacted so that California and federal rules for retirement plans will not conflict. However, due to the state's current budget situation, conforming state legislation is not a given. The Assembly and Senate Committees on Revenue and Taxation in the California Legislature have publicly stated that while they understand that full state conformity to the federal law is highly desirable, preliminary estimates suggest that full conformity will result in a significant loss of state tax revenue, so they anticipate there may be various attempts to conform partially rather than fully with EGTRRA provisions. State conforming legislation is critical to enable our employees to enjoy the full scope of the new federal retirement savings benefits. Tax laws of most states automatically conform to changes in federal retirement tax law in calculating state tax liability; unfortunately, in a minority of states, including California, the state tax codes do not automatically conform.

We have discussed this "nonconforming" issue with the Public Employees' Retirement System (PERS) and the Department of Administration (DPA), the administrator of the Savings Plus Programs' (SPP) 401(k) and 457 Plans, and we all acknowledge the need for conforming legislation. In fact, yesterday Assembly Bill (AB) 1743 was introduced and other bills are under development. We anticipate many private and public employers will work to pass conforming legislation. However, as is expected, the ultimate outcome of any legislation cannot be predicted.

Because the California state law currently does not conform to the new federal law, the higher federal deferral limits cannot be incorporated into the 403(b), 401(k) and 457 plans

Distribution:

CSU Presidents
Vice Chancellor, Human Resources
Payroll Managers
Director, SOSS
Associate Vice Presidents/Deans of Faculty

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until California amends its tax code. Therefore, the following information is provided for guidance:

- ▶ We anticipate that for the majority of employees conforming legislation may not be an issue, however, until further notice, employees who participate in the 403(b), 401(k) or 457 plans should use the 2001 maximum deferral limits as a guide and should not increase deferrals to the new federal maximums until further notice.

- ▶ Attachment A provides a summary of the 2001 maximum annual deferral limits.
 - ✓ If employees contribute to CSU's 403(b) Plan only, the maximum annual contribution is the lesser of \$10,500, 25% of adjusted gross pay, or the Maximum Exclusion Allowance.
 - ✓ If employees contribute to the Savings Plus Program 401(k) Plan only, the maximum annual contribution is the lesser of \$10,500 or 25% of adjusted gross pay.
 - ✓ If employees contribute to the Savings Plus Program 457 Plan only, the maximum annual contribution is the lesser of \$8,500 or 33 1/3 percent of taxable pay.
 - ✓ If employees contribute to both a 403(b) or 401(k) and a 457 in the same tax year, the maximum annual contribution is the lesser of \$8,500 or 33 1/3 percent of taxable.

- ▶ If legislation passes to conform California state tax law to the new federal limits, employees will have an opportunity to change their 403(b), 401(k) and 457 deferrals at any time throughout the tax year. At that time, employees in a 403(b) or 401(k) plan may also be able to enroll in the 457 plan and elect monthly contributions to meet annual goals.

- ▶ Employees who have already submitted paperwork to increase elective deferrals for the 2002 tax year, pursuant to federal maximum limits, are encouraged to reevaluate their situation in a few months if the state tax conformity issue is not favorably resolved. If California amends its law to conform to the higher federal limits, employees would have the opportunity to later increase their elective deferrals.

- ▶ The Savings Plus Plan Program (SPP) will provide plan participants with an update on the federal and state tax problem in their fourth quarter Savings Plus NewsLine issued later this month.

- ▶ Attachment B provides a summary of basic EGTRRA provisions related to retirement plans. Again, these limits are not available to employees due to the nonconforming state law issue.

- ▶ Attachment C is a draft letter to employees that campuses may use for communicating this information.

As always, campuses are advised to refer employees to their tax advisors or financial planners for specific assistance in understanding the impact of federal and state taxes on their individual situations.

We will keep you updated as meaningful information becomes available. If you have any questions, please contact Felice Bakre at (562) 951-4410. This Technical Letter is also available on Human Resources Administration's web page at: <http://www.calstate.edu/HRAdm/memos.shtml>.

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Attachments

Until the state tax law “conformity” issue is resolved, employees must follow the 2001 (pre-EGTRRA) maximum annual elective deferral limits for 2002, or until further notice. If the state tax issue is resolved to conform with EGTRRA, employees will have an opportunity at that time to adjust their elective deferrals to meet their retirement savings needs.

In accordance with tax year 2001 retirement plan guidelines, the maximum contribution limits for the 403(b), 401(k) and 457 plans are interrelated. Employees who participate in more than one plan in the same year are limited to the lowest maximum. Employees who wish to contribute to a 403(b) concurrently with a 401(k) or 457 must first obtain permission from the Savings Plus Program. The Savings Plus Program can be reached at (866) 566-4777 for more information.

PLAN	PLAN PROVISION	
403(b)	2001 Annual Deferral Limit	Catch-up Provision
	The lesser of three limits apply: 1. 402(g) limit –\$10,500 OR, 2. Maximum Exclusion Allowance (MEA) – 20% of taxable pay, times years of service, minus past contributions, OR 3. 415 limit –25% of adjusted gross pay.	IRC Section 402(g)(8) Catch-up Also referred to as the “15-year” catch-up. Permits certain long-term employees who have under-deferred in previous years to make additional contributions beyond the IRC Section 402(g) limit. Eligible employees may contribute an additional \$3,000 per year beyond the maximum annual deferral limit. Applies only to the 403(b) plan.
401(k)	The lesser of \$10,500 or 25% of adjusted gross pay.	None available.
457	The lesser of \$8,500 or 33 1/3 percent of taxable pay.	IRC Section 457(b) Catch-up Permits eligible participants to make up for 457 contributions not made in previous years. Participants should contact the Savings Plus Program for additional information.
Multiple Plans	If employees contribute to both the 403(b) or 401(k) <u>and</u> the 457 in the same tax year, the maximum annual contribution is the lesser of \$8,500 or 33 1/3 of taxable pay. The 403(b) and 401(k) \$10,500 limit would not apply.	

This chart illustrates basic provisions of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) related to retirement plans available to CSU employees. NOTE: These guidelines are not available until the state conforming tax issue is resolved.

Plan Provision	403(b)	401(k) Administered by DPA's Savings Plus Program	457 Administered by DPA's Savings Plus Program
<p>402(g) Elective Deferral Limit This is an annual maximum. It will be indexed annually for inflation after 2006.</p>	<p>\$11,000 in 2002 \$12,000 in 2003 \$13,000 in 2004 \$14,000 in 2005 \$15,000 in 2006</p>	<p>\$11,000 in 2002 \$12,000 in 2003 \$13,000 in 2004 \$14,000 in 2005 \$15,000 in 2006</p>	<p>\$11,000 in 2002 \$12,000 in 2003 \$13,000 in 2004 \$14,000 in 2005 \$15,000 in 2006</p>
<p>IRC Section 402(g)(8) Catch-up Also referred to as the "15-year" catch-up. Permits certain long-term employees who have under-deferred in previous years to make additional contributions beyond the IRC Section 402(g) limit. Applicable only to the 403(b) plan and can be used concurrently with the IRC Section 414(v) catch-up.</p>	<p>\$3,000 per year beyond the 402(g) limit, for up to 5 years or a lifetime maximum of \$15,000.</p>	<p>Not applicable</p>	<p>Not applicable</p>
<p>IRC Section 414(v) Catch-up Also referred to as the "over-age-50" catch-up. Permits participants who have attained at least age 50 by the end of a calendar year to make catch-up contributions on a graduated scale. Only an annual total of \$1,000 is permitted even if the employee is in 2 plans.</p>	<p>\$1,000 in 2002 \$2,000 in 2003 \$3,000 in 2004 \$4,000 in 2005 \$5,000 in 2006</p>	<p>\$1,000 in 2002 \$2,000 in 2003 \$3,000 in 2004 \$4,000 in 2005 \$5,000 in 2006</p>	<p>\$1,000 in 2002 \$2,000 in 2003 \$3,000 in 2004 \$4,000 in 2005 \$5,000 in 2006</p>
<p>IRC Section 457(b) Catch-up Also referred to as the "two times elective deferral" catch-up. Provides a maximum lifetime amount and is available to participants who have under-deferred to the 457(b) plan in prior years. Permits eligible participants to defer twice the amount of the elective deferral amount during the last three years before retirement. Applicable only to the 457 plan and can be used concurrently with the 403(b) plan's IRC Section 402(g)(8) catch-up; however, it cannot be used in conjunction with the IRC Section 414(v) "over-age-50" catch-up.</p>	<p>Not applicable</p>	<p>No applicable</p>	<p>\$22,000 in 2002 \$24,000 in 2003 \$26,000 in 2004 \$28,000 in 2005 \$30,000 in 2006</p>

DRAFT LETTER TO EMPLOYEE

Date:

Dear CSU Employee

RE: **Update: State and Federal Tax Law and Changes Affecting 401(k), 403(b) and 457 plans**

You recently received information on the Economic Growth and Tax Relief Reconciliation Act Of 2001 (EGTRRA), which significantly revised federal laws relating to retirement benefit programs.

This letter is to update you on recent issues related to EGTRRA and California State law. It has been established California tradition that State law is amended to conform to federal law when retirement legislation is enacted so that California and federal rules for retirement plans will not conflict. However, due to the state's current budget situation, conforming state legislation is not a given. The Assembly and Senate Committees on Revenue and Taxation in the California Legislature have publicly stated that while they understand that full state conformity to the federal law is highly desirable, preliminary estimates suggest that full conformity will result in a significant loss of state tax revenue, so they anticipate there may be various attempts to conform partially rather than fully with EGTRRA provisions.

State conforming legislation is critical to enable our employees to enjoy the full scope of the new federal retirement savings benefits. Tax laws of most states automatically conform to changes in federal retirement tax law in calculating state tax liability; unfortunately, in a minority of states, including California, the state tax codes do not automatically conform. ***Consequently, the higher federal deferrals introduced through EGTRRA cannot be incorporated into the 403(b), 401(k) and 457 plans until California amends its tax code.***

The California State University, the Public Employees' Retirement System (PERS) and the Department of Administration (DPA), the administrator of the Savings Plus 401(k) and 457 Plans, all acknowledge the need for conforming legislation. In fact, Assembly Bill (AB) 1743 was recently introduced and other bills are under development. However, since we cannot predict the ultimate outcome of state legislation, the following information is provided for guidance:

- ▶ ***The 2001 maximum annual contribution limits must be followed in 2002 because the California state law currently does not conform to the new federal law.*** For most employees conforming legislation may not be an issue because most currently do not contribute the maximums allowed. Attachment A provides a list of the elective deferral limits available for 2002 at this time:
 - ✓ If employees contribute to CSU's 403(b) Plan only, the annual maximum contribution is the lesser of \$10,500 or 25% of annual compensation.
 - ✓ If employees contribute to the Savings Plus 401(k) Plan only, the annual maximum contribution is the lesser of \$10,500 or 25% of annual compensation.
 - ✓ If employees contribute to the Savings Plus 457 Plan only, the annual maximum contribution is the lesser of \$8,500 or 33 1/3 percent of annual compensation.

- ✓ If employees contribute to both the 403(b) or 401(k) and the 457 plan in the same tax year, the maximum annual contribution is the lesser of \$8,500 annually or 33 1/3 percent of annual compensation.
- ▶ ***Employees who participate in the 403(b), 401(k) or 457 plans should use the 2001 deferral maximums as a guide and hold off increasing deferrals to the new federal maximums until further notice.***
- ▶ ***If*** legislation passes to conform California state tax law to the new federal limits, employees will have an opportunity to change their 403(b), 401(k) and 457 elective deferrals at that time. Employees participating in a 403(b) or 401(k) plan may also be able to enroll in the 457 plan at that time and elect monthly contributions to meet annual goals.
- ▶ Employees who already submitted paperwork to increase their elective deferrals (to meet the new federal maximums) are encouraged to reevaluate their situation in a few months if the state tax conformity issue is not favorably resolved. ***If*** California amends its law to conform to the higher federal limits, employees will have an opportunity to increase their elective deferrals at that time.
- ▶ Savings Plus Plan (SSP) participants will receive an update on the federal and state tax situation in the fourth quarter “Savings Plus NewsLine” newsletter issued later this month.
- ▶ Attachment B provides a summary of the basic provisions of EGTRRA related to retirement plans. ***These limits are not available to employees until the nonconforming state law issue is resolved.***

As always, please contact your tax advisor or financial planner for specific assistance in understanding the impact of federal and state taxes on your individual situation.

We will keep you updated as meaningful information becomes available.

If you would like additional information about the State’s 401(k) or 457 plans, please contact the Savings Plus program at (866) 566-4777. You may also obtain information via the Department of Personnel Administrator’s web page at <http://www.dpa.ca.gov>. For information on the CSU 403(b) plan, please contact (campus benefits representative) at _____.

Sincerely,
Campus Benefits Representative

Attachments