The Basics On The Catch-Up Contributions Allowed In 401(k) Plans

Congress added the new catch-up contribution option to retirement plans out of concern that baby boomers hadn't been saving enough for retirement. This new option enable savers age 50 and over to increase contributions at a time when retirement draws near. Age-50 catch-up contributions are possible in 401(k), 403(b) and 457 plans, and IRAs, but the rules differ among plans. This article focuses on 401(k) rules.

We have put together the answers to some of the most common questions we have been getting regarding the catch-up provision.

QUESTIONS

What is a catch-up contribution?

A catch-up contribution is any elective deferral made by an eligible participant that is in excess of the statutory limit ($15,500 in 2007), an employer-imposed plan limit, or any limit applied in order for the plan to satisfy the ADP nondiscrimination test for the year.

Who is eligible to make a catch-up contribution?

Plan participants who are or will turn 50 years of age during the calendar year are eligible to make catch-up contributions. However, the participant's regular plan contributions must reach at least one of the following limits before catch-up contributions can begin: the annual deferral limit, the plan's deferral limit, or the annual ADP limit for Highly Compensated Employees.

How many retirement plans offer this feature?

According to Fidelity, 93% of the more than 26,000 employer sponsored retirement plans they service offer the provision.

Are we required to provide this additional elective deferral to our plan participants?

No, a plan is generally not required to provide for catch-up contributions.

If we want to offer the catch-up provision, does our plan have to be amended?

There is a high likelihood that your plan will need to be amended in order for you to allow catch-up contributions. The IRS has provided model amendment language that can be used, but you should immediately check with your legal counsel or recordkeeper on what your specific plan needs.

Does the catch-up contributions have to be made from payroll deductions?

Yes, contributions must be made by payroll deduction.

Does the employer have to match these catch-up contributions?

No, an employer does not have to match these contributions. If you don't match, it would be wise to communicate this to your plan participants

Do we need to show these contributions separately on W-2 forms?

No, the IRS has indicated that regular and catch-up contributions can be reported together on W-2 forms.

How will catch-up contributions impact plan testing?

Among other testing issues, catch-up contributions are not considered when doing the ADP test and they are not considered in determining the amount of the minimum contribution required for a top-heavy plan.

How are these contributions treated for hardship withdrawals, loans or distributions purposes?

Catch-up contributions to a plan are treated for plan purposes as any other pre-tax contribution would be. For example, catch-up contributions would be treated as any other elective deferral when calculating available balances for loans.

If one of our plans permits catch-up contributions to be made, do all of our plans have to permit them?

Yes, if one plan of an employer permits catch-up contributions to be made, then catch-up contributions must be permitted in all plans of the employer permitting elective deferrals ("universal availability" requirement). See IRS Notice 2002-4 for more information.

What other issues do I have to think about if we want to offer this provision?

Actually allowing catch-up contributions within the plan may be the easy part. The harder part may be the implementation. For example, can your payroll system handle the raised minimum for eligible participants? Can payroll segregate catch-up contributions from other pre-tax deferrals? Can the plan recordkeeper handle this type of contribution? Are there additional costs involved? How will you communicate this new benefit to your employees, or how will you respond to employees if you don't offer it? How will you train your staff to answer questions related to it? Do forms and other operational issues need to be addressed or changed?
