Order Code 98-171 EPW

CRS Report for Congress

Received through the CRS Web

Retirement Plans With Individual Accounts: Federal Rules and Limits

Updated May 18, 2000

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Summary

As the federal income tax grew in importance during the 1940s, 1950s, and 1960s, employers devised ways in which employees could defer receipt of a part of their pay to postpone taxation of that income. These salary deferrals often are intended to be used in retirement, and most of these plans penalize cash withdrawals before a certain age, except in case of death, disability, or financial hardship. Thus, they often are called salary reduction *retirement* plans. Use of salary reduction retirement plans is widespread. In 1993, 37% of civilian nonagricultural wage and salary employees were covered by these plans, an increase from 27% in 1988.

The manner in which deferred compensation plans were initially established varied among employment sectors. Business firms' plans differed from those of educational organizations, which in turn differed from government plans. The various plan types were codified over the years as Congress responded to regulatory initiatives by the Internal Revenue Service and to concerns about loss of revenue and the fairness and integrity of these plans. The resulting statutes reflected the unique history of each plan type. Congress began to move toward more uniformity in the rules governing the different types of salary reduction plans in 1986 with passage of the Tax Reform Act of 1986 (P.L. 99-514), which contained several provisions that reduced disparities in plan rules. In 1996, Congress made additional changes in plan rules in the Small Business Job Protection Act of 1996 (P.L. 104-188), and further changes were made a year later by the Taxpayer Relief Act of 1997 (P.L. 105-34).

This report describes each type of salary reduction retirement plan authorized by federal law: individual retirement accounts (IRAs), §401(k) plans, the Federal Employees' Thrift Savings Plan, §403(b) plans, §457 plans, salary reduction simplified employee pension (SARSEP) plans, and savings incentive match plans for employees of small employers (SIMPLE). The rules governing plans are then presented in regard to: eligibility, vesting, tax treatment of contributions, limits on contributions, limits on investments, withdrawal options, and tax treatment of withdrawals. Exceptions to the general rules are noted. *This report is updated annually.*

An employee becomes eligible to participate in a plan once minimum requirements regarding age and length of service are met. An employee's contributions must be vested (i.e., become the individual's legal property) at once; employer contributions need not be vested until a tenure requirement has been met, which generally cannot exceed 5 years. Contributions to these plans and the investment earnings they accrue usually are not subject to the federal income tax until the funds are withdrawn. Annual contributions are limited, the ceilings varying by plan type. There are some statutory controls on allowable types of investments. An individual accountholder often may borrow from vested funds. Withdrawals may be made in the form of annuities, lump sums, or as untaxed rollovers into other tax-deferred plans.

Contents

Background 1

Summary Description of Retirement Plans With Individual Accounts 2
- Individual Retirement Accounts (IRAs) 3
  - Traditional IRAs 4
  - Roth IRAs 4
- Section 401(k) Plans 5
- The Federal Employees' Thrift Savings Plan 6
- Section 403(b) Plans 7
- Section 457 Plans 7
- Salary Reduction Arrangements in Simplified Employee Pension Plans (SARSEPs) 8
- Savings Incentive Match Plans for Employees of Small Employers (SIMPLE) 8

Plan Rules 9
- Eligibility Requirements 9
- Vesting 11
- Tax Treatment of Contributions 12
- Limits on Contributions 13
- Limits on Investments 19
- Withdrawal Options 19
  - Loans 19
  - Rollovers 20
  - Annuities and Cash Withdrawals 21
  - Required Minimum Distributions 22
- Tax Treatment of Withdrawals 22
  - General Rules 22
  - Early Withdrawals 23
  - Late Withdrawals 23
  - Large Distributions 23
  - Income Averaging 23

Appendix A: Comparison of Federal Rules for Retirement Plans by Plan Type 25

Appendix B: Abbreviations Used in This Report 41

Appendix C: Location of Statutory Provisions For Retirement Plans 43

List of Tables

Table 1. Determinants of Eligibility to Deduct Contribution to Traditional IRA in 2000 5
Table 2. Limits Defining Highly Compensated Group, 1987-2000 10
Table 3. Minimum Requirements for Vesting of Employer Contributions to Qualified Retirement Plans 11
Table 4. Limits on Salary Deferrals by Highly Compensated Employees Under the Nondiscrimination Test 14
Table 5. Limits on Annual Compensation That Can Be Used to Determine Plan Contributions, 1989-2000 15
Table 6. Limits on Annual Contributions to Salary Deferral Plans by Plan Type, 2000 17
Table 7. Annual Dollar Limits on Elective Salary Deferrals, 1975-2000 18
Table 8. Limits on Plan Distributions, 1987-1997 24
Table A-1. Eligibility Rules by Retirement Plan Type 26
Table A-2. Rules for Employee Contributions by Retirement Plan Type 29
Table A-3. Employer Contribution Rules by Retirement Plan Type 31
Table A-4. Nondiscrimination and Integration Rules by Retirement Plan Type 33
Table A-5. Plan Distribution Rules by Retirement Plan Type[a] 35
Table A-6. Rules[a] for Reporting, Disclosure, Fiduciary Responsibility and Allowable Investments by Retirement Plan Type 38

Retirement Plans With Individual Accounts: Federal Rules and Limits

Background

Numerous tax incentives have been established in federal law for voluntary retirement saving. Each type of incentive plan was begun for a specific purpose with its own set of rules. While the different plan types shared one trait in common — a deferral of current income taxation on salary contributed to a retirement plan — rules governing eligibility, contributions, and withdrawals varied significantly, reflecting the variety of practices that had developed among employers in different sectors of the economy. The Tax Reform Act of 1986 (P.L. 99-514) introduced a greater degree of uniformity to the rules for the various plan types and made their use for nonretirement purposes less attractive. Extensive changes were also made by the Small Business Job Protection Act of 1996 (P.L. 104-188) to encourage wider plan coverage.[1] Further changes were made in the Taxpayer Relief Act of 1997 (P.L. 105-34).[2]

This report provides a general description of the rules under which individual account retirement saving plans operate. First, it describes each of the following plan types:

- individual retirement accounts (IRAs);
- §401(k) plans;
- the Federal Employees' Thrift Savings Plan;
- §403(b) plans;
- §457 plans;
- salary reduction arrangements in simplified employee pension (SARSEP) plans; andsavings incentive match plans for employees of small employers (SIMPLE).

The report then summarizes the federal rules for these plans. These rules, which vary by type of plan, set standards that plans must meet to qualify for tax advantages. A plan's specific rules may differ from those described here so long as they are not in conflict with the relevant federal requirements.

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[1] The pension provisions of this law are described in: CRS Report 95-1028, *Pension Proposals for Simplification and Increased Access*, by James R. Storey.

[2] See CRS Report 97-796, *Changes Made by the Taxpayer Relief Act of 1997*, by James R. Storey. Also, see CRS Report 97-935, *Individual Retirement Accounts (IRAs): Changes Made by the Taxpayer Relief Act of 1997*, by James R. Storey.

Readers interested in a brief summary of how a particular type of plan works will find that information in the next section. For more detail on specific provisions, readers should locate topics of interest in the *Plan Rules* sections, which set forth the general rules regarding eligibility, vesting, contribution limits and tax treatment, investment limits, withdrawal options, and taxation of withdrawals. Exceptions to the general rules pertaining to each plan type are then noted.

Appendix A compares the rules in chart form by plan type. Appendix B identifies the abbreviations used in this report. Appendix C specifies the sections of federal statutes in which the various rules are located.

Summary Description of Retirement Plans With Individual Accounts

If an employer offers an individual account retirement plan, employees may instruct the employer to withhold payment of a specified portion of current salary for investment in the plan. The employer often contributes to the plan as well. Employees usually have a choice of several investment vehicles within the plan to which they may direct contributed funds.

Salary deferral arrangements are intended to help employees accumulate assets that can be used to provide retirement income. For most employees, the income from these plans will supplement benefits from Social Security. Many are covered also by an employer-sponsored defined benefit pension plan and/or another defined contribution plan,[3] but, for 44% of workers covered by a §401(k) plan, that plan is the only tax-deferred retirement arrangement made available by employers to employees.[4]

To participate in a salary deferral plan, an employee elects to give up a part of current wages and have those foregone earnings contributed to the plan by the employer. These "elective" contributions often are supplemented by "matching" and/or "nonelective" contributions from the employer. Employee and employer contributions that are in compliance with the law are not subject to the federal income tax in the year that the funds are contributed. Investment earnings on contributions also receive tax-deferred treatment.[5] However, when tax-deferred funds eventually

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[3] A defined benefit plan promises a retirement benefit amount that is usually determined by salary level and length of service. A defined contribution plan specifies the contributions to be made, but the benefits depend on investment performance. Salary reduction plans are defined contribution plans.

[4] The proportion with only a §401(k) plan rose from 41% in 1994 to 44% in 1995. Source: U.S. Dept. of Labor. Pension and Welfare Benefits Administration. Abstract of 1995 Form 5500 Annual Reports. *Private Pension Plan Bulletin*, no. 8, spring 1999. (Hereafter cited as Pension and Welfare Benefits Administration, *Private Pension Plan Bulletin*)

[5] When an amount of income is "tax-deferred," that amount is not included in the taxpayer's adjusted gross income for the year of deferral. Although the mechanism through which deferral is achieved may be called a "deduction" or an "exclusion," the amount on which tax

(continued...)

are withdrawn from the plan, they are then subject to the federal income tax.[6] If withdrawals are premature or tardy, as defined in tax law, special excise taxes may also apply.

Tax deferral offers two possible advantages to the employee. First, compound interest accrues on the portion of savings that would have been used to pay taxes, thereby yielding a larger after-tax asset in retirement. Second, the employee may be in a lower tax bracket in retirement and pay a smaller tax than would have been due if tax had been paid at the time the deferred wages were actually earned. (This second advantage became less important after the Tax Reform Act of 1986 lowered tax rates and reduced the number of tax brackets.) Except for New Jersey and Pennsylvania, states with income taxes follow federal law on tax deferral for these plans. Thus, federal tax advantages are reinforced by state tax laws for most participants.

To obtain these potential tax advantages, an employee must be willing to give up the current use of the wages contributed to the plan and abide by the plan's rules regarding investment and withdrawal. Rules on withdrawals were tightened for most types of plans by the Tax Reform Act of 1986.

A brief description of each plan type is given below.

Individual Retirement Accounts (IRAs)

Individual retirement accounts (IRAs) were authorized by the Employee Retirement Income Security Act (ERISA) of 1974 (P.L. 93-406) for persons not covered by employer pension plans. Eligibility was broadened to all employed individuals and their spouses by the Economic Recovery Tax Act of 1981 (P.L. 97-34). The Tax Reform Act of 1986 restricted the tax advantage of IRAs for certain taxpayers with income above specified levels. The Taxpayer Relief Act of 1997 relaxed those restrictions somewhat and authorized Roth IRAs, which are funded from after-tax contributions and provide tax-free income in retirement. The IRA is not a true salary deferral plan, since it is available to workers without any involvement of the employer and does not directly reduce the salary received by the worker. However, IRAs are included in this report since they are similar to salary deferral plans (i.e., they are based on elective contributions from tax filers with some earned income) and they serve as the investment vehicle for two types of employer plans (SEPs and SIMPLE IRAs).

In 1985, 16.2 million tax filing units (19% of all units with wage or salary income) reported IRA deductions, but the number of accountholders actively

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[5] (...continued)
is deferred eventually will be subject to taxation when it is withdrawn from the retirement plan.

[6] An exception is the Roth IRA, which accepts only after-tax contributions but permits tax-free withdrawals of both principal and investment earnings.

contributing fell after the 1986 law took effect.[7] Only 4.1 million tax filers (4% of all units with wage or salary income) reported IRA contributions for 1997. Participation rates fell at all income levels, the decline being greater, the higher the income.

Traditional IRAs. Anyone with wage income can contribute the lesser of $2,000 a year or 100% of annual earnings to an IRA. An IRA can be established for a nonworking spouse, whose annual contribution cannot exceed the lesser of (1) $2,000, or (2) 100% of the couple's combined earnings less the working spouse's IRA contribution.[8]

While any worker (and spouse) can contribute to an IRA, contributions are assured of income tax deferral only if at least one of two conditions is met: (1) the contributor is not eligible to participate in an employer-sponsored retirement plan;[9] or (2) the contributor has adjusted gross income (AGI) below $32,000 ($52,000 for a joint filer). A deduction for contributions of less than $2,000 is allowed if AGI falls between this level and $42,000 ($62,000 for a joint filer).[10] These rules are arrayed in **Table 1**. Nondeductible contributions are tax-free when withdrawn, but deductible contributions are taxed upon withdrawal. Taxes are deferred on IRA investment earnings until withdrawal occurs, whether or not the contributions that produced these investment earnings were deductible.

Roth IRAs. A Roth IRA can receive after-tax contributions of up to $2,000 annually. Qualified withdrawals are tax free. Contributions up to $2,000 are allowed only for taxpayers with AGI not in excess of $95,000 ($150,000 for joint filers). Allowable contributions are phased out at an AGI of $110,000 ($160,000 for joint filers). Traditional IRAs can be converted to Roth IRAs by payment of income tax on the IRA assets that have not been taxed. (For conversions made during 1998, this tax liability can be averaged over 4 years.) Eligibility for conversion is limited to tax filing units with AGI not in excess of $100,000.

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[7] U.S. Internal Revenue Service. *Statistics of Income*. Washington, various years.

[8] Before 1997, the combined annual contribution to the IRAs of a working and a nonworking spouse could not exceed $2,250. This provision was changed by P.L. 104-188.

[9] A person's eligibility for a deductible IRA may be limited by a spouse's employer plan coverage as well. Under new rules established in P.L. 105-34, a person whose spouse is in an employer plan can still deduct a full $2,000 IRA contribution from taxable income if the couple's AGI does not exceed $150,000. Partial deductibility is allowed if AGI is less than $160,000.

[10] The limits on annual IRA contributions and the income thresholds for tax deferral are not indexed for inflation. However, the tax deferral thresholds will rise until 2007 according to a schedule adopted in P.L. 105-34.

Table 1. Determinants of Eligibility to Deduct Contribution to Traditional IRA in 2000

Tax filing and employment status	Eligibility for employer pension plan	2000 Adjusted gross income (AGI)	Eligibility to deduct IRA contribution
Single/employed	Not eligible	Any amount	Full
Single/employed	Eligible	$0-$32,000	Full
Single/employed	Eligible	$32,001-$41,999	Limited[a]
Single/employed	Eligible	$42,000 or more	None
Joint/employed	Not eligible	Any amount	Full
Joint/employed	Eligible	$0-$52,000	Full
Joint/employed	Eligible	$52,001-$61,999	Limited[a]
Joint/employed	Eligible	$62,000 or more	None
Joint/nonworking spouse	Not eligible, nor is working spouse	Any amount	Full
Joint/nonworking spouse	Not eligible, but working spouse is eligible	$0-$150,000	Full
Joint/nonworking spouse	Not eligible, but working spouse is eligible	$150,001-$159,999	Limited[a]
Joint/nonworking spouse	Not eligible, but working spouse is eligible	$160,000 or more	None

[a] The ceiling on deductible contributions declines proportionately from $2,000 at the lower end of the AGI range to $0 at the upper end.

Section 401(k) Plans[11]

The §401(k) plan, also called a cash-or-deferred arrangement (CODA), was formally authorized by the Revenue Act of 1978 (P.L. 95-600) as a salary reduction arrangement for employees of profitmaking firms, although such plans had existed earlier under Internal Revenue Service (IRS) revenue rulings. Subsequently, certain nonprofit organizations were permitted to establish §401(k) plans. This authority was rescinded in the 1986 Tax Reform Act, with the following exceptions: rural electric cooperatives and associations of such cooperatives; rural telephone cooperatives; the Tennessee Valley Authority; government plans started before May 6, 1986; and private tax-exempt organizations' plans started before July 2, 1986. Effective in 1997 (P.L. 104-188), authority to establish §401(k) plans was regained by nonprofit employers but not by governments. This authority was restored to government agencies that operate water conservation and irrigation districts by P.L. 105-34.

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[11] Treatment similar to that for §401(k) plans is granted to employee contributions to certain trusts by §501(c)(18) of the tax code. This section, added by the Tax Reform Act of 1969 (P.L. 91-172), allows tax deferrals for contributions to trusts that were established as retirement saving plans for union members before June 25, 1959.

In 1995, 29.9 million workers were covered by §401(k) plans. Most of the covered group (28.1 million) were active participants.[12] Participation rates rise as earnings levels increase. While 87% of §401(k) plans are the primary retirement plans offered by employers, many of these are small firms. Only 44% of §401(k) active participants are in §401(k) plans that are their firms' primary retirement plans.[13]

A §401(k) plan permits employees to elect to contribute a part of wages on a tax-deferred basis to a plan that usually offers several investment options. Employers usually make contributions, which also are treated as tax-deferred income of the employees. In a typical plan, the employer puts in 50 cents for each dollar of employee contributions up to 6% of salary.

An individual's elective contributions are limited to $10,500 in 2000. (The limit was set at $7,000, effective in 1987, and has since been adjusted annually for price inflation.)[14] Further restrictions apply to "highly compensated" participants under "nondiscrimination" rules, which are intended to assure that plans benefit rank-and-file workers.[15]

The Federal Employees' Thrift Savings Plan

The Federal Employees' Retirement System Act of 1986 (P.L. 99-335), in establishing the Federal Employees' Retirement System (FERS) for federal employees covered by Social Security, created a salary reduction retirement plan modeled on the §401(k) plan. This plan also was made available, on different terms, to employees under the predecessor Civil Service Retirement System (CSRS). According to Federal Thrift Board data, as of March 1999, there were 1.9 million federal employees currently contributing through salary reductions.[16] Contributing employees represented 86% of FERS enrollees and 61% of CSRS enrollees. The plan's assets totaled $85 billion as of December 31, 1999.[17]

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[12] Pension and Welfare Benefits Administration, *Private Pension Plan Bulletin*, p. 49. Active participants are those who are current employees of the plan sponsor and eligible to contribute to the plan.

[13] Ibid., p. 51.

[14] The §401(k) employee contribution limit is adjusted annually. The adjustment is made by comparing the average Consumer Price Index (CPI-U) figure for the third quarter of the preceding calendar year to the corresponding figure for the prior year. The adjusted figure is rounded down to the nearest multiple of $500. Thus, the 2000 limit of $10,500 will not rise until inflation drives the adjusted figure to $11,000 or more.

[15] Beginning in 1999, a §401(k) plan that meets a "safe harbor" plan design set forth in P.L. 104-188 is exempt from nondiscrimination testing. In tax law, taxpayers who meet *safe harbor* criteria generally are presumed to be in compliance with the tax law related to those criteria.

[16] Another 0.2 million FERS enrollees received a government contribution to their thrift accounts equal to 1% of salary but chose not to make elective contributions.

[17] Pensions and Investments, New York, January 24, 2000.

Federal employees under FERS may contribute up to 10% of salary but no more than $10,500 in 2000; federal matching contributions apply to the first 5% of salary contributed. Employees under CSRS may contribute up to 5% of salary to the thrift plan, but they receive no government contributions.

The thrift plan offers participants a choice among three investment funds: government securities, common stocks, and fixed-income securities. New investment funds (a small capitalization stock index fund and an international stock index fund) were approved in P.L. 104-208 and will become available in October 2000.

Section 403(b) Plans

These plans, which are tax-sheltered annuities that permit employee salary deferrals, were established in law in 1958 (P.L. 85-866). They provide annuities for employees of public educational organizations and organizations that qualify for tax-exempt status under §501(c)(3) of the Internal Revenue Code. This latter group generally consists of nonprofit research, scientific, educational, and charitable organizations.

Employee tax-deferred contributions are generally subject to an annual ceiling of $10,500. This ceiling is adjusted for inflation in tandem with the indexed ceiling for §401(k) plans. (It was fixed at $9,500 from 1987 through 1997, however.) Total contributions from both employee and employer are subject to the overall limit on all retirement contributions on behalf of an employee. The nondiscrimination rules apply to contributions made by the employer to §403(b) plans and may limit contributions for highly compensated employees.

A large number of §403(b) plans are invested with the Teachers Insurance Annuity Association and the College Retirement Equity Fund (TIAA-CREF). At the end of 1999, TIAA-CREF managed assets worth $288 billion for 2.2 million participants from about 9,700 institutions.[18]

Section 457 Plans

Section 457 was added to the Internal Revenue Code by the Revenue Act of 1978. This legislation codified a practice of state and local governments that had developed over the years. These plans provide for salary deferrals by employees of state and local governments and other tax-exempt organizations. All states now offer §457 plans, but these plans generally are not offered to all their employees. At the end of 1998, §457 plans held $57 billion in assets.[19]

Unlike §401(k) and §403(b) plans, which are considered retirement plans "qualified" for preferred treatment under federal tax law, §457 plans are not

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[18] *College Retirement Equities Fund Prospectus*. CREF, New York. May 1, 2000.

[19] *Pensions and Investments*, July 26, 1999.

"qualified" plans.[20] Thus, the conditions for tax deferral of contributions to §457 plans are specified only in §457, and many of these rules differ from those of qualified plans.

Contributions are limited in 2000 to the lesser of $8,000 or one-third of compensation. This limit is reduced dollar for dollar for any contributions an employee makes to a §401(k) or §403(b) plan. The limit had been fixed at $7,500 from 1986 through 1997, but it became subject to inflation adjustments in $500 intervals in 1997 and received its first increase (to $8,000) in 1998.

Salary Reduction Arrangements in Simplified Employee Pension Plans (SARSEPs)

A SEP consists of IRAs that are funded completely by the employer on behalf of all eligible employees. Contributions are allowed up to the lesser of 15% of earnings or $30,000 annually and must apply to each employee account uniformly as a percent of salary. In 1992, no more than 4% of employees of small businesses participated in SEPs.[21]

This employer-provided retirement arrangement was expanded by a provision of the Tax Reform Act of 1986 to permit employees to make elective tax-deferred contributions to SEPs through salary reduction (SAR). SARSEPs were allowed only for firms with 25 or fewer employees. An employee with this option can make elective contributions that are in addition to amounts contributed by the employer, but total contributions from both sources are limited to the lesser of 25% of earnings or $30,000. Elective contributions are subject to the same $10,500 limit as a §401(k) plan. The authority to establish new SARSEPs expired on December 31, 1996, because of provisions in P.L. 104-188 authorizing SIMPLE (discussed below).

Savings Incentive Match Plans for Employees of Small Employers (SIMPLE)

P.L. 104-188 authorized employers with 100 or fewer employees and no employer-sponsored retirement plan to offer "salary incentive match plans for employees of small employers" (SIMPLE) in years beginning on or after January 1, 1997. These plans can be set up as either: (1) SIMPLE retirement accounts for all eligible employees; or (2) §401(k) plans operating under special rules. Employees can defer up to $6,000 a year (indexed in $500 intervals) from salary as contributions to the plan, which the employer must either match according to a specified formula or

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[20] The term "qualified plan" refers to a plan that is qualified as a tax-deferred plan by an Internal Revenue Service (IRS) determination and is, therefore, eligible for certain advantages under the tax laws. Of the plans described in this report, only §457 plans and IRAs are not qualified plans. The tax treatment of these plans is specified separately in the law.

[21] U.S. General Accounting Office. *Private Pensions: Changes Can Produce A Modest Increase in Use of Simplified Employee Pensions*. GAO/HRD 92-119, July 1992. Washington, GPO, 1992.

augment with a contribution of 3% of each participant's wages. SIMPLEs are exempt from certain nondiscrimination rules and reporting requirements.[22]

Plan Rules

Although the Tax Reform Act of 1986 made great strides toward bringing the different types of salary reduction plans under uniform rules, there still are significant variations by plan type. This section reviews the current rules for eligibility, vesting, contributions, investments, and withdrawals. *The general rules are stated first; important exceptions that pertain to particular types of plans are then provided.*

Eligibility Requirements

A plan offered by an employer must be available to all employees on a nondiscriminatory basis. Employees can be excluded on the basis of age (under 21) and length of service with the employer (less than 1 year). A 2-year eligibility limit can be imposed if benefits are fully vested at that time. No maximum age for eligibility is permitted.

There are also rules relating to a plan's breadth of coverage of the employer's workforce. A plan must cover either: (1) at least 70% of all "nonhighly compensated" employees; or (2) a percentage of such employees that equals at least 70% of the percentage of "highly compensated" employees the plan covers. If neither of these tests is met, the plan must meet the "average benefits test." This test requires that employer contributions for the nonhighly compensated, expressed as a percent of total employee compensation, equal at least 70% of the corresponding percentage figure for the highly compensated.

A highly compensated employee includes anyone who falls into one of two categories: (1) those who own at least 5% of the firm (5% owners); or (2) those with annual compensation above $85,000 in 2000 (adjusted annually for price inflation in $5,000 intervals). Employers can restrict the latter group further by requiring that they also fall within the top 20% of employees ranked by pay.[23] (The history of these inflation-adjusted amounts is shown in **Table 2**.)

Exceptions. In the case of a *SEP*, accounts must be established for all employees except those in categories that are excludible under federal law. A *SARSEP* may be offered only by employers with 25 or fewer employees. At least half of the employees must make elective salary deferrals.

An *IRA* is not subject to these eligibility rules since it is not employer-sponsored. To be eligible to contribute to an IRA, the only requirement is that the taxpayer either

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[22] For more information, see: CRS Report 96-758, *Pension Reform: SIMPLE Plans for Small Employers*, by James R. Storey.

[23] This definition of highly compensated was included in P.L. 104-188 to simplify provisions of prior law.

have earned income or have a spouse with earned income. (Whether or not IRA contributions are tax-deferred is discussed below under *Tax Treatment of Contributions*.)

A *SIMPLE* must extend eligibility to all employees who were paid at least $5,000 in any 2 prior years and are expected to earn at least $5,000 in the current year.

Federal eligibility requirements do not apply to *§457 plans*, which are not considered "qualified" retirement plans under the tax law. However, the state and local governments and the nonprofit organizations that sponsor §457 plans apply their own eligibility rules.

Table 2. Limits Defining Highly Compensated Group, 1987-2000

	Minimum annual salary to be in highly compensated group:[a]	
Year(s)	**For employees generally**	**For employees with pay in top 20% of workforce**
1987	$75,000	$50,000
1988	78,353	52,235
1989	81,720	54,480
1990	85,485	56,990
1991	90,803	60,535
1992	93,518	62,345
1993	96,368	64,245
1994	99,000	66,000
1995-96	100,000	66,000[b]
1997-99	80,000[c]	80,000[c]
2000	85,000	85,000

[a] Prior to 1987, there were no statutory limits defining the highly compensated group.
[b] The 1994 limit remained unchanged from year to year because of a new rounding rule that allows the limits to rise only in $5,000 intervals.
[c] The 1997 limits were set by P.L. 104-188. They are indexed in $5,000 intervals.

A special set of rules applies to eligibility for elective deferrals under *§403(b) plans*. The opportunity to make deferrals of more than $200 must be available to all employees on a basis that does not favor the highly compensated. Employees may be excluded from the plan only if they are either: (1) nonresident aliens with no U.S. income; (2) students in the employing institution who work for the institution fewer than 20 hours per week; or (3) employees who participate in another deferred compensation arrangement offered by the employer. A §403(b) plan maintained for church employees is exempt from rules for coverage and nondiscrimination. An educational institution may exclude all employees under age 26 in a §403(b) plan with vesting of 1 year or less.

A plan that has received no employer contributions since September 2, 1974, is not subject to these eligibility rules if it met the corresponding rules that were in effect before that date. This exception covers *§501(c)(18) plans*.

Vesting

Employer contributions deposited in a retirement plan may not become the property of the individual concerned until some condition is met. When an individual does gain legal ownership of retirement funds, those funds are said to be "vested" in that individual.

All salary deferral contributions by an *employee* must vest at once. Employer contributions must vest at least as quickly as one of the following schedules requires: 100% after 5 years (5-year cliff vesting); or 20% a year beginning with 3 years of service and reaching full vesting after 7 years (graded vesting). These vesting standards are displayed in **Table 3**.

Table 3. Minimum Requirements for Vesting of Employer Contributions to Qualified Retirement Plans

	Minimum percentage of employer contribution that must be vested			
			Top-heavy plan rule	
Completed years of participation	Cliff vesting	Graded vesting	Cliff vesting	Graded vesting
1	0	0	0	0
2	0	0	0	20
3	0	20	100	40
4	0	40	100	60
5	100	60	100	80
6	100	80	100	100
7 or more	100	100	100	100

Exceptions. *"Top-heavy" plans* must vest more quickly under one of two schedules: either 100% vesting after 3 years, or 20% a year beginning with 2 years of service. A top-heavy plan is one in which 60% or more of the assets are concentrated in the accounts of owners, officers, and highly compensated employees.

Employer contributions to *SIMPLEs* must vest at once.

Slower vesting had been allowed in collectively bargained *multiemployer plans*, which could use 10-year cliff vesting. However, P.L. 104-188 eliminated this special treatment as of the earlier of 1999 or the year in which the bargaining agreement expired.

Federal vesting standards do not apply to *§457 plans.* Vesting rules are not needed for *IRAs* since all contributions are from the participant.

Tax Treatment of Contributions

Amounts contributed by employees and employers that fall within the allowable limits discussed below (see *Limits on Contributions*) are not subject to the federal income tax in the year in which they are made. Taxation occurs in the year that the funds are withdrawn from the plan. Investment earnings on the contributions also receive tax-deferred treatment. However, contributions *are* subject to FICA (Social Security) and FUTA (unemployment) taxes in the year the funds are contributed.

A 10% excise tax is applied against the employer for any contributions in excess of the allowable limits. The employer can avoid this excise tax by refunding the excess contributions, together with earnings on those contributions, to plan participants within 2½ months after the plan year's end.

Excess deferrals by an employee that are withdrawn to avoid a penalty, if withdrawn by the April 15 following the employee's taxable year, are not subject to penalties for early or excess withdrawals (discussed later in the section entitled *Tax Treatment of Withdrawals*).

Exceptions. Income tax deferral is not allowed for contributions to *Roth IRAs*.

Contributions to *traditional IRAs* are not tax-deferred if the contributor is an active participant in an employer-sponsored plan and has AGI above a certain level. These AGI levels are not adjusted for inflation, but they will rise annually through 2007 according to a schedule adopted in P.L. 105-34. In 2000, if AGI is above $42,000 ($62,000 for a joint filer), no deduction is allowed. If AGI is between $32,000 and $42,000 ($52,000 and $62,000 for a joint filer), a deduction is allowed up to a ceiling. The deductible ceiling equals $2,000 times the following quantity: 1.0 minus the quotient of (1) the excess AGI over the lower end of the income range divided by (2) $10,000. An active participant in an employer plan includes anyone whose employer would have been obligated to contribute to the plan had the employee chosen to contribute, whether or not contributions were actually made.

The AGI thresholds for deductibility of IRA contributions formerly applied to an uncovered spouse of a person who has employer plan coverage. However, a higher threshold was adopted for uncovered spouses by P.L. 105-34. Full deductibility for noncovered spouses is now allowed for AGI of $150,000 or less. Partial deductibility is permitted up to an AGI of $160,000.

The AGI thresholds for full deductibility of IRA contributions by a single filer will increase to the following levels: $33,000 in 2001; $34,000 in 2002; $40,000 in 2003; $45,000 in 2004; and $50,000 in 2005 and thereafter. The phaseout interval for deductibility will continue to be $10,000. For joint filers, the AGI thresholds for full deductibility will increase to the following levels: $53,000 in 2001; $54,000 in 2002; $60,000 in 2003; $65,000 in 2004; $70,000 in 2005; $75,000 in 2006; and $80,000 in 2007 and thereafter. The phaseout interval for deductibility by joint filers

will continue to be $10,000 until 2007, when it will increase to $20,000. Thus, in 2007, partial deductibility will be allowed for joint filers with AGI up to $100,000.

A contribution to an *IRA* in excess of the $2,000 annual limit is subject to a 6% excise tax if not withdrawn from the IRA before April 15 following completion of the tax year.

The FICA and FUTA taxes do not apply to *SARSEP* salary reduction contributions.

Excise taxes do not apply to *§457 plans*, but excess contributions are treated as the employee's taxable income in the current year.

Limits on Contributions

Individual plans may set their own limits on the amounts that can be contributed. However, all plans must abide by the limits established in the Internal Revenue Code. Employee contributions from salary deferrals are limited to $10,500 in 2000 (indexed for inflation in $500 intervals). Persons who participate in more than one plan have the sum of their contributions to all plans subject to this $10,500 ceiling.

There is also an overall limit on combined contributions that can be made by employee and employer to an employee's accounts in all available defined contribution retirement plans. That limit is the lesser of $30,000 a year or 25% of compensation. In 1996, the $30,000 limit equaled one-fourth of the corresponding $120,000 indexed limit on benefits payable from defined benefit plans. Attainment of this ratio meant that the contribution limit thereafter would be indexed, but only in $5,000 intervals. Thus, the annual defined contribution limit will remain at $30,000 until the inflation-adjusted amount reaches $35,000.

A further limit may apply to elective salary deferrals by highly compensated employees and to employer matching.[24] The average deferral percentage of the highly compensated is limited by a formula tied to the average deferral percentage for nonhighly compensated employees (**Table 4**). This formula is called the "nondiscrimination test." The history of salary deferral limits is shown in **Table 7**.

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[24] The definition of a highly compensated employee is given in the section entitled *Eligibility Requirements*.

Table 4. Limits on Salary Deferrals by Highly Compensated Employees Under the Nondiscrimination Test

If average deferral rate[a] of nonhighly compensated is:	Then average deferral rate[a] of highly compensated may not exceed:[b]
0%	0%
1	2
2	4
3	5
4	6
5	7
6	8
7	9
8	10
9	11.25
10	12.50
11	13.75
12	15
13	16.25
14	17.50
15	18.75
16	20
17	21.25
18	22.50
19	23.75
20	25
21	25
22	25
23	25
24	25
25	25

[a] A group's deferral rate is determined by averaging the elective deferrals as a percent of salary for each employee in the group. A plan has the option to include qualified matching and nonelective contributions to the employee's account in performing this calculation.

[b] These limits on deferrals as a percent of salary apply to §401(k) and §501(c)(18) plans, to SARSEPs, and to employer contributions to §403(b) plans. However, they do not apply to SIMPLE §401(k) plans.

The level of annual compensation on which contributions can be based is limited to $170,000 in 2000. This limit was reduced from the 1993 level ($235,840) by P.L. 103-66. (See **Table 5** for the complete history of this limit.) The limit is indexed for inflation annually but can rise only in $10,000 steps. This limit on includible compensation constitutes an indirect limit on amounts that can be contributed by the highly compensated and, therefore, can affect a plan's nondiscrimination test calculations.

Table 5. Limits on Annual Compensation That Can Be Used to Determine Plan Contributions, 1989-2000

Year(s)	Maximum countable compensation[a]
1989	$200,000
1990	209,200
1991	222,220
1992	228,860
1993	235,840
1994-96	150,000[b]
1997-99	160,000
2000	170,000

[a] P.L. 99-514 extended to all qualified plans a $200,000 limit that had applied before 1989 only to SEPs and to collectively bargained plans.

[b] The 1993 limit was reduced to $150,000 for 1994 by P.L. 103-465. It may remain unchanged from year to year because it can rise with inflation only in $10,000 intervals.

Exceptions. Variations in limits on elective salary deferrals by plan type are shown in **Table 6**. *IRA* contributions are limited to the lesser of 100% of earnings or $2,000 (or a total of $4,000 for a worker and a nonworking spouse). The overall limit (the lesser of $30,000 or 25% of earnings) does not apply to IRAs, nor does the rule coordinating the limit on salary deferrals for persons in more than one plan. However, the IRA limit does govern contributions to all of the IRAs an individual owns.

Higher salary deferral limits apply for *§403(b) plan* participants with more than 15 years of service. These "catch-up" contributions cannot exceed $3,000 in any 1 year or $15,000 in total. However, catch-up contributions cannot be made if an employee's lifetime salary reductions exceed $5,000 times years of service.

Salary deferrals in a *§457 plan* are limited to the lesser of $8,000 (indexed in $500 intervals) or one-third of compensation. Up to $15,000 of unused deferrals may be contributed in one or more of an employee's last 3 years prior to retirement. §457 plan participants who also contribute to a §401(k) plan or a §403(b) plan have their combined deferrals for all plans limited to the $8,000 annual §457 ceiling.

The *Federal Employees' Thrift Savings Plan* limits salary deferrals to 10% of salary for employees covered by FERS and 5% of salary for those under CSRS. The limits established by the nondiscrimination test do not apply to the Thrift Savings Plan because of legislation included in the FY1988 Continuing Resolution (P.L. 100-202). The §401(k) annual limit on elective contributions of $10,500 does apply, however.

Annual salary deferrals in a *SIMPLE* are limited to $6,000 (indexed in $500 intervals). The nondiscrimination test is waived for deferrals to these plans.

Beginning in 1999, *§401(k) plans* that meet one of two employer contribution goals set forth in P.L. 104-188 have the nondiscrimination test waived. These "safe harbor §401(k)s" must have (1) employer contributions to the accounts of all eligible nonhighly compensated employees of at least 3% of pay or (2) matching contributions at least as generous as the following: $1 for each $1 of salary deferral up to 3% of pay, plus $0.50 for each $1 of salary deferral over the next 2% of pay.

Table 6. Limits on Annual Contributions to Salary Deferral Plans by Plan Type, 2000

Plan type	Limit is lesser of: Annual dollar limit	Limit is lesser of: Percent of earnings[a]	Is dollar limit inflation indexed?[b]	Does nondiscrimination test apply to elective salary deferrals?
IRA-employee	$2,000	100%	No	No
IRA-nonworking spouse	2,000[c]	[c]	No	No
401(k)	10,500[d]	25%	Yes	Yes[e]
403(b)	10,500[d]	25%[f]	Yes	No[g]
457	8,000[d]	33⅓%	Yes	No
501(c)(18)	10,500[d]	25%	Yes	Yes
SARSEP	10,500[d]	25%	Yes	Yes
Federal thrift plan—FERS	10,500[d]	10%	Yes	No
Federal thrift plan—CSRS	10,500[d]	5%	Yes	No
SIMPLE retirement account	6,000	[h]	Yes	No
SIMPLE 401(k)	6,000	25%	Yes	No

[a] The 25% limit for qualified plans applies to the sum of employer contributions and employee salary deferrals.

[b] A provision in P.L. 103-465 changed the indexing of these limits. The adjusted limit is now rounded down to the nearest amount divisible by 500.

[c] Contributions of a worker and a nonworking spouse in combination cannot exceed 100% of the worker's earnings.

[d] For persons participating in more than one plan, the $10,500 limit applies to the combined salary deferral contributions to §401(k), §403(b), and §501(c)(18) plans, to SARSEPs, and to the federal thrift plan. The lower $8,000 limit applies to the combined contributions to a §457 plan and any other plan.

[e] Effective in 1999, a §401(k) plan is exempt from the nondiscrimination test if it meets a "safe harbor" plan design set forth in P.L. 104-188.

[f] Salary deferral amounts in §403(b) plans are also limited by a formula that takes into account current salary, length of service, and amounts contributed in prior years.

[g] The nondiscrimination test applies only to employer contributions for §403(b) plans.

[h] No percentage limit is stated in the law for salary deferrals to SIMPLE retirement accounts.

Table 7. Annual Dollar Limits on Elective Salary Deferrals, 1975-2000

	Annual elective deferral limit by plan type:				
Year(s)	§401(k)[a]	§403(b)[b]	§457 [b]	IRA	SIMPLE
1975-78	—	[c]	—	$1,500	—
1979	—	[c]	$7,500	1,500	—
1980-81	[c]	[c]	7,500	1,500	—
1982-86	[c]	[c]	7,500	2,000	—
1987	$7,000	$9,500	7,500	2,000	—
1988	7,313	9,500	7,500	2,000	—
1989	7,627	9,500	7,500	2,000	—
1990	7,979	9,500	7,500	2,000	—
1991	8,475	9,500	7,500	2,000	—
1992	8,728	9,500	7,500	2,000	—
1993	8,994	9,500	7,500	2,000	—
1994-95	9,240[d]	9,500	7,500	2,000	—
1996	9,500	9,500[e]	7,500	2,000	—
1997	9,500	9,500	7,500[e]	2,000	$6,000[e]
1998-99	10,000	10,000	8,000	2,000	6,000
2000	10,500	10,500	8,000	2,000	6,000

[a] These limits also apply to §501(c)(18) plans, SARSEPs, and the Federal Employees' Thrift Savings Plan.
[b] Limits may be higher in some cases. See text for explanation.
[c] P.L. 99-514 placed dollar limits on §401(k) and §403(b) salary deferrals. Before that, deferrals were subject only to the overall limit on combined employee/employer contributions to qualified plans.
[d] Inflation indexing was changed so that the limit can rise only in $500 intervals.
[e] Beginning of inflation adjustments on the same basis as for §401(k) plans.

The $170,000 limit on the annual compensation that can be used as the basis for plan contributions is not effective for collectively bargained plans before the later of the bargaining agreement's expiration or January 1, 1997. Exempt plans have a $250,000 limit. The $170,000 limit also does not apply to *§401(k) or §403(b) plans sponsored by governmental employers*. These plans may operate under the compensation limit in effect on July 1, 1993. No compensation limit applies to *§457 plans*.

Limits on Investments

Persons acting in a fiduciary capacity are required to follow the "prudent person" rule when investing contributions from salary deferrals. That is, investments are to be made according to the judgments that a prudent investor would make acting individually in investing for retirement.

Unless a special exemption is granted, the law specifically prohibits certain transactions between a plan and "disqualified persons." The disqualified group includes owners, officers, employee organizations, fiduciaries, persons providing services to the plan, family members of disqualified persons, or major partners of any of these persons. An excise tax of 5% is imposed on the amount of any prohibited transaction. Federal law restricts defined benefit pension trusts from holding more than 10% of plan assets in property or stock of the plan sponsor. This restriction was extended to §401(k) plans (discussed below under *Exceptions*).

Salary deferral plans often allow participants to decide how to invest their accounts, but U.S. Department of Labor (DoL) regulations provide guidance on the investment options these plans can offer. A plan that allows participant-directed investing has to offer at least three diversified options with different risk/return characteristics.

Exceptions. Specific investment restrictions apply to *IRAs*, which cannot be invested in collectibles such as art, antiques, and other tangible assets. Such investments are treated as taxable distributions from the IRA. However, IRAs are allowed to invest in certain precious metals.

P.L. 105-34 established a limit on the investment of *§401(k)* assets in securities or property of the employer. Effective in 1999, salary deferrals in excess of 1% of pay that are invested in the employer's securities or property cannot exceed 10% of total plan investments unless the participant elects a higher percentage.

Federal laws on investment policies do not apply to *§457 plans*, but most states apply their own "prudent person" standards.

The DoL regulations that require a range of investment options apply only to qualified plans, thereby excluding *§457 plans* and *IRAs*.

Withdrawal Options

Funds may be withdrawn in four ways — as a loan, a rollover, an annuity contract, or a cash withdrawal. Loans and rollovers that comply with tax laws and regulations are considered nontaxable distributions. Each withdrawal method is discussed below.

Loans. Federal law permits, but does not require, qualified plans to allow loans. Borrowing is subject to a maximum of the lesser of: (1) $50,000; or (2) the greater of one-half of vested contributions or $10,000.

The term of a loan cannot exceed 5 years unless the loan is used to purchase a principal residence. Interest charged on a plan loan is not tax-deductible for the borrower, regardless of the loan's purpose. In determining the amount available for borrowing, the largest amount borrowed in the prior 12 months is deducted from the $50,000 maximum, and the reduced maximum is applied in considering a loan request. At the time that an employee ceases to be covered by a plan, any outstanding loan balance is treated as a taxable distribution from the plan.

Exceptions. Borrowing is not permitted from *IRAs, SEPs, SARSEPs,* or *SIMPLE retirement accounts*. State or local government *§457 plans* may allow loans beginning in 1999, but §457 plans of nonprofit organizations cannot.

The *Federal Employees' Thrift Savings Plan* allows borrowing in amounts up to the employee's own contributions plus investment earnings. Though loans originally were limited to four purposes (medical expenses, education expenses, purchase of a primary residence, financial hardship), this restriction was removed by P.L. 104-208. A thrift plan loan for home purchase may be paid off over 15 years, but other loans cannot exceed 4 years.

Rollovers. A rollover is a tax-free transfer of funds from one tax-deferred retirement account to another. Such transfers must be completed within 60 days to avoid taxation.

Upon leaving employment, a plan participant may roll over vested funds from a qualified salary reduction plan to a qualified plan offered by the next employer (if that plan accepts rollovers) or to a traditional IRA (but not to a Roth IRA). Effective in 1993, a plan distribution can be rolled over regardless of the proportion it constitutes of an individual's total assets in the plan.

Although a rollover is not subject to tax, mandatory income tax withholding at a rate of 20% applies to all lump-sum distributions received directly by a participant from an employer plan, even if the distribution eventually is rolled over and thus not currently taxable. Only rollovers executed by trustee-to-trustee transfers escape tax withholding.

Exceptions. The *Federal Employees' Thrift Savings Plan* does not accept rollovers. Rollovers are not permitted from or to *§457 plans*. Nontaxable transfers may be made between two §457 plans, however. A rollover from a *§403(b) plan* can be made only to another §403(b) plan or to a traditional IRA.

IRAs can be rolled over without regard to employment status, but only to other IRAs owned by the same person. IRA-to-IRA rollovers are limited to 1 per year for each IRA. A *Roth IRA* can be rolled over only to another Roth IRA. A *SIMPLE retirement account* can be rolled over to an IRA only after plan participation exceeds 2 years.

A *traditional IRA* can be converted to a *Roth IRA* by payment of the income tax on any untaxed funds withdrawn from the traditional IRA for this purpose. Only tax filers with AGI of $100,000 or less may convert a traditional IRA to a Roth IRA,

however. Conversions that occurred in 1998 were entitled to 4-year averaging in computing income tax liability.

Annuities and Cash Withdrawals. An annuity is obtained through a contract with an insurance company in which the retirement plan asset is used to purchase a series of benefit payments for a guaranteed time period, the participant's lifetime, or the joint lifetimes of the participant and a surviving beneficiary. A cash withdrawal is the direct removal of funds from an account by the participant, either in a lump sum or in a series of payments. Federal law requires that a plan must begin benefit payments to a participant no later than 60 days after the close of the plan year in which the later of three events occurs: (1) attainment of age 65 or, if earlier, the plan's normal retirement age; (2) completion of 10 years of service; or (3) separation from employment.

To be exempt from a 10% excise tax on early withdrawals, an annuity or a cash withdrawal must be received under one of the following conditions: (1) after attainment of age 59½; (2) upon the death of the accountholder; (3) because of a permanent disability; (4) upon separation from employment under an early retirement provision after attainment of age 55; (5) upon withdrawal at any age if in the form of a life annuity; or (6) because of medical expenses that are large enough to be eligible for itemized deduction treatment under the federal income tax.

At the plan's option, a cash withdrawal can be obtained while employed if needed to meet financial hardship,[25] but only the individual's elective deferrals can be withdrawn for this purpose. Hardship withdrawals are subject to the 10% early withdrawal excise tax unless one of the abovementioned six conditions for exemption are met.

Cash withdrawals are subject to the 20% mandatory income tax withholding described above under *Rollovers* if the withdrawal constitutes a lump-sum distribution or a series of periodic payments received over fewer than 10 years. Otherwise, income tax withholding is optional.

Exceptions. The abovementioned early retirement exception to the early withdrawal penalty (item 4) does not apply for *IRAs*. Also, financial hardship withdrawals are not applicable to *IRAs* since they are not employer plans.

However, two new exceptions included in P.L. 105-34 do apply to *IRAs*. Withdrawals from IRAs, including Roth IRAs, are no longer subject to the 10% early withdrawal tax if the funds are used to pay higher education expenses or to purchase a primary residence. This latter purpose is restricted to accountholders who have not owned a residence in the prior 2 years. The amount that may be withdrawn penalty-free for a home purchase is subject to a lifetime limit of $10,000.

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[25] Hardship withdrawals are allowed in order for a participant to meet immediate and heavy financial needs for which no other resources are available. The following needs meet the definition of hardship: medical expenses; purchase of a principal residence; tuition for postsecondary education; and prevention of eviction from, or foreclosure on, a principal residence.

Withdrawals from a *§457 plan* are permitted upon separation from employment, attainment of age 70½, "unforeseeable emergencies," or death. The early-withdrawal excise tax does not apply to §457 plans.

Early withdrawals from a *SIMPLE retirement account* are subject to a 25% excise tax if made within the accountholder's first 2 years of plan participation.

Required Minimum Distributions. Withdrawals must begin after the later of (1) attainment of age 70½, or (2) retirement from covered employment[26] to avoid tax penalties for late withdrawal. The required beginning date, when age is the controlling factor, is on or before the 1st of April following the calendar year in which age 70½ is attained. The amount of the required annual distribution is determined based on life expectancy using actuarial tables published by the IRS. The required minimum distribution must be made from each affected account. An individual with multiple IRAs must calculate the required distribution based on all IRAs held but may make the actual withdrawal from only one of the IRAs.

Exceptions. Age 70½ is still the sole criterion for required minimum distributions from *IRAs*. However, there is no required minimum distribution from a *Roth IRA*. Required minimum distributions from *§403(b) plans* can be delayed until age 75 for contributions and investment earnings that were credited to those plans before 1987.

Tax Treatment of Withdrawals

Withdrawals of untaxed funds from tax-deferred accounts, unless in the form of a loan or rollover, are taxable when received. However, a number of special situations require further explanation.

General Rules. Amounts withdrawn from salary reduction plans that were contributed or acquired on a tax-deferred basis are subject to the federal income tax in the year the funds are received. Withdrawals are not subject to FICA or FUTA taxes, however. If a plan holds funds that were taxed when contributed (i.e., after-tax contributions), the percentage of the withdrawn amounts that is subject to tax is equal to the percentage that the tax-deferred funds comprise of the account's total assets. For example, if 10% of an individual's vested assets were from after-tax contributions, only 90% of each withdrawal would be subject to the income tax. When funds are withdrawn from an IRA, the tax status is determined according to the tax status of all the individual's IRAs, not just the status of the IRA from which the funds were actually taken.

This pro rata approach to taxation applies regardless of the status of the contributions actually being withdrawn. That is, withdrawals of funds that were identified originally as after-tax contributions are still treated for tax purposes as if they were withdrawn from the larger pool of after-tax and before-tax contributions.

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[26] The retirement date option was instituted by P.L. 100-647 for participants in governmental §457 plans and church plans (§457 or §403(b) plans) and by P.L. 104-188 (effective in 1997) for participants in other types of plans.

This procedure does not change the total amount of taxable income; it simply speeds up the time of taxation by denying the individual control over when taxable amounts are used as income.

Exceptions. Withdrawals from a *Roth IRA* are not subject to the general rule for taxation of retirement distributions. A Roth IRA withdrawal is assumed to come first from contributions until all contributions have been withdrawn. Since contributions to a Roth IRA have already been taxed, these initial withdrawals are tax free, even if the accountholder does not meet the criteria that determine when withdrawals from a Roth IRA generally are tax free. Those criteria do determine when withdrawals of *investment earnings* from a Roth IRA are tax free, however. To withdraw investment earnings from a Roth IRA tax free, the initial investment must have been made for a tax year at least 5 years earlier, and one of the following conditions must exist: (1) the accountholder has attained age 59½; (2) the accountholder is deceased or disabled; or (3) the funds will be used to purchase a primary residence by an accountholder who has not had ownership interest in a home for the prior 2 years.

Early Withdrawals. Taxable withdrawals before age 59½, unless covered by the exceptions listed earlier in the section on *Annuities and Cash Withdrawals*, are subject to an excise tax for early withdrawal. This tax, 10% of the amount of taxable funds withdrawn, is in addition to the regular income tax liability.

Exceptions. The 10% penalty tax does not apply to withdrawals from *§457 plans*. The 10% penalty tax does apply to early withdrawals from *SIMPLE retirement accounts,* but the tax is higher (25%) on early withdrawals by SIMPLE accountholders who have been plan participants for less than 2 years.

Late Withdrawals. An excise tax is applied under all plans for late withdrawals. Late withdrawals are withdrawals that are deficient compared to the required minimum distributions. (See the preceding section on *Required Minimum Distributions.*) The excise tax for a late withdrawal is 50% of the amount of the deficiency.

Large Distributions. The excise tax for large distributions, which did not apply to *§457 plans*, was waived for 3 years (1997-1999) by P.L. 104-188. It was repealed permanently by P.L. 105-34. Prior to 1997, a 15% excise tax was levied for "excessive" distributions. This tax was applied to the excess distributions of an individual who received periodic payments from all plans that summed to more than $155,000 yearly in 1996 (indexed for inflation in $5,000 intervals). (The history of these limits since 1987 is shown in **Table 8**.) A lump-sum distribution was regarded as excessive if it were greater than $775,000 in 1996.[27]

Income Averaging. The 1986 Tax Reform Act phases out the practice of 10-year averaging of lump-sum distributions for tax purposes. Under 10-year averaging, the distribution is treated as if it were received in each of 10 years rather than in the

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[27] This lump-sum threshold amount was set at five times the threshold used to determine excessive annual distributions.

year of actual receipt. The 1986 act allows persons already over age 50 on January 1, 1986, to elect 10-year averaging, but they must use the higher income tax rates that were in effect before the 1986 Tax Reform Act took effect. The 1986 act also ended the option to treat a distribution as a receipt of capital gains under the pre-1974 capital gains tax rules. Such treatment was phased out over the period 1987-1992.

For taxpayers denied 10-year averaging by the 1986 Act, the law allowed 5-year averaging post-1986 tax rates. However, 5-year averaging was ended effective in 2000 by P.L. 104-188.

Table 8. Limits on Plan Distributions, 1987-1997

Year	Annual distribution limit
1987	$112,500
1988	117,529
1989	122,580
1990	128,228
1991	136,204
1992	140,276
1993	144,551
1994	148,500
1995	150,000
1996	155,000
1997	160,000[a]

[a] The limit was waived for 1997-1999 by P.L. 104-188 and then repealed by P.L. 105-34.

Appendix A: Comparison of Federal Rules for Retirement Plans by Plan Type

This appendix provides a series of six tables comparing the federal rules for different types of retirement plans. This comparison covers the plan types analyzed in this report and three other types of employer plans: money purchase plans, in which the employer purchases securities on the behalf of each covered employee on a periodic basis; profit-sharing plans, in which the employer allocates a percentage of annual profits to each employee; and defined benefit (DB) plans, which promise each covered employee that a benefit based on salary and/or tenure will be paid at retirement age from a pension fund.

The rules presented in these tables are federal *limits* on how plans can be designed. There is no mandate that employers offer plans, and plans often have flexibility within the federal rules to set specific limits with respect to such factors as retirement age, benefit level, and contribution rate. Some complications necessarily were omitted to produce this comparison in a compact format. For example, rules variations associated with a plan sponsor's being self-employed are not identified.

Table A-1. Eligibility Rules by Retirement Plan Type

Plan Type	Employer eligibility	Extent of workforce coverage required	Employee eligibility
Traditional IRA	Not applicable	Not applicable	All employed individuals and their spouses
Roth IRA	Not applicable	Not applicable	All employed individuals and their spouses with AGI less than $110,000 (single filers) or $160,000 (joint filers)
SEP IRA	Any employer	100% of nonexcludible employees	Plan may exclude: (1) those under age 21; (2) those who worked for firm in less than 3 of last 5 years; (3) those earning less than $400 in last year; (4) members of bargaining unit; (5) nonresident aliens with no U.S. income
SARSEP IRA	Those with 25 or fewer eligible employees; a SARSEP cannot be started after 12/31/96	At least 50% of eligible employees must defer salary	Plan may exclude: (1) those under age 21; (2) those who worked for firm in less than 3 of last 5 years; (3) those earning less than $400 in last year; (4) members of bargaining unit; (5) nonresident aliens with no U.S. income
SIMPLE IRA	Those with 100 or fewer employees earning at least $5,000; cannot offer another plan	100% of nonexcludible employees	Plan may exclude: (1) those earning less than $5,000 in each of 2 prior years and current year; (2) members of bargaining unit; (3) nonresident aliens with no U.S. income
§401(k)	Any nongovernmental employer; government plans limited to those adopted before 5/6/86 and certain irrigation and drainage entities	Plan must benefit at least 70% of employees who are not highly compensated, or meet one of two other tests	Plan may exclude employees: (1) until later of attaining age 21 or completing 1 year of service; (2) who are members of bargaining unit; (3) who are nonresident aliens with no U.S. income Educational organizations may exclude employees until later of age 26 or 1 year of service if benefits fully vested after 1 year
SIMPLE §401(k)	Nongovernmental employers with 100 or fewer employees earning at least $5,000; cannot offer another plan	Plan must benefit at least 70% of employees who are not highly compensated, or meet one of two other tests	Plan may exclude employees: (1) until later of attaining age 21 or completing 1 year of service; (2) who are members of bargaining unit; (3) who are nonresident aliens with no U.S. income Educational organizations may exclude employees until later of age 26 or 1 year of service if benefits fully vested after 1 year

Plan Type	Employer eligibility	Extent of workforce coverage required	Employee eligibility
Federal Thrift Savings	U.S. government	All employees in groups specified in law; federal agencies must contribute to accounts of all employees covered by FERS[a]	All employees in groups specified in law; employees under CSRS[a] ineligible for employer contributions
§403(b)	Religious, charitable, educational, research, and cultural organizations in the state and local government and nonprofit sectors	Plan must benefit at least 70% of employees who are not highly compensated, or meet one of two other tests	Plan may exclude employees: (1) who participate in §457 plan, §401(k) plan, or another §403(b) plan of employer; (2) who are in bargaining unit; (3) who are nonresident aliens with no U.S. income; (4) who are students in the sponsoring institution and work less than 20 hours a week Educational organizations may exclude employees until later of age 26 or 1 year of service if benefits fully vested after 1 year Eligibility in church plans determined by sponsor
§457	State and local government agencies, nonprofit organizations	No minimum federal requirement, but nonprofits can cover only selected groups	Eligibility determined by sponsor
Money purchase	Any employer	Plan must benefit at least 70% of employees who are not highly compensated, or meet one of two other tests	Plan may exclude employees: (1) until later of attaining age 21 or completing 1 year of service (2 years if benefits fully vested at that time); (2) who are members of bargaining unit; (3) who are nonresident aliens with no U.S. income Educational organizations may exclude employees until later of age 26 or 1 year of service if benefits fully vested after 1 year
Profit-sharing	Any private-sector employer	Plan must benefit at least 70% of employees who are not highly compensated, or meet one of two other tests	Plan may exclude employees: (1) until later of attaining age 21 or completing 1 year of service (2 years if benefits fully vested at that time); (2) who are members of bargaining unit; (3) who are nonresident aliens with no U.S. income Educational organizations may exclude employees until later of age 26 or 1 year of service if benefits fully vested after 1 year

Plan Type	Employer eligibility	Extent of workforce coverage required	Employee eligibility
Private-sector defined benefit	Any private-sector employer[b]	Plan must benefit at least 70% of employees who are not highly compensated, or meet one of two other tests	Plan may exclude employees: (1) until later of attaining age 21 or completing 1 year of service (2 years if benefits fully vested at that time); (2) who are members of bargaining unit; (3) who are nonresident aliens with no U.S. income Educational organizations may exclude employees until later of age 26 or 1 year of service if benefits fully vested after 1 year

[a] CSRS, the Civil Service Retirement System, was replaced for employees hired after 1983 by FERS, the Federal Employees' Retirement System. The Thrift Savings Plan was designed to be an integral part of the retirement benefit for post-1983 hires, along with a FERS DB plan and Social Security.

[b] Governmental employers also sponsor defined benefit (DB) plans. However, most federal rules for DB plans do not apply to governmental plans.

Table A-2. Rules for Employee Contributions by Retirement Plan Type

Plan Type	Annual limit on employee tax-deferred contributions	Annual limit on employee after-tax contributions	Nondiscrimination test for employee salary deferrals
Traditional IRA	$2,000 if employee (and spouse)[a] are not covered by an employer plan or if AGI does not exceed $32,000 (single filers) or $52,000 (joint filers); limit declines to $0 over next $10,000 of AGI;[b] limit is $0 for persons over age 70½	$2,000 minus allowable pre-tax contributions; same limit applies to employee's nonworking spouse	Not applicable
Roth IRA	Tax-deferred contributions not allowed	$2,000[a] if AGI does not exceed $95,000 (single filers) or $150,000 (joint filers); limit declines to $0 over next $15,000 of AGI for single filers (next $10,000 for joint filers)	Not applicable
SEP IRA	Employee contributions not allowed	Employee contributions not allowed	Not applicable
SARSEP IRA	$10,500 (indexed in $500 increments[c])	After-tax employee contributions not allowed	Average deferral percentage (ADP) of highly compensated employees cannot exceed ADP for other employees by more than lesser of: (1) 100% of the nonhighly compensated group's ADP; or (2) greater of (a) 2 percentage points, or (b) 25% of nonhighly compensated group's ADP; this test also applies to employer matching contributions
SIMPLE IRA	$6,000 (indexed in $500 increments[c])	After-tax employee contributions not allowed	Exempt from test
§401(k)	$10,500 (indexed in $500 increments[c])	After-tax employee contributions not allowed	Average deferral percentage (ADP) of highly compensated employees cannot exceed ADP for other employees by more than lesser of: (1) 100% of the nonhighly compensated group's ADP; or (2) greater of (a) 2 percentage points, or (b) 25% of nonhighly compensated group's ADP; this test also applies to employer matching contributions[d]
SIMPLE §401(k)	$6,000 (indexed in $500 increments[c])	After-tax employee contributions not allowed	Deemed to satisfy §401(k) test

Plan Type	Annual limit on employee tax-deferred contributions	Annual limit on employee after-tax contributions	Nondiscrimination test for employee salary deferrals
Federal Thrift Savings	Lesser of $10,500 (indexed in $500 increments[c]) or 10% of pay (5% of pay under CSRS)	After-tax employee contributions not allowed	§401(k) test waived by P.L. 100-202
§403(b)	$10,500 (indexed in $500 increments[c]); catchup deferrals allowed up to $3,000 a year, $15,000 lifetime, for those with over 15 years of service and whose past deferrals do not exceed $5,000 times years of service; contributions also limited by *exclusion allowance* that considers amount contributed over whole career	After-tax employee contributions not allowed	No test for employee salary deferrals, but the §401(k) test does apply to employer matching contributions[d]
§457	Lesser of $8,000 (indexed in $500 increments[c]) or ⅓ of pay; catchup deferrals allowed up to $15,000 in last 3 years before retirement	After-tax employee contributions not allowed	Not applicable
Money purchase	Tax-deferred employee contributions not allowed	Not applicable	Not applicable
Profit-sharing	Tax-deferred employee contributions not allowed[e]	Not applicable[e]	Not applicable
Private-sector defined benefit	Tax-deferred employee contributions not allowed	After-tax employee contributions allowed; no limit specified in federal law	Not applicable

[a] A nonworking spouse can also contribute $2,000, but the couple's combined contributions cannot exceed their combined earnings. A spouse's participation in an employer plan does not disqualify an individual from making a deductible contribution, but the maximum deductible contribution is phased out as the couple's joint AGI rises from $150,000 to $160,000.

[b] The $10,000 phase-out range begins at $32,000 and $52,000 for 2000, at $33,000 and $53,000 for 2001, at $34,000 and $54,000 for 2002, at $40,000 and $60,000 for 2003, at $45,000 and $65,000 for 2004, at $50,000 and $70,000 for 2005, at $50,000 and $75,000 for 2006, and at $50,000 and $80,000 for 2007 and thereafter. The phase-out interval remains at $10,000 until 2007, when it will increase to $20,000 for joint filers.

[c] When an amount is said to be "indexed in increments," the indexed amount remains unchanged until inflation adjustments exceed the specified increment, at which time the indexed figure rises by the amount of the increment. For example, the §401(k) salary deferral limit rose from $10,000 to $10,500 in 2000 because of 2 years of cumulative inflation adjustments to the $10,000 ceiling.

[d] A provision of P.L. 104-188, effective in 1999, deems the nondiscrimination test to be met for §401(k) plans and §403(b) plans that comply with a "safe harbor" design in regard to the level of employer contributions.

[e] In a conventional profit-sharing plan, the employer makes all the contributions. If after-tax employee contributions are made, the plan would be termed a profit-sharing *thrift* plan. Voluntary after-tax employee contributions are sometimes permitted by profit-sharing and thrift plans.

Table A-3. Employer Contribution Rules by Retirement Plan Type

Plan Type	Annual limit on employer contributions[a]	Is year-to-year flexibility allowed in employer contributions?	Vesting requirements for employer contributions	Employer plan funding requirements
Traditional IRA	No employer contribution	Not applicable	Not applicable	Not applicable
Roth IRA	No employer contribution	Not applicable	Not applicable	Not applicable
SEP IRA	Lesser of 15% of pay or $30,000 (indexed in $5,000 increments)	Yes	Immediate	Contributions and investment earnings held in IRAs
SARSEP IRA	Lesser of 15% of pay or $30,000 (indexed in $5,000 increments)	Yes	Immediate	Contributions and investment earnings held in IRAs
SIMPLE IRA	Employer must contribute according to one of two formulas: (1) 2% of pay; (2) 100% match of employee deferrals up to 3% of pay	Matching rate can apply to as little as 1% of pay, but must apply to 3% of pay at least 3 out of every 5 years	Immediate	Contributions and investment earnings held in IRAs
§401(k)	Lesser of 25% of pay or $30,000 (indexed in $5,000 increments)	Yes, if §401(k) is part of a profit-sharing or stock bonus plan	ERISA rules[b]	Contributions and investment earnings held in individual trust fund accounts
SIMPLE §401(k)	Employer must contribute according to one of two formulas: (1) 2% of pay; (2) 100% match of employee deferrals up to 3% of pay	Yes, if §401(k) is part of a profit-sharing or stock bonus plan	Immediate	Contributions and investment earnings held in individual trust fund accounts
Federal Thrift Savings	Employer must contribute 1% of pay to each FERS employee's account and match employee salary deferrals at rate of 100% for first 3% of pay plus 50% for next 2% of pay, yielding a maximum employer contribution of 5% of pay; employer cannot contribute to CSRS employees' accounts	No	Immediate for federal matching; 3 years for automatic 1% federal contribution (2 years for some noncareer employees)	Contributions and investment earnings held in individual trust fund accounts

Plan Type	Annual limit on employer contributions[a]	Is year-to-year flexibility allowed in employer contributions?	Vesting requirements for employer contributions	Employer plan funding requirements
§403(b)	Lesser of 25% of pay or $30,000 (indexed in $5,000 increments); also limited by *exclusion allowance* that considers all contributions over career	No	Immediate except for failure to pay premiums	Contributions fund individual annuities or may be invested in custodial trust fund accounts
§457	No employer contributions	Not applicable	Not applicable	In nonprofit plans, funds held by employer; in state/local plans, contributions and investment earnings held in individual trust fund accounts
Money purchase	Lesser of 25% of pay or $30,000 (indexed in $5,000 increments)	No	ERISA rules[b]	Minimum funding requirements apply; contributions are made according to a fixed formula
Profit-sharing	Aggregate amount cannot exceed 15% of compensation of all employees; also limited to lesser of 25% of individual's pay or $30,000 (indexed in $5,000 increments)	Yes	ERISA rules[b]	Contributions set by plan sponsor, do not have to be from current profits; minimum funding requirements do not apply
Private-sector defined benefit	Employer must contribute enough to avoid negative balance in *funding standard account*; may not exceed *full funding limit*	Yes, within a minimum/maximum range	ERISA rules[b]	Determined by ERISA and tax code;[c] must fund benefits earned each year and amortize any past unfunded liabilities over 30-40 years

[a] The annual employee pay upon which employer contributions can be based is limited to $170,000 (indexed in $10,000 increments). Limits on employer contributions apply to employee salary deferrals as well, because these deferrals are considered in the tax code to be contributions made by employers at the behest of employee elections to defer current receipt of a part of pay.

[b] ERISA and the tax code require that employer contributions be fully vested after completion of 5 years of service, or after 7 years if vested in steps of 20% beginning after 3 years of service.

[c] ERISA and the tax code set rules for the funding of defined benefit (DB) pension liabilities. DB plans must establish a *funding standard account* to which charges and credits are made. Plans must fund pension benefits earned each year (*normal cost*) and amortize past service liabilities over 30 to 40 years. Actuarial gains and losses must be amortized over 5 years and changes in actuarial assumptions over 10 years. An additional funding requirement (*deficit reduction contribution*) applies to plans that are less than 90% funded. The funding standard account provides employers with some funding flexibility.

Table A-4. Nondiscrimination and Integration Rules by Retirement Plan Type

Plan Type	Nondiscrimination rules[a]	Social security integration[b]	Rules for top-heavy plans[c]
Traditional IRA	Not applicable	Not applicable	Not applicable
Roth IRA	Not applicable	Not applicable	Not applicable
SEP IRA	Not applicable	Difference in contribution rates above and below Social Security taxable wage base cannot exceed 5.7 percentage points	Applicable
SARSEP IRA	Not applicable	Not allowed	Applicable
SIMPLE IRA	Not applicable	Not allowed	Exempt
§401(k)	Cannot discriminate among employees in regard to benefit availability, rights, or features	Not allowed	Applicable
SIMPLE §401(k)	Cannot discriminate among employees in regard to benefit availability, rights, or features	Not allowed	Exempt
Federal Thrift Savings	Not applicable	Not allowed	Exempt
§403(b)	Cannot discriminate among employees in regard to benefit availability, rights, or features	Difference in contribution rates above and below Social Security taxable wage base cannot exceed 5.7 percentage points	Applicable
§457	Not applicable	Not applicable	Not applicable
Money purchase	Cannot discriminate among employees in regard to benefit availability, rights, or features	Difference in contribution rates above and below Social Security taxable wage base cannot exceed 5.7 percentage points	Applicable

Plan Type	Nondiscrimination rules[a]	Social security integration[b]	Rules for top-heavy plans[c]
Profit-sharing	Cannot discriminate among employees in regard to benefit availability, rights, or features; allocation of employer contributions cannot favor highly compensated employees	Difference in contribution rates above and below Social Security taxable wage base cannot exceed 5.7 percentage points	Applicable
Private-sector defined benefit	Cannot discriminate among employees in regard to benefit availability, rights, or features; plan must benefit at least the lesser of: (1) 50 employees, or (2) the greater of (a) 40% of all employees, or (b) 2 employees	*Offset plan* cannot reduce pension below half of accrued benefit; difference in accrual rates above and below Social Security wage base cannot exceed 0.75 percentage point in *excess plan*	Applicable

[a] This column presents the nondiscrimination rules that apply to employer-provided benefits. Nondiscrimination testing of salary deferrals is displayed in **Table A-2**.

[b] If an employer takes Social Security benefits explicitly into account in designing a retirement plan, the plan is said to be *integrated*. Since Social Security benefits favor lower-paid workers, the tax code permits employer-sponsored benefits to favor higher-paid workers, so long as the benefits in combination with Social Security are *nondiscriminatory*.

[c] A top-heavy defined contribution plan is one in which the accounts of key employees hold more than 60% of the plan's total assets. A top-heavy defined benefit plan is one in which the present value of accrued benefits for key employees exceeds 60% of the present value of all accrued benefits. Top-heavy plans are required to vest employer contributions at least as fast as: (1) 100% after 3 years of service; or (2) 20% a year after 2 years. Top-heavy plans also are required to provide employer contributions for non-key employees at least as great as the lesser of: (1) 3% of pay; or (2) the rate provided for key employees. These rules apply only in years in which a plan meets the top-heavy criteria.

Table A-5. Plan Distribution Rules by Retirement Plan Type[a]

Plan Type	Excise tax on early withdrawals	Excise tax on late withdrawals	In-service withdrawals	Rollover options	Loan availability
Traditional IRA	10% of taxable amount withdrawn before age 59½ unless exception[b] applies	50% of amount by which withdrawal falls short of minimum required distribution[c] after age 70½	Allowed	Once a year to another traditional IRA; can be converted to Roth IRA by payment of tax on tax-deferred amounts by accountholders with AGI of less than $100,000	None
Roth IRA	10% of investment earnings withdrawn before age 59½ unless exception[b] applies	None	Allowed	Once a year to another Roth IRA	None
SEP IRA	10% of taxable amount withdrawn before age 59½ unless exception[b] applies	50% of amount by which withdrawal falls short of minimum required distribution[c] after age 70½	Allowed	To another SEP IRA or traditional IRA; can be converted to Roth IRA	None
SARSEP IRA	10% of taxable amount withdrawn before age 59½ unless an exception[b] applies	50% of amount by which withdrawal falls short of minimum required distribution[c] after age 70½	Allowed	To another SARSEP IRA or traditional IRA; can be converted to Roth IRA	None
SIMPLE IRA	10% of taxable amount withdrawn before age 59½ unless an exception[b] applies; penalty is 25% if withdrawal is within first 2 years of SIMPLE participation	50% of amount by which withdrawal falls short of minimum required distribution[c] after age 70½	Allowed	To another SIMPLE IRA or traditional IRA (if in SIMPLE at least 2 years); can be converted to Roth IRA	None
§401(k)	10% of taxable amount withdrawn before age 59½ unless exception[d] applies	50% of amount by which withdrawal falls short of minimum required distribution[c] after later of age 70½ or retirement	Allowed after age 59½, earlier in case of financial hardship	To an employer plan that accepts rollovers or to traditional IRA	Limited to the lesser of (1) $50,000 or (2) the greater of (a) 50% of vested amount or (b) $10,000

Plan Type	Excise tax on early withdrawals	Excise tax on late withdrawals	In-service withdrawals	Rollover options	Loan availability
SIMPLE §401(k)	10% of taxable amount withdrawn before age 59½ unless exception[d] applies	50% of amount by which withdrawal falls short of minimum required distribution[c] after later of age 70½ or retirement	Allowed after age 59½, earlier in case of financial hardship	To an employer plan that accepts rollovers or to traditional IRA	Limited to the lesser of (1) $50,000 or (2) the greater of (a) 50% of vested amount or (b) $10,000
Federal Thrift Savings	10% of taxable amount withdrawn before age 59½ unless exception[d] applies	50% of amount by which withdrawal falls short of minimum required distribution[c] after later of age 70½ or retirement	Allowed in case of financial hardship; one-time withdrawal allowed by employees after age 59½	To an employer plan that accepts rollovers or to traditional IRA	Limited to sum of employee's contributions plus related investment earnings; also limited to lesser of (1) $50,000 or (2) the greater of (a) 50% of vested amount or (b) $10,000
§403(b)	10% of taxable amount withdrawn before age 59½ unless exception[d] applies	50% of amount by which withdrawal falls short of minimum required distribution[c] after later of age 70½ or retirement; minimum required distribution of §403(b) assets acquired before 1987 can be delayed to age 75	Allowed after age 59½, earlier in case of financial hardship	To another §403(b) plan or to traditional IRA	Limited to the lesser of (1) $50,000 or (2) the greater of (a) 50% of vested amount or (b) $10,000
§457	No excise tax; withdrawals allowed only in event of job separation, attainment of age 70½, financial emergency, or death	50% of amount by which withdrawal falls short of minimum required distribution[c] after later of age 70½ or retirement	Allowed after age 70½, earlier for emergencies	To another §457 plan	Not allowed in nonprofit plans; in state/local plans, allowed up to lesser of (1) $50,000 or (2) greater of (a) 50% of vested amount or (b) $10,000
Money purchase	10% of taxable amount withdrawn before age 59½ unless exception[d] applies	None; plan must start distributions after later of age 70½ or retirement	Allowed	To an employer plan that accepts rollovers or to traditional IRA	Limited to the lesser of (1) $50,000 or (2) the greater of (a) 50% of vested amount or (b) $10,000

Plan Type	Excise tax on early withdrawals	Excise tax on late withdrawals	In-service withdrawals	Rollover options	Loan availability
Profit-sharing	10% of taxable amount withdrawn before age 59½ unless exception[d] applies	None; plan must start distributions after later of age 70½ or retirement	Allowed for assets held in plan at least 2 years	To an employer plan that accepts rollovers or to traditional IRA	Limited to the lesser of (1) $50,000 or (2) the greater of (a) 50% of vested amount or (b) $10,000
Private-sector defined benefit	10% of taxable amount withdrawn before age 59½ unless exception[d] applies	None; plan must start distributions after later of age 70½ or retirement	Not allowed	To an employer plan that accepts rollovers or to traditional IRA	Limited to the lesser of (1) $50,000 or (2) the greater of (a) 50% of vested amount or (b) $10,000

[a] Generally, retirement income is subject to the federal income tax upon receipt, but only to the extent that the funds have not been taxed previously. If income is received from an account or plan that includes both taxed and untaxed funds, the income tax applies to the same proportion of the income as untaxed funds make up of the total retirement asset.

[b] The exceptions are: death, disability, withdrawal in the form of a life annuity, higher education expenses, up to $10,000 for a qualified home purchase, payment of medical expenses in excess of 7.5% of AGI, or payment of health insurance premiums after receiving unemployment benefits for at least 12 weeks. Withdrawals from a Roth IRA are presumed to come first from contributions, which usually are not taxed when withdrawn and thus are not subject to this 10% penalty.

[c] The minimum required annual distribution must be enough to use up the asset over the accountholder's (and beneficiary's) expected lifetime(s).

[d] The exceptions are: death, disability, retirement under an early retirement provision after attainment of age 55, withdrawal in the form of a life annuity, or payment of medical expenses in excess of 7.5% of AGI.

Table A-6. Rules[a] for Reporting, Disclosure, Fiduciary Responsibility and Allowable Investments by Retirement Plan Type

Plan Type	Required reporting by plan to federal agencies	Required disclosure by plan to participants	Requirements on plan fiduciaries	Prohibited investments
Traditional IRA	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498	Distributions reported to accountholder on Form 1099-R; contributions and account balances reported to accountholder on Form 5498	Exempt from ERISA rules[b]	Art, antiques, and other collectibles (except certain precious metals); penalty for prohibited transactions[c]
Roth IRA	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498	Distributions reported to accountholder on Form 1099-R; contributions and account balances reported to accountholder on Form 5498	Exempt from ERISA rules[b]	Art, antiques, and other collectibles (except certain precious metals); penalty for prohibited transactions[c]
SEP IRA	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498 Plan data reported to IRS on Form 5500 unless plan begun as *model plan*	Distributions reported to accountholder on Form 1099-R; contributions and account balances reported to accountholder on Form 5498 Simplified version of ERISA disclosure rules[d] also applies	ERISA rules apply[b]	Art, antiques, and other collectibles (except certain precious metals); penalty for prohibited transactions[c]
SARSEP IRA	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498 Plan data reported to IRS on Form 5500 unless plan begun as *model plan*	Distributions reported to accountholder on Form 1099-R; contributions and account balances reported to accountholder on Form 5498 Simplified version of ERISA disclosure rules[d] also applies	ERISA rules apply[b]	Art, antiques, and other collectibles (except certain precious metals); penalty for prohibited transactions[c]

Plan Type	Required reporting by plan to federal agencies	Required disclosure by plan to participants	Requirements on plan fiduciaries	Prohibited investments
SIMPLE IRA	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498	Distributions reported to accountholder on Form 1099-R; contributions and account balances reported to account-holder on Form 5498 Amended ERISA rules also apply: trustee must provide annual plan summary; employer must give plan description to eligibles and notify them of chance to elect participation	Employer relieved of fiduciary liability for losses related to participant control of assets, which occurs at earliest of: (1) choice among investment options; (2) rollover of funds to another account; (3) completion of 1 year in plan	Art, antiques, and other collectibles (except certain precious metals); penalty for prohibited transactions[c]
§401(k)	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498 Plan data reported to IRS on Form 5500; simplified reporting applies for plans with less than 100 participants	Distributions reported to participants on Form 1099-R ERISA rules also apply[d]	ERISA rules apply[b]	Investments in securities or real property of the employer of deferrals in excess of 1% of pay cannot exceed 10% of total unless individual chooses; penalty for prohibited transactions[c]
SIMPLE §401(k)	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498 Plan data reported to IRS on Form 5500; simplified reporting applies for plans with less than 100 participants	Distributions reported to participants on Form 1099-R ERISA rules also apply[d]	ERISA rules apply[b]	Investments in securities or real property of the employer of deferrals in excess of 1% of pay cannot exceed 10% of total unless individual chooses; penalty for prohibited transactions[c]
Federal Thrift Savings	Distributions reported to IRS on Form 1099-R	Transactions and account balances reported to participants semi-annually; plan summary provided by agencies to employees when plan changes	Rules set forth in USC Title 5, Section 8477	Investment limited to five funds established by law, two of which are not yet in operation

Plan Type	Required reporting by plan to federal agencies	Required disclosure by plan to participants	Requirements on plan fiduciaries	Prohibited investments
§403(b)	Distributions reported to IRS on Form 1099-R; contributions and account balances reported to IRS on Form 5498 Plan data reported to IRS on Form 5500; simplified reporting applies for plans with less than 100 participants	Distributions reported to participants on Form 1099-R ERISA rules also apply[d]	ERISA rules apply[b]	Penalty for prohibited transactions[c]
§457	Distributions reported to IRS on Form 1099-R	None[e]	None[e]	None[e]
Money purchase	Distributions reported to IRS on Form 1099-R Plan data reported to IRS on Form 5500; simplified reporting applies for plans with less than 100 participants	Distributions reported to participants on Form 1099-R ERISA rules also apply[d]	ERISA rules apply[b]	Penalty for prohibited transactions[c]
Profit-sharing	Distributions reported to IRS on Form 1099-R Plan data reported to IRS on Form 5500; simplified reporting applies for plans with less than 100 participants	Distributions reported to participants on Form 1099-R ERISA rules also apply[d]	ERISA rules apply[b]	Penalty for prohibited transactions[c]
Private-sector defined benefit	Distributions reported to IRS on Form 1099-R Plan data reported to IRS on Form 5500; simplified reporting applies for plans with less than 100 participants	Distributions reported to participants on Form 1099-R ERISA rules also apply[d]	ERISA rules apply[b]	Penalty for prohibited transactions;[c] investment in employer's securities or real property cannot exceed 10% of plan assets

[a] In addition to the requirements shown in this table, the financial institutions that invest plan assets also must file reports to comply with federal and state laws regulating banks, brokerage firms, and insurance companies.
[b] ERISA requires that plan fiduciaries act prudently and solely in the interests of plan participants and beneficiaries.
[c] Prohibited transactions involve the sale or transfer of assets between a participant, plan sponsor, or fiduciary and another interested party (e.g., family members, plan service providers). The penalty is an excise tax, raised to 15% from 10% by P.L. 105-34.
[d] Each participant must be furnished with a summary plan description and a summary annual financial report.
[e] Though federal laws on disclosure, fiduciary standards, and investment policy do not apply to §457 plans, state laws may apply.

Appendix B: Abbreviations Used in This Report

ADP. Average deferral percentage, a measure used in the nondiscrimination test for §401(k) and §403(b) plans.

AGI. Adjusted gross income.

CRS. Congressional Research Service.

CSRS. Civil Service Retirement System.

DB. A defined benefit pension plan, which promises participants a future benefit based on tenure and salary and holds funds in reserve to cover the obligations of those promised benefits.

DC. A defined contribution plan, which accrues funds in individual accounts for each participant. The assets in an individual's account become the vested property of the participant for use in retirement.

DoL. U.S. Department of Labor.

ERISA. Employee Retirement Income Security Act of 1974 (P.L. 93-406).

FERS. Federal Employees' Retirement System.

FICA. Federal Insurance Contributions Act, which authorizes collection of the federal payroll tax that funds the Social Security system.

FUTA. Federal Unemployment Tax Act, which authorizes collection of the federal payroll tax that funds certain activities under the federal-state Unemployment Compensation system.

GAO. U.S. General Accounting Office.

GPO. U.S. Government Printing Office.

IRA. Individual retirement account.

IRS. U.S. Internal Revenue Service.

PWBA. Pension and Welfare Benefits Administration, the division of the U.S. Department of Labor that has enforcement responsibilities under ERISA.

SARSEP. A simplified employee pension plan that includes a salary reduction agreement as authorized by §408(k) of the tax code.

§**401(k) Plan.** A qualified employer retirement plan that includes a salary reduction agreement authorized by §401(k) of the tax code.

§**403(b) Plan.** A tax-deferred annuity plan authorized by §403(b) of the tax code for sponsorship by certain educational, cultural, and research organizations.

§**457 Plan.** A nonqualified deferred compensation plan authorized by §457 of the tax code for sponsorship by government and nonprofit employers.

§**501(c)(18) Plan.** A union-sponsored thrift plan granted tax-deferred status by §501(c)(18) of the tax code.

SEP. A simplified employee pension plan as authorized by §408 of the tax code.

SIMPLE. A savings incentive match plan for employees of small employers as authorized by §408(p) of the tax code.

USC. United States Code.

Appendix C: Location of Statutory Provisions For Retirement Plans

Law/section number	Provisions of section
Internal Revenue Code of 1986:	
72(a)	Treatment of annuities as income
72(b)	Exclusion of contributions to retirement plans from income
72(c)	Definitions of certain terms used in other sections
72(h)	Lump-sum payment option
72(m)	Special rules for annuities and distributions
72(o)	Rules for deductible employee contributions
72(p)	Rules for plan loans
72(q)	Penalty for early withdrawal
72(s)	Distribution requirements upon death of accountholder
72(t)	10% early withdrawal excise tax
219	Adjustment to AGI for IRA contributions
401(a)	Rules for qualified employer retirement plans
401(b)	Retroactive plan amendments
401(c)	Rules for self-employed individuals
401(d)	Rules for owner-employee plans
401(f)	Rules for custodial accounts
401(g)	Definition of annuity
401(i)	Definition of union-negotiated qualified plan
401(k)	Rules for cash or deferred arrangements (§401(k) plans)
401(m)	Nondiscrimination test for employee salary deferral contributions and matching employer contributions
401(n)	Coordination of qualified plan rules with qualified domestic relations orders

Law/section number	Provisions of section
402(a)	Rules for rollovers
402(b)	Tax treatment of contributions to nonexempt trust
402(c)	Tax treatment of foreign pension trusts
402(e)	Tax treatment of lump-sum distributions
402(f)	Requirement for written explanation of rollovers
402(g)	Limits on §401(k) and §403(b) elective deferrals
402(h)	Limits on contributions to SEPs
402(i)	Treatment of self-employed as employees for certain purposes
403(a)	Taxation of qualified employee annuities
403(b)	Rules for tax-sheltered annuities for §501(c)(3) organizations and public schools (§403(b) plans)
403(c)	Taxation of nonqualified annuities
404	Tax treatment of employer contributions
406	Treatment of employees of foreign affiliates
407	Treatment of employees of domestic firm with foreign operations
408	Rules for IRAs, SEPs, SIMPLEs
410	Minimum standards for plan participation
411	Minimum standards for vesting of benefits
412	Minimum funding standards
413	Rules for collectively bargained plans, multiemployer plans
414(a)	Service for predecessor employer
414(b)	Employees of controlled group of corporations
414(c)	Employees of commonly controlled partnerships and proprietorships
414(d)	Definition of governmental plan

Law/section number	Provisions of section
414(e)	Definition and treatment of church plans
414(f)	Definition of multiemployer plan
414(g)	Definition of plan administrator
414(h)	Tax treatment of contributions
414(i)	Definition of defined contribution (DC) plan
414(l)	Plan mergers and consolidations, transfers of plan assets
414(m)	Employees of affiliated service group
414(n)	Employee leasing
414(p)	Definition of qualified domestic relations order
414(q)	Definition of highly compensated employee
414(r)	Rules for separate lines of business (SLOB rules)
414(s)	Definition of compensation
415	Limits on benefits and contributions
416	Rules for top-heavy plans
417	Minimum standards for survivor annuity provisions
457	Rules for deferred compensation plans of state and local governments and tax-exempt organizations (§457 plans)
501(c)(18)	Tax exemption for certain employee pension trusts
3121	Treatment of retirement contributions by FICA tax
3306	Treatment of retirement contributions by FUTA tax
4972	Excise tax on employer for nondeductible plan contributions
4973	Excise tax on excess contributions to IRAs and §403(b) plans
4974	Excise tax on failure to make minimum required distribution
4975	Excise tax on prohibited fund transactions
4979	Excise tax on employer for excess plan contributions
4980A (repealed)	Excise tax on excess plan distributions

Law/section number	Provisions of section
Employee Retirement Income Security Act of 1974:	
3	Definition of terms
4	Types of benefit plans covered
101-111	Reporting and disclosure rules
202	Rules for employee coverage
203	Vesting standards
204	Benefit accrual rules
205	Rules for joint and survivor annuity option
206	Rules for benefit commencement
401-405, 409-413	Rules for fiduciary conduct
406, 408	Prohibited transactions
501-513	Administration and enforcement
514	Preemption of state laws