



For your information

Volume 35 | Issue 80 | October 18, 2012

## Fiscal Cliff and Employee Plan Limits

If Congress allows the “Bush-era Tax Cuts”, among others, to expire, creating a so-called “fiscal cliff” - what will that mean for retirement plans? Aside from changing the relative tax advantage of plan benefits as compared to the taxation of income from investments outside of the plan because of changes in tax rates for capital gains and dividends, the answer is – nothing. Most other benefit plan limits in our annual COLA [For Your Information](#) will not be affected by the fiscal cliff with the exception of adoption benefits.

### Background

While the implications of the fiscal cliff encompass a broad array of federal tax and spending issues, for retirement plans the Bush-era Tax Cuts include the Internal Revenue Code (Code) changes in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). EGTRRA is the source of many benefit plan changes, including specific increases in the dollar limits used for plans. Here are some of the changes EGTRRA offered retirement plans:

- **Compensation limit:** The limit on annual compensation allowed to be taken into account in determining benefits in qualified plans rose from \$170,000 in 2001 to \$200,000 for 2002 due to EGTRRA.
- **Allocation limits for defined contribution plans:** Under EGTRRA, the Code section 415 annual addition limits rose from \$35,000 to \$40,000 in 2002 and the 25% of compensation limit was reset at 100%. Limits on elective deferrals rose to \$11,000 in 2002 (from \$10,500 in 2001), faster \$1,000 annual increases were put in place through 2006, and the various catch-up contribution opportunities were added.
- **Roth contributions:** The option to allow elective deferrals to be made on a Roth basis was added by EGTRRA.
- **Vesting:** EGTRRA mandated faster vesting rule for matching contributions (100% after 3 years or a 6-year graded schedule).
- **Multiple use test:** This onerous test, which combined ADP and ACP test results for elective deferrals and matching contributions, was repealed by EGTRRA.
- **Portability for eligible rollover distributions:** EGTRRA harmonized the rollover rules across various types of plans so that, for example, qualified plan money could be rolled over into a participant's 403(b) annuities and governmental 457(b) plans.

As with other tax changes in EGTRRA, all of the benefit plan changes were set to “sunset” at the end of 2010.

## Permanence in PPA for Retirement Plans

The Pension Protection Act of 2006 addressed the various EGTRRA changes by removing the sunset provisions for retirement plans and IRAs. Unless and until Congress revisits and specifically revises these retirement plan rules with future legislation, plan administrators need not fret that “falling off the fiscal cliff” will automatically change plan operations that stem from the EGTRRA changes. As a result, the 2013 cost-of-living adjusted plan limits announced today (see our October 18 [For Your Information](#)) will apply as planned.

## What about Other Benefit Plans?

Although the retirement benefit plan limits are not affected by the fiscal cliff, the adoption credit is at risk. For taxable years beginning after December 31, 2012, the amount of the adoption credit only applies in the case of special needs adoptions, and it is reduced to \$6,000. The employer-provided adoption assistance exclusion is no longer applicable. The phase-out range based on adjusted gross income is reduced to lower income levels (i.e., between \$75,000 and \$115,000). The maximum credit, exclusion, and phase-out range will not be indexed for inflation. Certain special rules for special needs adoption expenses do not apply, and the credit may no longer offset alternative minimum tax liability.

As noted in our October 18 [For Your Information](#), many updated figures normally included in IRS’ annual [revenue procedure](#) were omitted, such as the 2013 income tax brackets and estate tax limits. The IRS was faced with publishing figures based on 2013 tax law with or without the “fiscal cliff”. For now, neither were published.

In addition to omitting the adoption limits, the IRS annual revenue procedure omitted the annual limit on qualified transportation fringe benefits. The American Recovery and Reinvestment Act of 2009 temporarily (from March 1, 2009 through December 31, 2010) increased the monthly transit pass/vanpool limit to equal the monthly parking limit. This provision was extended by law through 2011, and the limit reverted back to the usual amount for 2012. As of this time there is nothing in place to increase the transit pass/vanpool to equal the parking limit for 2013.

## In Closing

While it is possible that Congress will enact changes during the “Lame Duck” session that would rein-in current benefit plan limits, we believe it is highly unlikely. Until actual changes are enacted, plan sponsors should aim to implement the 2013 benefit thresholds and assume business as usual for limits that IRS has specifically announced. It is expected that any future changes that are not automatically triggered by the fiscal cliff will have prospective effect and offer a reasonable timeframe for implementation.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.  
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