

## FREQUENTLY ASKED QUESTIONS ABOUT TAX-DEFERRED ANNUITY (TDA) CALCULATIONS

### 1. How much of my salary can I tax-defer?

The amount of salary that may be tax-deferred is limited by Section 403(b), 415, and 402(g) of the Internal Revenue code (IRC). It is determined by several formulas, which use factors such as salary, years of service, current plan contributions, and prior tax-deferred contributions by both the employer and employee.

### 2. What is the maximum amount I am allowed to tax-defer?

The amount you may defer is calculated based on your salary, years of service, and prior tax deferrals. However, regardless of calculation results, tax-deferred contributions generally can't exceed \$10,500. An exception to the rule may be allowed for employees with 15 years of service with an eligible employer who may tax-defer \$13,500 if calculation results permit.

### 3. I have fifteen years of service with my employer. Am I eligible for the special 15-year catch-up election?

Salary reduction contributions are usually limited to a percentage of salary up to \$10,500. However, IRC Section 402(g) provides that in limited situations, you may be allowed greater deferral. The calculation which determines whether you can exceed \$10,500 with your TDA calculation requires two elements: (1) you have at least 15 years of service with an institution that is eligible for Alternative Limits; and (2) the employee's salary reduction possibility under the limit (General or one of the Alternatives) selected is limited by the \$10,500 cap.

### 4. I read somewhere that I can tax-defer 25% of my compensation. Why does the calculation I received indicate a smaller percentage?

The calculation results are derived from formulas found in the IRC Sections 403(b), 415, and 402(g). The results under these formulas are dependent upon the type of retirement plan offered to employees, compensation, prior listing of contributions made, as well as other variables, which may decrease the percentage. The 25% limit is just one of the limits.

### 5. Who is eligible for an Alternative Limit?

The alternative limits are available to employees of teaching institutions, hospitals, churches, home health care service organizations and health and welfare service agencies. The most important aspect of choosing an alternative limit in any year, at any institution, is that choosing an alternative precludes the use of a different alternative limit in any future year. This means that the election of an alternative limit is a lifetime election. While it is always possible to revert back to the general limit, employees may not elect a different alternative limit in future years.

### 6. Which limit is right for me?

**Alternative Limit A** is available only to employees who are terminating employment and have never chosen an alternative limit. In some situations, "A" may provide for greater deferral than the other alternatives. However, it is generally advisable to defer even modest amounts of salary earlier in the employee's career through alternatives "B" or "C", rather than waiting until the year of termination. Also, if the employee returns to work, he or she would not be able to choose any one of the alternative limits after using "A". Finally, "A" may provide no greater deferral than "B" or "C", even in the retirement year, since the \$10,500 or \$13,500 maximum could not be exceeded.

**Alternative Limit B** is generally higher than what's available through Alternative Limit C for those with several years of service who haven't made much use of their deferral opportunities. However, despite the fact that "B" often offers the largest deferral, there is no guarantee it will always be as high as it is initially. It may actually decline after continued use.

**Alternative Limit C** generally offers the greatest deferral to newly hired employees. It tends to be a good choice for those who want to defer the maximum from the start and continue to do so indefinitely. Although, it may be exceeded by "B" at a later date, "C" tends to allow individuals to defer at stable percentage of salary year after year. "C" tends to be a good choice for those who move from job to job.

### 7. Can you provide a simple definition of the 402(g) limits?

Section 402(g) of the Internal Revenue Code limits the amount of elective deferrals to a 403(b) plan in any year. The general cap is \$10,500. Therefore, if an individual's limits under Section 403(b) and 415(c) are above \$10,500, the 402(g) limit will restrict them to \$10,500. It is important to understand that the 402(g) limit is a cap, which means that an individual cannot exceed this amount. It does not necessarily mean that the individual is eligible to defer up to this cap. If the limit under Section 403(b) or 415(c) is lower than \$10,500 then the lowest of these limits will govern.

### 8. When would an employee be ineligible to exceed \$10,500 under the 15 Year Rule?

The Fifteen Year Rule provides additional tests to be calculated if an individual has been employed with the same institution for the equivalent of 15 full-time years. The tests

determine if the individual is eligible to exceed the general cap of \$10,500 by up to \$3,000, resulting in a maximum of \$13,500 for that year. Employment for the equivalent of 15 full-time years triggers this test but it does not necessarily mean that this individual is eligible to contribute up to the \$13,500 cap. The additional formulas under the 15 Year Rule are as follows, and the applicable cap is the lowest of the results:

$$\$10,500 + \$3,000 = \$13,500$$

$$\$10,500 + (\$15,000 - \text{amount contributed under 402(g) above } \$9,500 \text{ since 1987, above } \$10,000 \text{ since 1998}) \text{ and } \$10,500 \text{ beginning in 2000.}$$

$$\$10,500 + (\$5,000 \times \text{Years of Service}) - \text{Prior Voluntary Reduction}$$

The lifetime maximum amount of contributions in excess of the \$10,500 limit is \$15,000.

**9. How does the return of excess deferrals that exceed the \$10,500 limit affect the employee's taxes?**

The amounts of the excess elective deferral, which is returned to the employee by April 15, is included in the taxable income for the year of deferral and therefore is subject to taxation. The amount of the earnings and/or losses is reported and taxed in the year in which they are returned to the employee. Therefore, the amount of the 2000 excess contributions, which are returned by April 15, 2001, should be included in the employee's 2000 taxable income (assuming the excess elective deferral was made in 2000) and will be reflected in a 1099R form mailed by the vendor in 2001. Taxable interest income will be reflected on a 1099R form for 2001 mailed by the vendor in 2002.

**10. What exactly is the IRS penalty for over-contributing to a Tax-Deferred Annuity?**

The funds may be subject to double taxation if the 402(g) limit is exceeded and not corrected by the April 15 deadline. The other limits do not result in a double tax. The amount of the 402(g) excess deferral is taxable in the year it was contributed and is taxable again when the funds are distributed.