

Mike Webb, Vice  
President, Retirement,  
Cammack LaRhette  
Consulting

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## The 15-Year Catch-Up Election: Is it Becoming the “Dinosaur of 403(b) Plans?”

The 15-year catch-up election has been an institution in the 403(b) plan marketplace for many years; having long outlasted other provisions of the Tax Code related to 403(b) plan contribution limits (remember the “exclusion allowance” calculation?). Though it has never been a required provision in retirement plans, it was rare that eligible organizations (now clarified in the final 403(b) regulations to be educational organizations, hospitals, health and welfare service agencies, and church-related organizations) would prevent employees from utilizing this catch-up election to potentially increase the amount participants can defer to a 403(b) plan.

However, the sentiment to continue the 15-year catch-up election as a stalwart provision of a 403(b) retirement plan is changing. In fact, since the issuance of the final 403(b) regulations, a number of plan sponsors have eliminated, or plan to eliminate, the provision. Why is this the case? This article will attempt to address the trend.

### 15-Year Catch-Up Election: The Basics

In order to understand one of the primary reasons the 15-year catch-up election is being revisited by many 403(b) plan sponsors, the basics of the election must be considered. The 15-year catch-up election increases participants’ 402(g) elective deferral limit (\$17,000 in 2012) by the LEAST of the following three amounts:

- \$3,000
- The EXCESS of
  - \$15,000, over
  - The total elective deferrals made by the employee of the plan sponsor for prior years, or
- The EXCESS of
  - \$5,000 multiplied by the number of years of service the employee has with the plan sponsor
  - The total elective deferrals made for the employee at the plan sponsor for prior years

Confused thus far? If not, congratulations! However, many plan sponsors make the mistake thinking the \$3,000 amount is guaranteed, increasing the maximum deferral to \$20,000 in 2012 (the addition in recent years of the age-50 catch-up election, where an additional deferral of \$5,500 is guaranteed, only adds to the confusion).

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Others believe the election can only be used for five years, (five times the maximum dollar limitation of \$3,000), when, in fact, if the 402(g) limit is exceeded by less than \$3,000 in any given year, the election can continue until \$15,000 is used up. I can go on and on regarding plan sponsor (and participant) confusion over the limit, but suffice to say that plan sponsors prefer simplicity in their 403(b) plans, and the 15-year catch-up election is anything but.

In addition, per the definition, the calculation of the limit requires the knowledge of participants' ENTIRE contribution history, and historic data collection is not a strong point of many nonprofit employers. Vendors can often fill the gaps, but coordination of data can be difficult in multiple/legacy vendor situations, especially when participants may have utilized a vendor early in their working career that has long since been eliminated from the plan.

### The Advent of the Age-50 Catch-Up Election and 15-Year Catch-Up Impact

Years ago, the 15-year catch-up election was the ONLY method of increasing the 402(g) elective deferral limit. In addition, other contribution limits greatly restricted what employees could defer to their 403(b) plans. However, over time, those contribution limits were either eliminated or greatly relaxed, and the age-50 catch-up election, which permits an increase in the 402(g) elective deferral limit of \$5,500 without restriction, was added. Thus it can be argued that the use of a 15-year catch-up election has become less essential.

In addition, the IRS requires coordination between the 15-year and age-50 catch-up elections that can be quite problematic. This issue comes into play when participants are eligible for BOTH the age-50 catch-up election AND the 15-year catch-up election. The IRS has an ordering rule which states: if the basic 402(g) limit on elective deferrals is exceeded, any excess is FIRST attributed to the use of the 15-year catch-up election. Thus, if a participant is eligible for both elections, the 15-year catch-up election MUST be calculated even if the intent is to use the far less complicated age-50 catch up election.

Let's use an example to illustrate the complexity of the interaction of these limits: A participant who, at age 50, satisfies the requirements of the 15-year catch-up election (completed 15 years of service, average lifetime deferral with employer does not exceed \$5,000, cumulative excesses under the election do not exceed \$15,000), wishes to utilize the age-50 catch-up to defer \$22,500 in 2011 (the \$17,000 general limit plus the \$5,500 age-50 catch-up).

Since the participant also qualifies for the 15-year catch-up election, the first \$3,000 of the \$5,500 excess is considered to be 15-year catch-up contribution (the maximum amount that can be utilized under the 15-year catch-up election), while the remaining \$2,500 is attributable to the age-50 catch-up. Since this \$3,000 will count against the \$15,000 cumulative limit on excesses under the

15-year catch up election, it is possible that, if the participant defers in similar fashion in future years and later wishes to defer under both the 15-year and age-50 catch-up elections, the participant may find that the 15-year catch-up limit has been exhausted even though he/she believes that it had never been used!

More importantly, this interaction requires the 15-year catch-up calculation to be performed, which is complex and prone to error. In fact, one of the primary defects uncovered in IRS audits of 403(b) plans is 15-year catch-up election failures.

### Conclusion

Due to complexity, lack of historic data, general relaxing of contribution limits and IRS audit potential, a growing number of 403(b) plan sponsors avoid the calculation entirely by only permitting the age-50 catch-up election, and prohibiting the use of the 15-year catch-up election. Generally, plan sponsors permit existing elections to continue until limits have been exhausted, but do not allow new 15-year catch-up elections. It is likely premature to identify this trend as a permanent one, but it will be interesting to see whether the 15-year catch-up election becomes a “dinosaur” in the next five years, ten years, or beyond.

**NOTE: A modified version of this article appears in the most recent issue of ASPPA/NTSAA's *Market Beat* publication**

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