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IRS Fact Sheet

Media Relations Office **Washington, D.C.** **Tel. 202.622.4000**
For Release: January 2002 **Release No: FS-2002-05**

2002 TAX LAW CHANGES: IRAS / RETIREMENT PLANS

Taxpayers will find many changes affecting their retirement planning this year as a result of the Economic Growth and Tax Relief Reconciliation Act of 2001. They may be able to contribute more to retirement plans, get larger tax benefits for doing so and have more options for handling plan distributions.

Saver's Tax Credit

The Saver's Credit is based on the first $2,000 contributed to IRAs, 401(k)s and certain other retirement plans. This credit is for individuals with incomes up to $25,000 ($37,500 for a head of household) and married couples with incomes up to $50,000. The taxpayer must also be at least age 18, not a full-time student, and not claimed as a dependent on another person's return.

The credit is a percentage of the qualifying contribution amount, with the highest rate for taxpayers with the least income, as shown in this chart:

Credit Rate	*Income:* *Married, Joint*	*Head of Household*	*Others*
50%	up to $30,000	up to $22,500	up to $15,000
20%	$30,001 – 32,500	$22,501 - $24,375	$15,001 – 16,250
10%	$32,501 – 50,000	$24,376 - $37,500	$16,251 – 25,000

When figuring the Saver's Credit, taxpayers who have received distributions from their retirement plans generally must subtract these amounts from their contributions. This rule applies for distributions starting two years before the year the credit is claimed and ending with the filing deadline for that tax return. For 2002, a taxpayer subtracts distributions received from Jan. 1, 2000, through Apr. 15, 2003, from the total 2002 retirement contributions, then multiplies the result (but not more than $2,000) by the credit rate applicable for the taxpayer's filing status and income level.

The subtraction rule does not apply to distributions which are rolled over into another plan, nor to withdrawals of excess contributions.

The Saver's Credit is in addition to whatever other tax benefits may result from the retirement contributions. For example, most workers at these income levels may deduct all or part of their contributions to a traditional IRA. Contributions to a 401(k) plan are not subject to income tax until withdrawn from the plan.

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Higher Contribution Limits for IRAs, Employer Plans

Taxpayers may contribute up to $3,000 in 2002 to either traditional or Roth IRAs. The elective deferral limit for 401(k) plans, 403(b) annuities (for employees of public schools and 501(c)(3) organizations), Section 457 plans (for employees of state or local governments or tax-exempt organizations) and salary reduction SEPs (Simplified Employee Pensions) is $11,000. For SIMPLE plans, the salary reduction limit is $7,000.

Employers' plans may better provide for the needs of retirees. For defined contribution plans, the annual addition may be up to 100% of an employee's compensation, but not more than $40,000. For defined benefit plans, the annual benefit limit is raised to $160,000.

Higher Contribution Limits for Taxpayers Age 50 and Over

Taxpayers who are at least 50 years old may contribute more to certain retirement plans – how much depends on the type of plan. For IRAs and elective deferrals in SIMPLE plans, the extra amount for 2002 is $500, giving a total taxpayer contribution limit of $3,500 for IRAs and $7,500 for SIMPLE plans. For other elective deferral plans – including 401(k)s, 403(b)s, Section 457 plans and salary reduction SEPs – the extra amount is $1,000, giving a total contribution limit of $12,000.

Permissible Rollovers

Employees have greater freedom to make a tax-free rollover of distributions from one type of retirement plan to another. This is important for a person who changes jobs and wants to move retirement assets from one employer's plan to another. Some plans have been limited to rollovers to or from the same type of plan. Now, qualified plans, 403(b) annuities, Section 457 plans and IRAs may accept rollovers from another plan, even if they are different types. For example, workers switching from a government agency to a public school might roll over their Section 457 plan assets to a 403(b) annuity. As before, plans may accept rollovers, but they are not required to do so.

A surviving spouse may roll over the decedent's distributions from an employer plan into the survivor's employer plan. Previously, a surviving spouse could roll over such distributions only into an IRA.

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IRA assets may be rolled over to employer plans even if they did not come from another employer plan. Employees who roll over employer plan distributions into an IRA no longer have to keep that IRA separate – a “conduit IRA” – in order to do a future rollover to another employer’s plan. However, taxpayers born before 1936 who want to keep special capital gains and ten-year averaging benefits will need a conduit IRA to move assets from one employer plan to another.

Rollovers from IRAs to employer plans may not include any after-tax contributions. Distributions are considered to consist first of the taxable IRA portion, thus maximizing the amount eligible for rollover. Rollovers from employer plans may include after-tax contributions to those plans if the rollover is a direct trustee-to-trustee transfer. A receiving employer plan – but not an IRA trustee – must separately track such contributions and related earnings.

Faster Vesting for Matching Contributions from Employers

Employees will now gain a nonforfeitable right to an employer’s matching contributions to their defined contribution plan more quickly. The plan has the option of fully vesting employees after three years of service (down from five), or granting employees gradual vesting rights of 20% each year, beginning after two years of service and resulting in full vesting after six years. (The old schedule went from three to seven years.) The new vesting schedule is for employer matches in plan years starting after 2001, except for plans covered under a collective bargaining agreement. The new schedule does not apply to employee vesting in other types of contributions.

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