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Update on Retirement Plan Limits and Deferred Compensation

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The Internal Revenue Service recently announced the 2008 cost-of-living adjustments applicable to retirement plans.

For defined contribution plans, the limit on the annual addition to a participant's account will increase to \$46,000 in 2008. For defined benefit plans, the annual benefit limit will increase to \$185,000.

Unfortunately, the annual contribution limitation for 401(k) plans will remain at \$15,500 in 2008. Likewise, the limit on deferrals under deferred compensation plans of state and local governments and tax-exempt organizations will remain at \$15,500. The dollar limit on catch-up contributions to an employer plan for individuals aged 50 or over remains at \$5,000. The maximum amount of compensation an employee may elect to defer for a SIMPLE plan remains at \$10,500.

On a separate note, the Internal Revenue Service recently announced that employers with non qualified deferred compensation plans will have one extra year of transition relief before they must comply with the final nonqualified deferred compensation regulations under Section 409A.

Under Section 409A, a non qualified deferred compensation plan is an arrangement that provides employees or service providers with a legally binding right during a tax year to compensation (i) that has not been actually or constructively received and included in the employee/provider's gross income, and (ii) that may be payable to the employee/provider in a later year. The arrangement could be evidenced in a formal written deferred compensation plan or could consist of one sentence in an employment or service provider agreement. Section 409A taxes the employee/provider on the value of the deferred compensation when it is no longer subject to a substantial risk of forfeiture. In addition, the employee/provider is hit with a 20% excise tax and an interest penalty.

Due to the complexity of Section 409A and its regulations, it is a wise idea for employers, employees and service providers who have any kind of deferred compensation arrangement, whether evidenced by a formal plan or one sentence in an employment agreement, to consult their counsel as soon as possible regarding these rules.

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