



## The Vita Viewpoint Important Information for Decision Makers

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### IRS Announces Retirement Plan COLAs for 2006

#### **Overview**

The Internal Revenue Service has announced the cost-of-living adjustments applicable to dollar limitations for retirement plans for 2006. The Social Security Administration has also announced the updated wage base for 2006.

Section 415 of the Internal Revenue Code provides for dollar limitations on benefits and contributions under qualified retirement plans. It also requires that the Commissioner annually adjust these limits for cost-of-living increases. Many of the pension plan limitations will change for 2006. For most of the limitations, the increase in the cost-of-living index meets the statutory thresholds that trigger their adjustment.

#### **Limits and Thresholds**

	<b><u>2005</u></b>	<b><u>2006</u></b>
Elective Deferral Limit (401k & 403b plans)	\$14,000	\$15,000
Annual Contribution Limit	\$42,000	\$44,000
Annual Compensation Limit	\$210,000	\$220,000
Highly Compensated Employee Threshold	\$95,000	\$100,000
Top-Heavy Plan Key Employee Comp	\$135,000	\$140,000
Catch-Up Contributions	\$4,000	\$5,000
Income Subject to Social Security	\$90,000	\$94,200

#### **Definitions**

Elective Deferral Limit means the maximum contribution that can be made on a pre-tax basis to a 401(k) or 403(b) plan (Internal Revenue Code section 402(g)(1)). Some still refer to this as the \$7,000 limit (its original setting in 1987).

Annual Contribution Limit means the maximum annual contribution amount that can be made to a participant's account (IRC section 415). This limit is actually expressed as the lesser of the dollar limit or 100% of the participant's compensation, applied to the combination of employee contributions, employer contributions and forfeitures allocated to a participant's account. This limit was increased for the first time since its inception last year.

Annual Compensation Limit means the maximum compensation amount that can be considered in calculating contribution allocations. A plan cannot consider any employee compensation in excess of this amount (401(a)(17)). This limit is also imposed in calculating certain nondiscrimination tests (such as the Actual Deferral Percentage).

**Definitions (continued)**

Highly Compensated Threshold means the minimum compensation level established to determine highly compensated employees for purposes of nondiscrimination testing (Section 414(q)(1)(B)).

Catch up Contributions addresses the additional contribution amount that certain individuals aged 50 or over can now make above the normal limits. These so-called 'catch up' contributions were initiated under the Economic Growth and Tax Relief Act of 2001 (EGTRA).

Social Security Wage Base is the maximum amount upon which employers and employees pay FICA tax during the calendar year. The FICA tax rate continues at 6.20%. Medicare tax is paid on total income with no limit and continues at a rate of 1.45% for both employee and employer.

Special Note: For budgeting purposes this wage base increase represents an additional company cost of \$260.40 for each highly compensated employee earning \$94,200 or more.

***For questions or additional information, please contact  
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