fact sheet

SURS
STATE UNIVERSITIES RETIREMENT SYSTEM

Internal Revenue Code Section 415(b) & Excess Benefit Arrangement

This fact sheet attempts to summarize the limits set forth in IRC §415(b) and the SURS Administrative Rule 80 Ill. Admin. Code § 1600.145 (Compliance with Final 415 Treasury Regulations).

What is Internal Revenue Code Section 415(b)?

Internal Revenue Code Section 415(b) (IRC 415(b)) is a federal tax provision that limits the amount of an "annual benefit" that an individual can receive from a tax-qualified defined benefit pension plan, such as the State Universities Retirement System (SURS) Tier I and Tier II Traditional and Portable plans. The annual benefit payable from SURS retirement plan is subject to dollar limits imposed by IRC 415(b). This law was enacted to prevent employers from using tax-qualified defined benefit plans as tax shelters for highly compensated employees.

In order to protect the tax-exempt status of the plan, it is important that SURS maintain compliance with the limits set forth in IRC 415(b). In order to maintain compliance and protect member benefits, the SURS Excess Benefit Arrangement (EBA) was created. Benefits payable to a member in excess of the IRC 415(b) limits are paid through the SURS EBA, which is funded by the state on a "pay-as-you-go" basis. The rules for the EBA are found at 80 Ill. Admin. Code § 1600.430 (Excess Benefit Arrangement).

What are the IRC 415(b) limits?

- The 2017 annual dollar limit is $215,000 for retirees aged 62 and older. The IRS periodically adjusts this limit based on inflation in $5,000 increments.
- For members who retire between the ages of 50 and 61, the annual limit is a lower, age-adjusted limit that is actuarially equivalent to the limit for retirees aged 62 and older.
- The $215,000 annual limit is used instead of the actuarial age-adjusted limit for retirees under age 62 if:
    - The retiree was a police office or firefighter with 15 or more years of service
    - The annual benefit is for a survivor's annuity payable due to the pre-retirement death of a member
    - The annual benefit is for a disability retirement before age 62
- Special IRC 415(b) limits are used in the following situations:
    - The retirement benefit is treated as meeting the IRC 415(b) limit if all combined benefits from the employer's retirement plan do not exceed $10,000 annually, and the retiree has not participated in a defined contribution plan offered by the employer.
    - If the retiree participated in SURS for less than 10 years, then the IRC 415(b) limit is reduced by 10 percent for every year of participation less than 10 (but not lower than 10 percent of the 415(b) limit).

How is a retiree's "annual benefit" for IRC 415(b) limit purposes determined?

- Once the original annuity has been calculated, SURS begins the process of determining the portion of the annuity designated as the "annual benefit" for IRC 415(b) limitation purposes.
- All retirement benefits are screened at retirement and annually thereafter to identify those that meet criteria for testing for the IRC 415(b) limit.
- In addition to the amount of the monthly retirement annuity, any lump-sum payments such as a refund of survivor contributions and a refund of excess contributions are also considerations in determining whether or not the member meets the testing criteria. Lump-sum payments are actuarially converted into annuities for testing purposes.
- If staff determines that a member's benefit meets the criteria for IRC 415(b) limit testing, the accounting staff uses a custom-built actuarial tool which calculates the "annual benefit" amount that is payable under the SURS qualified trust.
- If the "annual benefit" exceeds the IRC 415(b) limit, the "annual benefit" is split into two portions:
    - Dollar Limited Benefit: The maximum annual amount of the retirement benefit payable to the retiree from the SURS qualified trust. Payments from the SURS qualified trust are reported on IRS Form 1099-R.

fact sheet

- Excess Benefit Arrangement: The amount in excess of the IRC 415(b) limit that is payable to the retiree through the EBA. Payments from the EBA are reported on IRS Form W-2 as nonqualified deferred compensation plan payments. As such, if paid as lump-sum benefit, they may not be rolled over to an eligible retirement plan to avoid taxation.

How are EBA payments taxed?

Excess Benefit Arrangement (EBA) payments are taxable gross income under federal tax law, and are treated as distributions from a nonqualified deferred compensation plan of a taxable corporation per Section 415(m)(2) of the Internal Revenue Code. IRS Publication 957 characterizes nonqualified deferred compensation plan distributions as “special wage payments” that are reportable on IRS Form W-2. EBA payments may not be rolled over to an eligible retirement plan (such as a 401(a) plan, 403(b) plan, 457(b) plan or an IRA). SURS remits taxes to the Internal Revenue Service based on the withholding instructions provided by each retiree under Form W-4P. At the end of the tax year, SURS issues to the retiree a Form 1099-R and a Form W-2 to reflect payments and tax withholdings on the Dollar Limited Benefit and the EBA portions of the retirement benefit.

Illinois tax law excludes all SURS benefit payments from taxable income for state income tax purposes.