



401(k) Plan Administration Overview

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Overview & Plan Components



401(k) Plans – What Are They?

- ▶ **Qualified retirement plan – defined contribution plan**
- ▶ **Profit sharing plan or stock bonus plan that includes 401(k) arrangement**
- ▶ **Regulated by ERISA – Employee Retirement Income Security Act**



401(k) Plans – What Are They?

- ▶ **ERISA enforced by Department of Labor Employee Benefits Security Administration (EBSA), IRS, and Pension Benefit Guarantee Corporation (PBGC). Law preempts state law**



401(k) Plans – What Are They?

- ▶ **401(k) arrangement – salary reduction agreement (cash or deferred arrangement or CODA) – agreement to defer percent of pay (or fixed amount) into plan**
- ▶ **Employee’s pay is reduced, and same amount is contributed to 401(k) plan by employer on employee’s behalf**



401(k) Arrangement

- ▶ **Election to defer must be made before compensation is currently available**
- ▶ **Deferral election can apply to non-regular compensation payments (bonuses, commissions, tips, etc.)**
- ▶ **Plan defines compensation eligible for deferral election – reasonable definition**



401(k) Arrangement

- ▶ If compensation includes taxable noncash compensation, must apply deferral percentage to all compensation and deduct amount from cash compensation
- ▶ Section 401(a)(17) compensation limit does not apply



401(k) Arrangement

- ▶ Tips – difficult to defer from tips if cash is already in hand, but if tips are pooled, can defer from them
- ▶ Eligibility for deferral feature – maximum is age 21 and completion of one year of service



Contribution Types

- ▶ **Pre-tax Elective Deferrals**
- ▶ **Designated Roth Contributions**
 - ▶ Both pre-tax deferrals and Roth contributions included in elective deferral limits – lesser of 100% of compensation or 402(g) dollar limit (\$19,000 in 2019)



Contribution Types

- ▶ **Employee After-Tax Contributions – voluntary or mandatory contributions**
- ▶ **Catch-Up Contributions – participants age 50 or older in current calendar year**
 - ▶ can defer additional \$6,000 in 2019 – separate limit from elective deferral limit



Contribution Types

- ▶ **Employer Matching Contributions**
- ▶ **Employer Nonelective contributions**
- ▶ **Qualified Nonelective Contributions (QNEC) – 100% vested**
- ▶ **Qualified Matching Contributions (QMAC) – 100% vested – only match elective deferrals**



Contribution Types

- ▶ **Top-Heavy Contributions – minimum employer contribution given to non-key employees when plan is deemed to be top-heavy**
 - ▶ generally required to provide 3% nonelective contribution
- ▶ **Loan repayments – amortization schedule**



Timing of Contributions to Plan

- ▶ **Elective deferrals - contributed as soon as monies can reasonably be segregated from general assets of employer, but no later than 15th business day of following month**
 - ▶ For small employers – safe harbor if remit on or before 7th business day following date employee would have received amounts as compensation



Timing of Contributions to Plan

- ▶ **Employer matching contributions and employer discretionary nonelective contributions – contributions to plan must be made no later than October 15th of the following year**
 - ▶ If plan requires deposits sooner, follow plan document



Timing of Contributions to Plan

- ▶ **Loan repayments – follow amortization schedule; similar due dates to elective deferrals**



Plan Document

- ▶ **Master or Prototype Plan (M&P Plan) –includes basic plan document and adoption agreement**
- ▶ **Volume Submitter Plan – basic plan document and adoption agreement are one single document**



Plan Document

- ▶ Individually Designed Document
- ▶ Starting in 2017, Master, Prototype, and Volume Submitter Plans have been replaced with Pre-Approved Plans
- ▶ Summary Plan Description (SPD)
- ▶ Summary of Material Modifications (SMM)



Compensation

- ▶ No single definition of compensation to use for qualified plans. Plans can use different definitions of compensation for different purposes
- ▶ In IRC, two definitions of compensation – Section 415(c)(3) and Section 414(s)




Compensation

- ▶ **Use Section 415 definition for the following:**
 - ▶ 415 contribution and benefits limits
 - ▶ Identifying Highly Compensated Employee (HCE)
 - ▶ Top Heavy minimum contributions
 - ▶ Employer's tax deduction for contributions to plan



Compensation

- ▶ **Use Section 414(s) definition for the following:**
 - ▶ Contribution made to design-based safe harbor plan or safe harbor 401(k) plan
 - ▶ Calculating participant's actual deferral ratio and actual contribution ratio for ADP/ACP tests
 - ▶ Average benefit test - Section 410(b) fail safe language using average benefit test



Compensation

- ▶ **Use any definition (including Section 415 or Section 414(s)) for the following:**
 - ▶ Allocations and accruals – nonelective contributions and QNECs
 - ▶ Permitted deferrals in 401(k) plan
 - ▶ Employer matching contributions



Compensation

- ▶ **Section 415(c)(3) statutory definition**
- ▶ **Three safe harbor definitions:**
 - ▶ Simplified Compensation
 - ▶ Wages for Income Tax Withholding – Section 3401(a)
 - ▶ W-2 Wages



Compensation

- ▶ **All definitions include elective deferrals (including catch-up) or elective contributions (Section 125 cafeteria plans, Section 132 qualified transportation fringe)**
- ▶ **All definitions include differential wage payments paid to individuals serving in the military**



Compensation

- ▶ **Post-severance compensation – generally cannot include except for the following:**
 - ▶ Pay if severance had not occurred – paid after severance from employment but before later of 2 ½ months after severance from service or end of limitation year in which severance occurs



Compensation

- Cash-out of accrued but unused sick, vacation, or other leave that could have been used if severance had not occurred (may be included if paid by later of 2 ½ months from severance from service or end of limitation year severance occurs)




Compensation

- Distribution from nonqualified deferred compensation plan that would have been payable whether or not severance occurred (may be included if paid by later of 2 ½ months from severance from service or end of limitation year severance occurs)



Compensation

- ▀ Salary continuation payments for disabled participants (may be included – no time limit)
- ▀ Salary continuation payments for participants in military service (may be included – no time limit)



Compensation

- ▀ **Post-severance payments such as ordinary severance pay or parachute payment are not included in Section 415 definition**




Compensation

- ▶ **Section 414(s) definition – definition of compensation that satisfies Section 414(s):**
 - ▶ Any Section 415 compensation definition (statutory, simplified, W-2 wages, wages for income tax withholding)




Compensation

- ▶ Any safe harbor definition under Section 414(s) – Section 415 compensation with specified adjustments – one or more of the following:
 - ▶ First modification – subtract certain benefits (must subtract all – can't pick and choose)
 - cash and noncash taxable fringe benefits



Compensation

- ▀ Second modification – include elective deferrals
- ▀ Third modification – exclude any portion of compensation for some or all HCEs in plan



Compensation

- ▀ Any reasonable definition of compensation that does not favor highly compensated employees – requires testing of “alternative definition” of compensation
 - ▀ Compensation is reasonable if it excludes on a consistent basis irregular or additional compensation – be careful with overtime if it is consistently paid



Compensation

- Compensation excluded over a specified dollar limit (Section 401(a)(17) limit) is reasonable, but percentage of employee's compensation is unreasonable
- **Nondiscrimination testing – Compensation Ratio Test**



Employer Match

- **Employer matching contributions can be done either per payroll period or at the end of the year**
 - Calculated per payroll period (pay as you go), could end up using compensation period shorter than entire plan year
 - Calculated at the end of the plan year, a “true-up” calculation may be required



Vesting

- ▶ **Portion of account balance or pension benefit that is nonforfeitable. Portion not vested can be forfeited**
- ▶ **Elective contributions (including designated Roth contributions), QMACs, QNECs, after-tax employee contributions must always be 100% vested**



Vesting

- ▶ **Statutory minimum vesting schedules**
 - ▶ Three-Year Cliff
 - ▶ Six-Year Graded Vesting Schedule
- ▶ **Full vesting required at normal retirement age**
- ▶ **Employer contributions to safe harbor 401(k) plan are 100% vested**



Measuring Service

- ▶ **Eligibility, vesting, and benefit service**
 - ▶ Counting-Hours Method – plan counts hours of service; year of service is earned when participant is credited with 1,000 hours of service
 - ▶ Elapsed Time Method – period of service is determined based on dates. Each one-year period of service is a year of service



Measuring Service

- ▶ **Break-In-Service:**
 - ▶ One-year break in service – employee does not complete more than 500 hours of service
 - ▶ One-year break-in-service rule
 - ▶ Rule of parity



Measuring Service

- ▶ **Watch out for leaves of absence or rehired employees – will trigger break-in-service rules**
- ▶ **Benefit service can require completion of 1,000 hours of service, employment on last day of plan year, or both condition**



Forfeitures

- ▶ **Forfeitures – employee terminates with less than 100% vested account balance. Nonvested portion subtracted from participant's account balance**
- ▶ **Forfeitures can be used by plan to reduce employer contributions, provide additional allocations to remaining participants, and pay reasonable administrative expenses of plan**



Contribution Limits

- ▶ **Elective Deferral Limit – Section 402(g) limit – \$19,000 in 2019**
- ▶ **Catchup – Section 414(v)(2)(B)(i) – \$6,000**
 - ▶ Statutory limit, employer-provided limit, or ADP testing limit

- ▶ Determined at end of plan year – compare elective deferrals with applicable limit



Contribution Limits

- ▶ **Section 415(c)(1)(A) Limit – \$56,000 in 2019**
 - ▶ Limit is lesser of 100% of employee's compensation or dollar limit

- ▶ Contributions Include:
 - ▶ Elective deferrals (including designated Roth contributions) – does not include catch-up contributions



Contribution Limits

- ▶ Employee after-tax contributions
- ▶ Employer matching contributions
- ▶ Employer nonelective contributions
- ▶ Reallocated forfeitures
- ▶ Amount of contribution to take into account is limited by Section 401(a)(17) limit



Contribution Limits

- ▶ **Amount of contribution to take into account is limited by Section 401(a)(17) limit**
 - ▶ Limits compensation used in calculating employer contributions, but not elective deferrals
 - ▶ Also limits compensation included in ADP and ACP nondiscrimination tests



Other Plan Types

- ▶ **Safe Harbor 401(k) Plan – to avoid ADP testing, plan makes QNEC or QMAC contributions**
 - ▶ QMAC – matching contribution of 100% of each employee's elective deferral up to 3% and 50% of employee's elective deferral over 3% and up to 5% of compensation (basic matching formula)



Other Plan Types

- ▶ QNEC – employer makes nonelective contribution of 3% to all NHCEs regardless of whether the employee contributes to plan
- ▶ Requires notice to employees and 100% immediate vesting of employer contributions



Other Plan Types

- **Qualified Automatic Contribution Arrangement (QACA) – automatic deferral percentage made to plan unless employee affirmatively elects to change percentage deferral or elects not to defer**



Other Plan Types

- Minimum deferral percentage default rate – initial period at least 3%; three plan years following, default rate is at least 4%, 5%, and 6% respectively; all later years, default rate cannot be less than 6% or greater than 10%
- Notice requirement
- Employer must make contributions – similar to safe harbor 401 (k)



Other Plan Types

- ▶ **Participant-directed plan (ERISA Section 404(c) plan) – participant chooses how to invest assets in account**
 - ▶ provides fiduciary protection for employer against investment losses resulting from participant control over investment decisions and account assets – must identify plan as 404(c) plan in SPD



Other Plan Types

- ▶ **403(b) plan – used primarily by 501(c)(3) nonprofit entities, public school districts, churches, etc.**
- ▶ **457 plans – governmental plans (state and local governments) use eligible 457(b) plans; ineligible 457(f) plans are used as deferred compensation plans similar to nonqualified deferred compensation plans**



Annual Testing



Annual Testing

- **Highly compensated employee (HCE):**
 - 5% owner of employer's stock or capital at any time during current or preceding year, or
 - received annual compensation greater than \$125,000 during the preceding year (2019)
 - earning more than \$120,000 in 2018 will classify an employee as HCE in 2019 plan year
 - earning more than \$125,000 in 2019 will classify an employee as HCE in 2020 plan year



Annual Testing

- ▶ **Minimum coverage testing – Section 410(b)**
 - ▶ Ratio percentage test – percentage of NHCEs benefitting under the plan is at least 70% of percentage HCEs benefitting under plan
 - ▶ Average benefit test is made up of two separate tests (both must be passed) – nondiscriminatory classification test and average benefit percentage test



Annual Testing

- ▶ **Actual Deferral Percentage Test (ADP) – must pass one of the following test:**
 - ▶ ADP of HCEs is not more than 125% of ADP of NHCEs, or
 - ▶ ADP of HCEs is lesser of:
 - ▶ 2% greater than ADP of NHCEs and
 - ▶ 2 times ADP of NHCEs



Annual Testing

- ▶ ADP is average of actual deferral ratios of HCEs and NHCEs
- ▶ Actual deferral ratio is elective contributions divided by eligible compensation. Note: deferrals do not include catch-up deferrals, but do include designated Roth contributions



Annual Testing

- ▶ HCEs – elective deferrals and compensation used is current plan year
- ▶ NHCEs – elective deferrals and compensation used is prior plan year (prior-year testing method) unless election is made to use current year deferrals and compensation (current-year testing method)



Annual Testing

- ▀ Compensation used is Section 414(s) compensation
- ▀ Top-paid group election – plan can elect to limit number of employees who are treated as HCEs



Annual Testing

- ▀ **Actual Contribution Percentage Test (ACP) – must pass one of the following tests:**
 - ▀ ACP of HCEs is not more than 125% of ACP of NHCEs, or
 - ▀ ACP of HCEs is lesser of:
 - ▀ 2% greater than ACP of NHCEs and
 - ▀ 2 times ACP of NHCEs



Annual Testing

- ▶ **ACP is average of actual contribution ratios of HCEs and NHCEs**
 - ▶ Actual contribution ratio is employee after-tax contributions and employer match (Section 401(m) contributions) divided by eligible compensation
 - ▶ Compensation used is Section 414(s) compensation



Annual Testing

- ▶ **General Nondiscrimination Testing – Section 401(a)(4) – used for testing employer nonelective contributions**
- ▶ **Top-Heavy Testing (Section 416) – testing to determine if present value of accrued benefits for key employees is more than 60% of present value of accrued benefits for all employees**

Annual Testing

- ▶ **Key employee is an includible officer earning \$180,000 or more, a 5% owner, or a 1% owner having annual compensation greater than \$150,000 (for 2019) – different definition from HCE**
- ▶ **Section 415 Limit Testing – annual testing to determine if contributions exceed 415(c) limit**

Questions?



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