Alliant
RETIREMENT CONSULTING

A Plan Sponsor's Guide to Retirement Plans

CONTENTS

401(k)

OVERVIEW

401(k) plans allow employers to contribute a portion of employees' wages to an individual account under the plan.

- The underlying plan can be a profit-sharing, stock bonus, pre-ERISA money purchase pension, or a rural cooperative plan.
- Generally, deferred wages (elective deferrals) are not subject to federal income tax withholding at the time of deferral. They are not reported as taxable income on the employee's individual income tax return.
- 401(k) plans are permitted to allow employees to designate some or all of their elective deferrals as "Roth elective deferrals" that are generally subject to taxation under the rules applicable to Roth IRAs. Roth deferrals are included in the employee's taxable income in the year of the deferral.

TAX ADVANTAGES

Two of the tax advantages of sponsoring a 401(k) plan are:

- Employer contributions are deductible on the employer's federal income tax return to the extent that the contributions do not exceed the limitations described in section 404 of the Internal Revenue Code. Refer to Publication 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans), for more information about deduction limitations.
- Elective deferrals and investment gains are not currently taxed and enjoy tax deferral until distribution.

TYPES AVAILABLE

There are several types of 401(k) plans available to employers. They include traditional 401(k) plans, safe harbor 401(k) plans, and SIMPLE 401(k) plans. Different rules apply to each.

For tax-favored status, a plan must be operated in accordance with the applicable rules. Therefore, it is important that the employer be familiar with the special rules that apply to its plan so the plan is administered in accordance with those rules. To qualify for the tax benefits available to qualified plans, a plan must both contain language that meets certain requirements (qualification rules) of the tax law and be operated in accordance with the plan's provisions.

TRADITIONAL 401(K) PLANS

A traditional 401(k) plan allows eligible employees to make pre-tax elective deferrals through payroll deductions. Also, employers have the option of making contributions on behalf of all participants, making matching contributions based on employees' elective deferrals, or both.

Employer contributions can be subject to a vesting schedule, which provides that an employee's right to employer contributions becomes nonforfeitable only after a period of time or be immediately vested.

Rules relating to traditional 401(k) plans require that the plan's contributions meet specific nondiscrimination requirements. To ensure the plan satisfies these requirements, the employer must perform annual tests, known as the Actual Deferral Percentage (ADP) and Actual

Contribution Percentage (ACP) tests. These tests verify that deferred wages and employer matching contributions do not discriminate in favor of highly compensated employees.

SAFE HARBOR 401(K) PLANS

A safe harbor 401(k) plan is similar to a traditional 401(k) plan, but it must provide for fully vested employer contributions. These contributions may be:

- Employer matching contributions
- Limited to employees who defer, or
- Made on behalf of all eligible employees, regardless of whether they make elective deferrals.

Safe harbor 401(k) plans are also not subject to the complex annual nondiscrimination tests that apply to traditional 401(k) plans. If a safe harbor 401(k) plan does not provide any additional contributions in a year, it is exempt from the top-heavy rules of section 416 of the Internal Revenue Code.

Notice requirements

Employers sponsoring safe harbor 401(k) plans must satisfy certain notice requirements. The notice requirements are satisfied if:

- Each eligible employee for the plan year is given written notice of the employee's rights and obligations under the plan.
- The notice satisfies the content and timing requirements.

Content requirements

The notice must describe:

- The safe harbor method in use.
- How eligible employees make elections.
- Any other plans involved.

Income Tax Regulations section 1.401(k)-3(d)(2), contains information on satisfying the content requirement using electronic media and referencing the plan's Summary Plan Description. The timing requirement requires that the employer must provide notice within a reasonable period before each plan year. This requirement is deemed to be satisfied if the notice is provided to each eligible employee at least 30 days and not more than 90 days before the beginning of each plan year. There are special rules for employees who become eligible after the 90th day. See Income Tax Regulations section 1.401(k)-3(d)(3). Both the traditional and safe harbor plans are for employers of any size and can be combined with other retirement plans.

RESTRICTION ON CONDITIONS OF PARTICIPATION

A 401(k) plan cannot require, as a condition of participation, that an employee complete more than 1 year of service.

AUTOMATIC ENROLLMENT IN A 401(K) PLAN

A 401(k) plan can have an automatic enrollment feature allowing the employer to:

- Automatically reduce the employees' wages by a fixed percentage or amount.
- Contribute that amount to the 401(k) plan unless employees chose not to have their wages reduced, or
- Have them reduced by a different percentage.

These contributions qualify as elective deferrals and are an effective way for many employers to increase participation in their 401(k) plans. For more information about 401(k) plans with an automatic enrollment feature, refer to Income Tax Regulations section 1.401(k)-1(A)(3)(ii).

ELECTIVE DEFERRAL LIMITS

The law, under IRC section 402(g), limits the amount that a participant can defer on a pre-tax basis each year. See the 401(k) Plan Contribution Limits. Elective deferrals that exceed the section 402(g) dollar limit for a year or are recharacterized as after-tax contributions as part of a correction of the Actual Deferral Percentage (nondiscrimination) test are included in the employee's gross income.

MATCHING CONTRIBUTIONS

If the plan document permits, the employer can make matching contributions for an employee who contributes elective deferrals to the 401(k) plan. For example, a 401(k) plan might provide that the employer will contribute 50 cents for each dollar that participating employees choose to defer under the plan. As mentioned earlier, employer matching contributions may be subject to annual tests to determine if nondiscrimination requirements are met.

OTHER EMPLOYER CONTRIBUTIONS

If the plan document permits, the employer can make additional contributions (other than matching contributions) for participants, including participants who choose not to contribute elective deferrals to the 401(k) plan.

If the 401(k) plan is top-heavy, the employer may be required to make minimum contributions on behalf of certain employees. In general, a plan is top-heavy if the account balances of key employees exceed 60% of the account balances of all employees. The rules relating to the determination of whether a plan is top-heavy are complex. Please refer to section 1.416-1 of the Income Tax Regulations for the rules describing how to determine whether a plan is top-heavy.

EMPLOYEE COMPENSATION TAKEN INTO ACCOUNT

For 2021, no more than $290,000 of an employee's compensation can be taken into account when figuring contributions. This is indexed for inflation.

VESTING REQUIREMENTS

All employees must be fully (100%) vested in their elective deferrals. A plan may require completion of a specific number of years of service for vesting in other employer or matching contributions. For example, a plan may require that the employee complete 2 years of service for a 20% vested interest in employer contributions and additional years of service for increases in the vested percentage.

DISTRIBUTIONS

Distribution rules govern when a plan may or must distribute benefits to participants.

REPORTING ELECTIVE DEFERRALS

The employer reports elective deferrals on the participant's Form W-2, Wage, and Tax Statement. Although these amounts are not treated as current income for federal income tax purposes, they are included as wages subject to social security (FICA), Medicare, and federal unemployment taxes (FUTA). Refer to Publication 525, Taxable and Nontaxable Income, for more information about elective deferrals.

Plan Provisions

PLAN DOCUMENT

Your plan document describes who is covered under your plan, i.e., who benefits under your plan, and what contributions or benefits will be provided to those covered employees. Your employees' rights to contributions and benefits are derived from the plan document.

You must operate your plan strictly in accordance with the terms of your plan document, including:

- Covering employees that your plan document describes as being covered and when the plan document says they should be covered.
- Providing them with the contributions or benefits set out in the plan document.

Even if the terms of your plan do not reflect your intent, you must follow the terms of your plan. Of course, the terms of your plan may be amended by a plan amendment.

Section 411(d)(6) prohibits the reduction of any participant's accrued benefit by an amendment of the plan. In a defined contribution plan (a 401(k), profit-sharing, money purchase plan, etc.), this means that no employee's account can be reduced because of a plan amendment. A plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment will be treated as reducing accrued benefits.

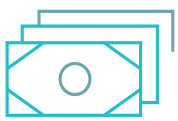
MINIMUM PARTICIPATION REQUIREMENTS

Section 410(a)(1) of the Internal Revenue Code sets forth the minimum age and service requirements for a qualified retirement plan. In general, a plan cannot require, as a condition of participation, that an employee complete a period of service with the employer extending beyond the later of:

- Be age 21; or
- Complete one year of service

Section 410(a)(4) sets forth the rules for plan entry dates (the dates when an eligible employee must begin participation). Under Code section 410(a)(4), a plan is not qualified unless it provides that an employee who is otherwise eligible to participate under the terms of the plan commences participation no later than the earlier of:

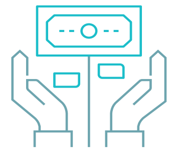
- The first day of the first plan year beginning after the date on which the employees satisfied the Code section 410(a)(1) minimum age and service requirements; or
- The date six months after the date on which the employee satisfied the minimum age and service requirements.



CASH OR DEFERRED ARRANGEMENT (CODA)

Under a CODA, participants may elect to have their employer contribute a specific amount to the plan in lieu of receiving it in cash as wages. In order to satisfy the requirements of section 401(k), the plan must satisfy the Actual Deferral Percentage (ADP) test that requires the deferral of income into the CODA by highly compensated employees be proportional to that of non-highly compensated employees. Generally, amounts that the participant elects to defer may only be distributed upon specific events including death, disability, termination of employment, hardship, and attainment of age 59 ½. The plan document must state that the Actual Deferral Percentage (ADP) test of Code section 401(k)(3) will be satisfied and must actually satisfy the test in operation.

Additionally, the law has changed to allow an employer not to perform an ADP test if it makes a safe harbor contribution to the plan on behalf of employees. In addition to the safe harbor contribution, certain notice requirements are also applicable.



402(G) LIMIT

Elective deferrals are amounts that employees elect to contribute to a retirement plan out of their compensation. A plan that provides for elective deferrals, for example a 401(k) plan, must provide that for each participant the amount of elective deferrals under the plan and all other plans, contracts, or arrangements of an employer maintaining the plan may not exceed the amount of the limitation in effect under Code section 402(g)(1) (Code section 401(a)(30)). In addition to the plan terms providing that elective deferrals must satisfy the requirements of Code section 402(g), elective deferrals must satisfy these requirements in operation. This limit is $19,500 in 2021, subject to cost-of-living adjustments in later years.

The law allows participants who are age 50 and over to make additional elective deferrals to the plan over the statutory limit. For taxable years beginning in 2015, the additional elective deferrals is $6,500 (subject to cost-of-living adjustments in later years). The limit is unchanged for 2021.

425 LIMIT

The limitations on benefits and contributions for retirement plans are set forth in Code section 425. The annual benefit limitation is **$230,000 for 2019** for a defined benefit plan and is subject to cost-of-living adjustments for later years for each employee.

The limitation on annual contributions is $58,000 for 2021 for a defined contribution plan and is subject to cost-of-living adjustments for later years. For each employee, deferrals are amounts that employees elect to contribute to a retirement plan out of their compensation. A plan that provides for elective deferrals, for example, a 401(k) plan, must provide that for each participant, the amount of elective deferrals under the plan and all other plans, contracts, or arrangements of an employer maintaining the plan may not exceed the amount of the limitation in effect under Code section 402(g)(1) (Code section 401(a)(30)).

In addition to the plan terms providing that elective deferrals must satisfy the requirements of Code section 402(g), elective deferrals must satisfy these requirements in operation. This limit is $19,500 in 2021 (subject to cost-of-living adjustments in later years).

The law allows participants age 50 and over to make additional elective deferrals to the plan over the statutory limit. For taxable years beginning in 2015 and 2016, the additional elective deferrals is $6,500 (subject to cost-of-living adjustments in later years).

MAXIMUM ANNUAL COMPENSATION

The maximum annual compensation of each employee that can be taken into account under a plan for any year must not exceed $290,000 for 2021 and is subject to cost-of-living adjustments in later years.

VESTING REQUIREMENTS

Code section 411 provides the minimum vesting requirements. This requires that each employee vest or own, at a minimum, a stated percentage of their interest in the plan each year. Your plan's vesting schedule is in your plan document.

Many plans provide for 100% vesting for all employees immediately upon their commencement of participation.

- All employees must be 100% vested by the time they attain Normal Retirement Age under the plan and when the plan is terminated.
- Amounts that are not vested may be "forfeited" by the employees when they separate from service with the employer.

Your plan describes how these forfeitures will be used to increase benefits or fund future benefits for other plan participants. Forfeitures must not be applied in a defined benefit plan to increase the benefits any employee would otherwise receive under the plan.

REQUIRED MINIMUM DISTRIBUTIONS

An employee's assets may not remain in the retirement plan indefinitely. Section 401(a)(9) sets out the latest date by which distributions must begin and the distribution's minimum amount. A plan must provide that the interest of each employee will be distributed to them not later than the required beginning date which means, in general, April 1 of the calendar year following the later of:

- The calendar year in which the employee attains age 72, or
- The calendar year in which the employee retires. This does not apply to an employee who is a 5-percent owner.

At a minimum, the distributions must be:

- Evenly spread over the life of the employee, or
- Over the lives of the employee and a designated beneficiary, or

- Over a period not extending beyond the life expectancy of the employee and a designated beneficiary.

Plan Audit

Federal law requires the annual audit of a defined benefit or defined contribution retirement plan (including 401(k)) when the plan's total eligible participants reach 100.

There are three types of eligible participants:

- Active – Individuals who are currently employed by the plan sponsor, covered under the plan, and receiving credited service. Note: This includes those eligible, but not participating.
- Retired or separated – Individuals who are no longer employed by the company and are either receiving benefits or entitled to receive benefits.
- Deceased – Individuals who have passed away and have one or more beneficiaries either receiving benefits or entitled to receive benefits.

An accurate total eligible participant count is important. When it reaches 100, the plan administrator is required to hire a qualified third party CPA firm to conduct an independent audit of the retirement plan. This audit information is incorporated into Form 5500, which is filed with the IRS.

ARE THERE ANY EXCEPTIONS TO THE THRESHOLD OF 100 ELIGIBLE PARTICIPANTS?

Yes, the 80-120 Participant Rule allows a plan that filed Form 5500 as a "small plan" last year to file its current Form 5500 in the "small plan" category again this year. It also allows a plan to forego the audit requirement if it now has up to 120 participants at the beginning of the current plan year – which otherwise would meet the 100 participant threshold and require a "large plan" filing and annual audit.

WHAT IS THE GOAL OF AN AUDIT?

The primary objective of the audit is to render an opinion on the financial data of the plan, and if it presents fairly, all material aspects of the financial status of the plan. During the audit, procedures are performed to ensure the 401(k) or other retirement plan is in compliance with both government regulations and requirements specified within the plan documents. Auditors consider several questions in their analysis, including:

- Do all eligible employees have the same opportunity to participate?
- Are assets of the plan fairly valued?
- Have contributions to the plan been made in a timely manner?
- Are accounts of the participants fairly stated?
- Were benefit payments made according to the terms of the plan?

- Were there any issues identified that may impact the plan's tax status?
- Have there been any transactions made that are prohibited under ERISA?

HOW ARE THE AUDIT RESULTS USED BY PLAN SPONSORS?

Audited financial statements, along with the auditor's report, must be attached to the Form 5500 filing. Once the annual audit is complete, the plan administrator, and those charged with governance, receive various other communications. These communications can be used to help strengthen internal controls, correct any areas of noncompliance, improve processes, and gain a deeper appreciation of fiduciary responsibility.

Non-Discrimination Testing

The contributions or benefits provided under a plan must not discriminate in favor of highly compensated employees. Section 401(a)(4) contains the test for nondiscrimination that a qualified plan must satisfy. The purpose of this test is to assure that the benefits provided to highly compensated employees are proportional to those provided to non-highly compensated employees.

HIGHLY COMPENSATED EMPLOYEE (HCE)

Under the plan, contributions or benefits must not discriminate in favor of highly compensated employees. Generally, employees with compensation of $130,000 or more from the employer in the prior year are considered highly compensated for 2021 (subject to cost-of-living adjustments).

In order to satisfy this requirement with regard to elective deferrals and employer matching contributions, 401(k) plans may provide (safe harbor) minimum employer contributions or meet the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests.

ADP - ACTUAL DEFERRAL PERCENTAGE TEST

The ADP test counts elective deferrals (both pre-tax and Roth deferrals, but not catch-up contributions) of the HCEs and non-HCEs. Dividing a participant's elective deferrals by the participant's compensation gives you that participant's Actual Deferral Ratio (ADR). The average ADR for all Non-Highly Compensated Employees (NHCEs), even those who chose not to defer, is the ADP for the NHCE group. Do the same for the HCEs to determine their ADP.

The ADP test is met if the ADP for the eligible HCEs doesn't exceed the greater of:

- 125% of the ADP for the group of NHCEs, or the lesser of:
    - 200% of the ADP for the group of NHCEs, or the ADP for the NHCEs plus 2%

Calculate the ACP the same way, instead dividing each participant's matching and after-tax contributions by the participant's compensation.

The ACP test is met if the ACP for the eligible HCEs doesn't exceed the greater of:

- 125% of the ACP for the group of NHCEs, or the lesser of:
    - 200% of the ACP for the group of NHCEs, or the ACP for the NHCEs plus 2%

ACP - ACTUAL CONTRIBUTION PERCENTAGE TEST

If a retirement plan permits employee and/or matching contributions, the plan must satisfy the requirements of Code section 401(m). The plan document must state that the Actual Contribution Percentage (ACP) test of Code section 401(m)(2) will be satisfied and must actually satisfy the test in operation.

The ACP test requires that the employee and matching contributions provided for highly compensated employees be proportional to those for non-highly compensated employees. Code section 401(m) does not apply to a defined benefit plan unless employee contributions to the plan are allocated to a separate account.

Similar to the ADP safe harbor contribution, a safe harbor exists for the ACP test if the ADP safe harbor contribution is made and timely notice is provided to participants. Additionally, the level of matching contributions is limited in order for the ACP safe harbor to apply.

You may base the ADP and ACP percentages for NHCEs on either the current or prior year contributions. The election to use current or prior year data is in the plan document. Under limited circumstances, the election may be changed.

TOP HEAVY

A plan must satisfy certain vesting and minimum benefit requirements if the plan is top-heavy. In general, a plan is top-heavy if 60 percent of the aggregate accrued benefits or account balances under the plan are for the benefit of certain "key employees." Generally, a key employee is:

- A 5 percent owner of the employer,
- A 1 percent owner of the employer with over $150,000 in compensation from the employer, or
- An officer of the employer with over $185,000 (in 2021 and subject to cost-of-living adjustments in later years) in compensation from the employer.

Plan Sponsor Filing Requirements

The plan sponsor is responsible for ensuring that its plan operates in compliance with the rules related to qualified plans. The plan sponsor is also subject to certain filing requirements. A list of those requirements is included here. Penalties may apply for the late filing or non-filing of required returns and reports.

This checklist may be used as a tool to help you meet 401(k) filing requirements. This checklist is not intended to be all-inclusive.

Required to be filed annually:		
Item	**Explanation**	**Due to:**
Form 5500, Annual Return/ Report of Employee Benefit Plan or **Form 5500-EZ**, Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan with applicable schedules and independent auditor's report, if applicable.	An administrator or sponsor of an employee benefit plan subject to ERISA must file information about each plan every year. A Form 5500-EZ may generally be filed for a plan that provides benefits solely for an individual (and spouse) who wholly owns a trade or business; or partners (and spouses) in a partnership.	**IRS/DOL:** By the last day of the 7th month after the end of the plan year.
Form W-2, Wage and Tax Statement and **Form W-3**, Transmittal of Wage and Tax Statements	Reports wages and the amount of elective deferrals for a 401(k) plan.	**Employees:** By January 31st following the calendar year. **IRS:** By February 28th following the calendar year.

Required to be filed when applicable:		
Item	**Explanation**	**Due to:**
Form 945, Annual Return of Withheld Federal Income Tax	Used to report income tax withheld from distributions made from qualified plans. Deposits of the tax with Form 8109 to an authorized depositary must be made at specified times during the tax year.	**IRS:** By January 31st of the year following the calendar year in which the distribution was made.
Form 990-T, Exempt Organization Business Income Tax Return	Used to report gross unrelated business income of $1,000 or more. Generally deposits of the tax with a Form 8109 to an authorized depositary must be made at specified times during the tax year.	**IRS:** By the 15th day of the 4th month after the end of the tax year.
Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.	Used to report distributions, including direct rollovers, from qualified plans.	**Participant:** By January 31st following the calendar year of the distribution. **IRS:** By February 28th of the year following the calendar year of the distribution.

Required to be filed when applicable (cont.):		
Item	**Explanation**	**Due to:**
Form 5310-A, Notice of Plan Merger or Consolidation, Spinoff or Transfer of Plan Assets or Liabilities; Notice of Qualified Separate Lines of Business (QSLOB)	Used to inform the IRS of plan merger or consolidation, spinoff or transfer of plan assets or liabilities, or QSLOB.	**IRS:** At least 30 days prior to plan merger, consolidation, spinoff or transfer of plan assets to another employer. **For QSLOB:** By the later of October 15th of the year following the testing year, or the 15th day of the 10th month after the end of the plan year of the plan of the employer that begins earliest in the testing year.
Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts	Used to report and pay additional taxes.	**IRS:** As an attachment to the Individual Income Tax Return. *(Note: filed by participant)*
Form 5330, Return of Excise Taxes Related to Employee Benefit Plans	Used to report tax on the following IRC sections: 4971 – minimum funding deficiency 4972 – nondeductible contributions to qualified plans 4973(a)(3) – excess contributions to a 403(b)(7) custodial account 4975 – prohibited transactions 4978, 4978A – certain ESOP dispositions 4979 – excess contributions to plans with cash or deferred arrangements 4979A – certain prohibited allocations of qualified securities by an ESOP 4980 – reversion of qualified plan assets to employers 4980F – failure of applicable plans reducing future benefit accruals to satisfy notice requirements	**IRS:** For taxes due under: 4971 – later of the last day of the 7th month after the end of the employer's tax year or 8 ½ months after the last day of the plan year that ends with or within the filer's tax year. 4972, 4973(a)(3), 4975, 4978, 4978A, and 4979A – last day of the 7th month after the end of the tax year of the employer or other person who must file this return. 4979 – last day of the 15th month after the close of the plan year to which the excess contributions or excess aggregate contributions relate. 4980 – last day of the month following the month in which the reversion occurred. 4980F – last day of the month following the month in which the failure occurred.
Form 5558, Application for Extension of Time to File Certain Employee Plans Returns	Provides a 2 ½ month extension to file the Form 5500 or 5500-EZ; a 6 month extension to file Form 5330.	**IRS:** By the last day of the 7th month after the end of the plan year for a 5500 extension; before otherwise due for a 5330 extension.

Summary Plan Description

DISTRIBUTIONS

Required distributions

A 401k plan must provide that each participant will either:

- Receive his or her entire interest (benefits) in the plan by the required beginning date (defined below), or

- Begin receiving regular periodic distributions by the required beginning date in annual amounts calculated to distribute the participant's entire interest (benefits) over his or her life expectancy or over the joint life expectancy of the participant and the designated beneficiary (or over a shorter period).

These required distribution rules apply individually to each qualified plan. The required distribution from a 401k plan cannot be satisfied by making a distribution from another plan. The plan document must provide that these rules override any inconsistent distribution options previously offered.

Minimum distribution

When the participant's account balance is to be distributed, the plan administrator must determine the minimum amount required to be distributed to the participant each calendar year. Information to help the administrator figure the minimum distribution amount is included in Publication 575, Pension and Annuity Income.

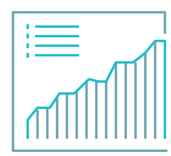
The **required beginning date** is April 1 of the first year after the later of the following years:

- Calendar year in which the participant reaches age 70½.

- Calendar year in which the participant retires.

However, a plan may require that the participant begin receiving distributions by April 1 of the year after the participant reaches age 70½, **even if the participant has not retired.**

If the participant is a 5% owner of the employer maintaining the plan, then the participant must begin receiving distributions by April 1 of the first year after the calendar year in which the participant reaches age 70½. Additional information to help determine a participant's required beginning date is included in Publication 575.



Distributions after the starting year

The distribution required to be made by April 1 is treated as a distribution for the starting year. (The starting year is the year in which the participant reaches age 70½ or retires, whichever applies, to determine the participant's required beginning date, above.) After the starting year, the participant must receive the required distribution for each year by December 31 of that year. If no distribution is made in the starting year, required distributions for 2 years must be made in the next year (one by April 1 and one by December 31).

Distributions after participant's death

Publication 575 includes information regarding the special rules covering distributions made after the death of a participant.

Hardship distributions

A 401(k) plan may allow employees to receive a hardship distribution because of an immediate and heavy financial need. Hardship distributions from a 401k plan are limited to the amount of the employee's **elective deferrals** and generally do not include any income earned on the deferred amounts. If the plan permits, certain employer matching contributions and employer discretionary contributions may also be included in hardship distributions. Hardship distributions cannot be rolled over to another plan or IRA.

A distribution is treated as a hardship distribution only if it is made on account of the hardship. For purposes of this rule, a distribution is made on account of hardship only if the distribution is made both on account of an **immediate and heavy financial need** of the employee and is **necessary to satisfy that financial need**. The determination of the existence of an immediate and heavy financial need and of the amount necessary to meet the need must be made in accordance with nondiscriminatory and objective standards set forth in the plan.

A distribution on account of hardship must be limited to the distributable amount. The **distributable amount** is equal to the employee's total elective contributions as of the date of distribution, reduced by the amount of previous distributions of elective contributions.

Immediate and heavy financial need

Whether an employee has an immediate and heavy financial need is to be determined based on all relevant facts and circumstances. A distribution made to an employee for the purchase of a boat or television would generally not constitute a distribution made on account of an immediate and heavy financial need. **A financial need may be immediate and heavy even if it was reasonably foreseeable or voluntarily incurred by the employee.**

Generally, distributions of elective deferrals **cannot** be made until one of the following occurs:

- The participant dies, becomes disabled, or otherwise has a severance from employment.
- The plan terminates and no successor defined contribution plan is established or maintained by the employer.
- The participant reaches age 59½ or incurs a financial hardship.

Depending on the terms of the plan, distributions may be:

- Non-periodic, such as lump-sum distributions, or
- Periodic, such as annuity or installment payments.

In certain circumstances, the plan administrator must obtain the participant's consent before making a distribution. Generally, consent is required if the participant's account balance exceeds $5,000. Depending on the type of benefit distribution provided for under the 401k plan, the plan may also require the consent of the participant's spouse before making a distribution. A plan may provide that rollovers from other plans are not included in determining whether the participant's account balance exceeds the $5,000 amount.

If a distribution in excess of $1,000 is made, and the participant (or designated beneficiary) does not elect to (i) receive the distribution directly or (ii) make an election to roll over the amount to an eligible retirement plan, the plan administrator must:

- Transfer the distribution to an individual retirement plan of a designated trustee or issuer
- Notify the participant (or beneficiary) in writing that the distribution may be transferred to another individual retirement plan

POST SEVERANCE PAY

Post-severance compensation is defined by the IRS as compensation that would have been paid if the severance had not occurred. It is important to note there are certain types of post-severance compensation that do qualify as compensation under the §415. If the post-severance compensation would have been paid had the employee not been severed from employment, such as compensation for hours worked up until the employee's severance date but not paid until after the severance date, and the compensation is paid before the later of (1) 2 ½ months after severance or (2) the end of the plan year in which the severance occurs.

Post-Severance Pay Included in the Definition of Compensation

Example: An employee is severed on a Thursday. The employee has hours worked on Monday through Thursday of that week. Those hours are included in the employer's payroll on the second Friday after the employee's termination date. That compensation would be eligible for 401(k) deferral.

Post-Severance Pay Excluded from the Definition of Compensation

The amount of time between when an employee earns compensation and when it is paid can be longer in the case of commission pays, bonuses, etc. The following is an example situation to illustrate how this would work:

(1) a salesperson receives commission which is paid on the second pay in January of year 2 for sales in the fourth quarter of year 1,

(2) this employee terminated employment on October 15 of year 1, but had sales that earned him commission for the period October 1 through October 15, and

(3) the plan's year end is December 31.

Since the second paycheck of January will be 2 ½ months after the employee's severance, and after the end of the limitation year, the compensation in this example **would be excluded** even if commission pay is normally included in the definition of compensation for non-severed employees.

Glossary of Terms

401K PLAN

A tax-deferred retirement plan that can be offered by businesses of any kind. A company's 401k plan can be a "cash election" profit-sharing or stock bonus plan, or a salary reduction plan. A 401k plan carries many unique advantages for both employer and employee.

403(B) PLAN

SECTION 403(b) of the Internal Revenue Code allows employees of public school systems and certain charitable and nonprofit organizations to establish tax-deferred retirement plans which can be funded with mutual fund shares.

404(C)

Optional regulation on plan sponsor to provide certain information and fund choices so plan participants can make informed decisions about their retirement plan investments.

A

Actual contribution percentage (ACP)

The result of the average of ratios of combined contributions to compensation for both highly compensated and non-highly compensated employees in a 401(k) plan. Each employee's ratio is calculated and then averaged for the group.

Actual Deferral Percentage (ADP)

The proportion of a plan participant's compensation that is contributed to a 401k plan as an employee elective deferral.

Annual defined contribution limit

The maximum 401k contribution limit that applies to all employee and employer 401k contributions in a calendar year. This limit is the lesser of 100% of the employee's total pre-tax compensation or a fixed amount that can change annually.

Automatic contribution arrangement

A feature in a plan whereby a covered employee's compensation is reduced by an amount specified in the plan and contributed to the plan on the employee's behalf unless the employee makes an affirmative election to have a different amount or no amount contributed to the plan. In the case of a 401k plan with an automatic contribution arrangement, the amounts withheld from employees' compensation are contributed to the plan as elective deferrals and the percentage of compensation contributed is called the default deferral rate.

Auto enrollment

The practice of enrolling all eligible employees in a plan and beginning participant deferrals without requiring the employees to submit a request to participate. Plan design specifies how these automatic deferrals will be invested. Employees who do not want to make deferrals to the plan must actively file a request to be excluded from the plan. Participants can generally change the amount of pay that is deferred and how it is invested.

Auto escalation

A plan which automatically increases the percentage of (retirement) funds saved from salary and generally features a default or standard contribution escalation rate.

B

Blackout period

When a plan sponsor decides to switch from one plan vendor to another, there is typically a period during which participants are not permitted to make changes in their investment selections. This is known as the blackout period. Once the blackout period commences and until it ends, participants can no longer direct the investments in their accounts. Blackout periods can last up to 60 days.

Bundled plan

A 401k package which includes all investment, administration, education, and recordkeeping that is sold as one unit. This is in contrast to a basic 401k plan in which the plan sponsor can individually hire each component provider separately.

C

Catch-up provision

A provision found in some 401k plans that allows an eligible employee who is at least age 50 to make higher annual contributions in the years prior to retirement.

Cliff vesting

A 401k plan with "Cliff Vesting" vests 100% of employer contributions after a specified number of years of service. After three years of service, benefits must be fully vested.

Compliance testing

Testing required by the IRS to make sure that the 401k plan is fair to both highly compensated and non-highly compensated employees.

Contingent beneficiary

A contingent beneficiary stands second-in-line, behind the primary beneficiary, to inherit the assets of a retirement plan.

Controlled group

A group of trades or businesses (employers) that are related through ownership. A controlled group of employers is either:

1. One or more chains of employers connected through ownership with a common parent employer where at least 80% of each employer, other than the common parent, is owned by one or more of the other employers and the common parent owns at least 80% of one or more of the other employers ("parent-subsidiary controlled group");

2. Two or more employers where five or fewer common owners satisfy an 80% common ownership test and a 50% identical ownership test ("brother-sister controlled group"); or

3. Three or more employers where each employer is in either a parent-subsidiary controlled group or a brother-sister controlled group and at least one of the employers is the common parent employer in a parent-subsidiary controlled group and is also in a brother-sister controlled group ("combined group").

Corrective distribution

A distribution of funds from the plan to correct a nondiscrimination test or to correct a contribution in excess of a statutory limitation.

D

Default

A failure to repay a plan loan in accordance with the provisions specified in the plan document. The document must identify the events that constitute the failure and the parameters for any grace period.

Default deferral rate

In the case of an automatic contribution arrangement in a 401k plan, the percentage of compensation, specified in the plan, withheld automatically from a covered participant's compensation (unless the participant elects otherwise) and contributed to the plan as an elective deferral.

Defined benefit

A defined benefit plan is an employer maintained plan that pays out a specific, pre-determined amount to retirees. Defined benefit plans are guaranteed by PBGC.

Defined contribution

A defined contribution plan does not promise a specific benefit at retirement, but does provide regular, set contributions to a pension fund. Defined contribution plans tend to be less expensive than defined benefit plans.

Designated Roth contribution

An elective deferral designated as a Roth contribution when contributed to the plan and which is not excludable from gross income.

Discretionary match

A match that is not defined by the plan document and can be changed at the plan sponsor's discretion.

Discrimination testing

All tax qualified retirement plans must be administered in compliance with several regulations to meet Internal Revenue Service guidelines. Every tax qualified retirement plan (like a 401k) must pass a series of numerical measurements each year. These include the ADP Test (Actual Deferral Percentage), ACP Test (Actual Contribution Percentage), Multiple Use Test and Top-heavy Test. Typically, doing these tests is called discrimination testing.

Distributions and withdrawals

When money is withdrawn from a 401k plan, the withdrawal is referred to as a distribution. 401k plan assets can be withdrawn without penalty after age 59 1/2. Employees are required to begin taking distributions after age 70 1/2.

E

Eligibility

Requirements for an employee to enter the plan subject to exclusions in the plan document. The most restrictive an employer can make 401(k) eligibility is to require an employee to be at least 21 years of age and have one year of service with at least 1,000 hours worked.

Elective deferral

An amount contributed to a 401k plan by an employee. Elective deferrals can be either pre-tax or designated as Roth contributions if the plan has a Roth option.

Entry date

Date an eligible employee can begin deferring into the plan. It can be any time, monthly, quarterly, semi-annually, or annually.

Eligible automatic contribution arrangement

A type of automatic contribution arrangement that may be included in a 401k plan. Under the feature, a participant may elect to receive a one-time distribution of elective deferrals withheld under the automatic contribution arrangement. The arrangement must satisfy a uniformity requirement and a notice requirement.

Employer matching contribution

The amount that the employer contributes to the employee's 401k account. Matching contributions are usually configured to provide a set percentage of an employee's contribution up to a fixed limit.

Elapsed time method for eligibility

The elapsed-time method is an alternative for retirement plans to define crediting service for eligibility. In this system, a year of service is completed when the employee completes 12 months or 365 days of service, regardless of how much he or she actually worked during that period.

Employer discretionary contributions

Some employers also make an additional contribution at plan-year end in the form of increased matching contributions and/or a profit sharing contribution. These employer contributions are considered a tax-deductible business expense and also grow on a tax-deferred basis.

Enhanced matching contribution

A matching contribution under a safe harbor 401k plan that provides each participant with a matching contribution that is greater than the basic matching contribution.

Employee Retirement Income Security Act (ERISA)

This law was passed in 1974 and is a comprehensive package dealing with all areas of pensions and employee benefits, not just 401k plans. ERISA includes requirements on pension disclosure, participation standards, vesting rules, funding, and administration.

F

Fiduciary

An individual or an institution charged with the duty of acting for the benefit of another party as to matters coming within the scope of the relationship between them. For example, any person who exercises any discretionary authority or control over the management of a 401k retirement plan or its assets. A fiduciary is to act solely in the interest of plan participants and their beneficiaries.

Fiscal year

An accounting period consisting of 12 consecutive months.

Fixed match

A matching contribution that is specifically provided for in the plan document and that must be contributed each year unless and until the plan is amended.

Frozen plan

A plan under which accruals and/or contributions have ceased but assets are still held for participants and beneficiaries.

G-H

Hardship withdrawal

An in-service distribution from the plan which is made because the participant has suffered severe financial difficulty or an extraordinary event as defined by the plan document.

Highly compensated employee (HCE)

A Highly Compensated Employee (HCE) is anyone who:
Owned more than 5% of the interest in a business at any time during the year or the preceding

year, regardless of how much compensation that person earned or received; or, for the preceding year, received compensation from the business of more than $125,000 for 2019, and, if the employer so chooses, was in the top 20% of employees when ranked by compensation.

I

In-service withdrawal

A withdrawal from a retirement savings plan by a participant who remains employed. In-service withdrawals are severely restricted by law and by most plans. In-service withdrawals of elective deferrals (employee salary reduction contributions) are prohibited by law prior to age 59 1/2. While allowed by law after that age, most plans do not allow it.
In-service withdrawals of employer contributions are allowed under some circumstances prior to age 59 1/2, but most plans prohibit it.

J-M

Lump sum

The distribution, in a single payment, of a participant's entire vested accrued benefit under the plan (or what remains of the participant's vested benefit at the time of the single-sum distribution).

Master/prototype plan

A master plan is a plan that is made available by a sponsor for adoption by employers and for which a single funding medium is established for use by all adopting employers. A prototype plan is a plan that is made available by a sponsor for adoption by employers and under which a separate funding medium is established for each adopting employer.

Matching contribution

Employer contributions that are made on account of elective deferrals or employee after-tax contributions.

Minimum contribution

A contribution required to be made to a plan in any year in which it is determined to be top-heavy.

N

Named Fiduciary

The plan document must name one or more fiduciaries (called the "Named Fiduciary") with the duty and the power under ERISA to control, manage and administer the plan. The Named Fiduciary can be an employee of the plan sponsor or an independent party.

Non-discrimination rules

Rules denying an employer, employee, or both the benefit of tax advantages if the plan discriminates in favor of highly compensated or key employees as demonstrated by government-specified tests.

Non-elective contribution

A type of contribution an employer chooses to make to their employee's retirement plan account regardless of whether the employee makes a contribution to the plan.

Non-highly compensated employee (NHCE)

This group of employees is determined on the basis of compensation or ownership interest. See Highly Compensated Employee.

Non-qualified deferred compensation plan

A plan subject to tax, in which the assets of certain employees (usually Highly Compensated Employees) are deferred. These funds may be reached by an employer's creditors.

Non-qualified plan

A pension plan that does not meet the requirements for preferential tax treatment. This type of plan allows an employer more flexibility and freedom with coverage requirements, benefit structures, and financing methods.

O

Opinion letter

A written statement issued by the IRS to a sponsor or master and prototype mass submitter as to the acceptability of the form of a master/prototype plan under §401(a) and, in the case of a master plan, the acceptability of the master trust under §501(a).

Orphan plan

A defined contribution plan for which there is no plan sponsor or other plan fiduciary willing to act with respect to the plan.

P

Participant

An employee who is eligible to either make contributions to the retirement plan or to share in employer contributions to the plan.

Participant contributions

The dollars that employees contribute to their 401k plans.

Participant directed account

A plan that allows participants to select their own investment options. See Participant Directed Investing.

Participant directed investing

In this case, the employee decides how to invest his or her funds. It is the company's responsibility to offer a variety of investment opportunities so that the employee can make investments according to his or her long-term goals and risk.

Pension Benefit Guarantee Corp (PBGC)

A guarantee fund, established by ERISA, which covers all defined benefit pension plans. Companies with a defined benefit plan must pay premiums into this fund according to the number of employees in the plan and the current ratio of assets to liabilities in the plan.

Plan administrator

The individual, group, or corporation named in the plan document that is responsible for day-to-day operations. The plan sponsor is generally the plan administrator if no other entity is named.

Plan document

A written instrument under which the plan is established and operated.

Plan fiduciary

Anyone who exercises discretionary authority or discretionary control over management or administration of the plan, exercises any authority or control over management or disposition of plan assets, or gives investment advice for a fee or other compensation with respect to assets of the plan.

Plan sponsor

The entity (generally the employer) responsible for establishing and maintaining the plan.

Plan trustee

Someone who has the exclusive authority and discretion to manage and control the assets of the plan. The trustee can be subject to the direction of a named fiduciary, and the named fiduciary can appoint one or more investment managers for the plan's assets.

Plan vendor

Companies that administer, service and/or sell 401k plans. They are generally employed by the plan sponsor.

Plan year

The calendar or fiscal year for which plan records are maintained.

Profit sharing plan

A defined contribution pension plan that uses a variable level of contributions based on company profits. Profit sharing plans allow firms to limit allocations to a pension fund in lean years. However, they suffer from lower maximum deduction limits than standard plans.

Q-R

Qualified Default Investment Alternative (QDIA)

An investment option a plan sponsor may use for 401k plan contributions in the absence of direction from a plan participant.

Qualified Domestic Relations Order (QDRO)

A judgment, decree, or order that creates or recognizes an alternate payee's (such as former spouse, child, etc.) right to receive all or a portion of a participant's retirement plan benefits.

Qualified Plan

A private retirement plan that meets the rules and regulations of the Internal Revenue Service. Contributions to such a plan are generally tax-deductible; earnings on such contributions are always tax sheltered until withdrawal.

Rollover

An employee's transfer of retirement funds from one retirement plan to another plan of the same type or to an IRA without incurring a tax liability. The transfer must be made within 60 days of receiving a cash distribution. The law requires 20 percent federal income tax withholding on money eligible for rollover if it is not moved directly to the second plan or an investment company.

Roth 401k

A 401(k) feature that allows employees to make elective contributions on an after-tax basis. Withdrawals, generally after age 59½, of any money from the account (including investment gains) are tax-free.

S

Safe harbor 401k

A safe harbor 401k is similar to a traditional 401k plan, but the employer is required to make contributions for each employee. The safe harbor 401k eases administrative burdens on employers by eliminating some of the complex tax rules ordinarily applied to traditional 401k plans.

Salary Reduction Plan (Cash or Deferred Arrangement) CODA

A CODA is a defined contribution plan that allows participants to have a portion of their compensation (otherwise payable in cash) contributed pre-tax to a retirement account on their behalf. They include 401k, 403b, and 457 plans.

Savings or thrift plan

A defined contribution plan in which participants make contributions on a discretionary basis with limits and to which employers may also contribute, usually on the basis of fully or partially matching participants' contributions. Contributions are commonly made with after-tax earnings.

Service provider

A company that provides some type of service to a 401k plan, including managing assets, recordkeeping, providing plan education, and plan administration.

Summary Plan Description (SPD)

ERISA requires a Summary Plan Description (SPD) be distributed to each plan participant and to each beneficiary receiving benefits under the plan as follows: For existing plans, a new participant must receive a copy of the SPD within 90 days after becoming a participant, and a beneficiary must receive a copy within 90 days after first receiving benefits.

T-Z

Tax-free rollover

Provision whereby an individual receiving a lump-sum distribution from a qualified pension or profit sharing plan can preserve the tax deferred status of these funds by a "rollover" into an IRA or another qualified plan if rolled over within 60 days of receipt.

Third-party administrator

A party hired by a plan or its fiduciaries to aid in performing management and/or recordkeeping functions on behalf of the plan.

Vesting

The period of time an employee must work at a firm before gaining access to employer-contributed pension income. For 401k plans, employee contributions are immediately vested, but employer contributions may be vested over a period of several years.

Volume submitter plan

A type of individually-designed retirement plan that has been pre-approved by the IRS.

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