Agenda

1. Document Failures
2. Notice Failures
3. Missed Deferral Opportunity
4. Funding with Forfeitures (or not)
5. When is testing required
6. Other “watch outs”
Document Failures

- You are either a SH plan or not
  - Cannot condition on giving notice
  - Must be in place for full PY (except first year)
  - First year must be in place by 3 months before end of PY (Oct. 1st for calendar year plans)

Document Failures

- Current tested 401(k) must be converted as of first day of next PY
- Profit Sharing plan (no deferral feature) can be converted with at least 3 months left in PY
Document Failures

• So what to do if document does not have proper language?

• EPCRS - VCP

Document Failures

• What if plan uses all the correct provisions (fully vested contributions at the correct levels, etc.) and even gave notices out, but does not contain actual SH language?
  – Not a SH
  – Will IRS allow amendment to be a SH under VCP?

  – Bob’s suggestion – run; not walk – to an ERISA attorney
IRS Position on Mid-Year Amendments

• Plan provisions that satisfy the safe harbor requirements must be adopted before the first day of the plan year and remain in effect for an entire 12-month plan year
• If plan is amended, then plan will not satisfy the safe harbor rules
• There are limited exceptions

IRS Position on Mid-Year Amendments

• IRS feels that a mid-year change is only OK if the IRS says you can make it
  – Can a plan sponsor make a change to a provision not reflected in the SH notice?
• Final regulations authorize IRS to issue guidance to allow other mid-year amendments
  – Revenue rulings, notices, announcements, etc.
  – On IRS priority plan - see next slide
IRS Position on Mid-Year Amendments

• ASPPA GAC has asked that IRS look at items that do not affect SH or the notice first,
• Then look at items that are in notice or may affect SH

Allowable Changes

• Roth Deferral option
• Roth Conversion option (expired 12/31/14)
• Adding beneficiary events to hardship provisions
• Spousal definition to conform with *Windsor* decision
• Cease or terminate SH
• Change of plan year, so long as preceded by SH PY and followed by 12-month SH
Allowable Changes
(non binding verbal guidance)

- Expand coverage to include employees previously not included (so long as existing participants are not affected)
- Change of investment vendor
- A retroactive corrective amendment to address a coverage failure
- Change of trustees

PPA Restatements

- We are in a restatement period
- Can I restate in middle of year – restatement is retroactive anyway?
  - Yes
  - Issue is what effective date can be used for the restatement
  - If no discretionary changes being made then can have a retroactive effective date of restatement
- Bob’s suggestion – amend as of 1st day of next PY is always safest approach (1/1/16)
Impermissible Change

• What happens if an impermissible change is made mid-year?
• Would require VCP
• 3 options:
  – Amendment doesn’t affect SH status so no problem
  – Amendment is void and SH status retained
  – Plan is not a SH

Annual Notice - Content

• SH formula (match or nonelective)
• Other contributions or potential contributions
• Plan to which SH contribution made (if employer sponsors another plan)
• Compensation that may be deferred (type and amount)
• How to make deferral elections
• Periods available to make deferrals
• Vesting and withdrawal provisions of all sources of funds
• How to obtain other plan information
Documentation and Disclosure

- Annual notice requirement - “reasonable period before each plan year”
- Deemed to be reasonable if distributed 30-90 days prior to plan year (safe harbor period for the Safe Harbor Notice)
- If less than 30 days before plan year still may be okay if it is deemed reasonable under a facts and circumstances test

Documentation and Disclosure

- Newly Eligible employee – no sooner than 90 days before eligibility date and no later than eligibility date
- For a newly established SH plan, all eligible employees are “newly eligible,” therefore plans can be established during last month of prior year
Bob’s Opinion - FWIW

• Closer to 30 days the better
• 3% nonelective does not really affect deferrals so you have a better argument if this is very close to first day of plan year
• SH match – deferral amounts may be affected so you will want to show IRS if the timing of the distribution of notice affected deferral elections

Failure to Provide Safe Harbor Notice

• Previously, IRS recommended VCP
• ER unlikely to incur costs of VCP for what it considers a harmless error
• IRS newsletter suggests correction by way of example (Fall 2008)
  – Not official but an indication of what the IRS probably would accept
Failure To Provide Notice

• BLM maintains safe harbor 401(k) plan with basic safe harbor match
• BLM fails to provide notice to all participants
  – Ann became eligible on 1/1/15
    • In addition to not providing her with the notice, BLM failed to inform her of her right to make elective deferrals
    • Earns $30,000/year
  – Bob (existing participant) defers at a 2% rate and earns $50K/year
    • Although BLM did not provide him a notice, he was aware that:
      – he could change his deferral rate, and
      – the plan’s matching formula did not change for 2015

Correction Options - SCP

• Ann receives $1,350 (plus earnings)
  – 50% x (3% x $30,000) – deferrals
  – 100% x $900 – match
• No correction for Bob – not affected by failure
• Not guaranteed (facts and circumstances)
• Document determination in case of audit
• Late notice reduces correction
• Note: see 2015 update to EPCRS for new corrective options that might apply
Correction Options - VCP

• Sanction payment
• Attorney cost
• Who knows what the correction may be

Administrative Procedures

• IRS requires the ER to reform its administrative procedures to ensure that future failures do not occur
• For example, the ER could establish a calendar identifying due dates by which it must complete certain plan tasks
• The ER should commit to writing (e.g., memorandum for the file) the reforms it is adopting
• The written description of the implemented changes is particularly important if the ER’s correction does not involve a corrective contribution
• The ER also should document why the failure to provide the notice did not affect certain EEs
  – Comment: IRS examiners are more persuaded by documents created at the time of correction than a verbal explanation given at an audit
Safe Harbor Nonelective

• The IRS does not discuss the correction for a plan providing the SH nonelective contribution rather than the SH match
• IRS officials have stated several times that:
  – ER maintaining such a plan probably could correct simply by providing the notice late (even if it were after the beginning of the plan year), and
  – Correcting its administrative procedures to prevent further failures

Missed Deferral Opportunity

• Missed deferral opportunity = 50% of “missed deferrals”
• “Missed deferrals”
  – For SH match = greater of 3% of compensation or maximum % at which the employer matches at 100%
  – For nonelective = 3% of compensation
Missed Match Opportunity

- When correcting for a missed deferral opportunity you calculate the match at the total missed amount (not the 50% corrective contribution amount)

Example: Improper Exclusion

- Bob (NHCE) was improperly excluded from plan during 2014
  - 2014 compensation = $50,000
- ADP SH plan with basic match (100% on first 3)
- Missed deferral = 3%
- Missed deferral opportunity = $750 (50% x [3% x $50,000])
- Missed match = $1,500 (3% x $50,000 x 100%)
Defective Notice

• What if notice was given out timely but was defective
• Presumably same approach as failure to timely provide the notice
  – Is the missing information something that would affect a participant’s decision to defer?

Compensation

• Safe harbor contribution must be based on definition of compensation that satisfies IRC §414(s)
• What if definition does not satisfy §414(s) (e.g., if plan excludes bonuses)?
  – Plan is no longer SH and amendment needed to add ADP tests
  – Corrective amendment to use total comp can be made
Creative Plan Design

• Top Heavy Exemption
• Cross-testing
• Maximizing match

Creative Plan Design – Top Heavy Exemption

• Plans that allow only elective deferrals and contributions that satisfy the safe harbor are exempt from TH
Creative Plan Design – Top Heavy Exemption

Exemption does NOT apply if:

- Forfeitures are allocated to the accounts
- Nonelective discretionary contributions are allocated
- Longer eligibility is required for the SH contribution than for elective deferrals

Creative Plan Design – Top Heavy Exemption

- If the plan is not exempt from TH rules, remember that the SH contributions can be applied to satisfy TH

- Example – if an employee defers 2% and receives a 2% match; then only an additional 1% is needed to satisfy TH
Creative Plan Design – Cross Testing

• The 3% nonelective may be used to satisfy 401(a)(4) testing.

• It can be applied as part of the Gateway that needs to be satisfied prior to cross-testing

• But watch out for....

Creative Plan Design – Cross Testing

• Note: that if any nonelective is received; then the total gateway must be satisfied

• So if an employee receives 3% nonelective SH but is not entitled to additional nonelective a problem may occur (see next slide)
Creative Plan Design – Cross Testing

Example:

- Plan is a 3% nonelective SH plan
- Plan is cross-tested and needs a 5% gateway
- Profit Sharing nonelective is discretionary and subject to 1000 hours or last day rule
- If a participant leaves...must make sure somehow gets the full 5% (document should specify)

Creative Plan Design – Cross Testing

Triple Duty Nonelectives

- Satisfy SH
- Satisfy TH
- Apply towards Gateway

- Effective use of Employer $
Creative Plan Design – Maximizing Match

• Remember the rules
• Still satisfy SH if do not match deferrals in excess of 6% OR make a discretionary match of 4%

• Soooooo....How about an enhanced match of dollar for dollar on the first 4% and an additional match of 1% discretionary on the first 4%. (Reward those that defer and stay within rules)

Creative Plan Design – “Triple Stacked Match “

• Basic Match, plus
• Additional Fixed match*
• Additional Discretionary match*

* Note: as long as you do not match on deferrals in excess of 6% or the discretionary match is more than 4% you are good to go
Creative Plan Design – Employer profile

• Many NHCEs are not deferring — so most employer contributions are directed to HCEs (but watch out once you commit to match formulas just in case the NHCEs decide to contribute)

• Employers that may not want to use a cross-tested or permitted disparity plan due to cost of gateway or disparity in age of HCEs

The QACA

• How it differs from a traditional SH plan

• Auto enroll feature
• Specific range of auto enroll
• SH contributions do not have to be vested immediately but rather after two years of service
The QACA

- Default contribution % must be uniform, except:
  - Varies based on years of service
  - Limited by 402(g) - $18,000
  - Suspension due to hardship withdrawal
  - Deferral rate effective prior to effective date of QACA is not reduced

- See next slide for specific ranges

The QACA

- Default deferral 1st period = at least 3% but no more than 10%
  - 2nd Period = at least 4% but no more than 10%
  - 3rd Period = at least 5% but no more than 10%
  - 4th and later periods = at least 6% but no more than 10%

- 1st period can last until end of year following plan entry
- See next slide for example

- Note: Periods do not have to end on last day of PY
- May use anniversary or bonus date
The QACA

- DoH = 1/16/14
- DOE = 2/01/14
- Calendar year plan

  - Initial period may end as late as 12/31/15

The QACA

- Match

  - Dollar for Dollar on the first 1%
  - 50 Cents on the Dollar for the next 5%
  - Defer 6% = 3.5% Match

  - Less expensive per participant but probably have more participants due to automatic enrollment feature
Funding SH contributions with Forfeitures

• If your document currently says that you can – then you are okay
• If your document is silent – be aware that IRS is auditing and not allowing
• New documents will not allow

Don’t forget to test when...

• There are after-tax contributions (not Roth)
• Match on deferrals in excess of 6%
• Discretionary match greater than 4%
• Higher rate of match for HCEs than NHCEs
“Watch Outs” for all SH Plans

• SH required to only be given to the NHCEs
• However, need to follow document and accrual requirements
• Example – if calendar year plan states that all participants get the SH, employer cannot decide after the PYE that the HCEs (even the owners) will not get the SH amounts!!!
Questions