

Eligible Employees in Light of a Plan's Excluded Classes



ASPPA

Making Retirement Plans Work

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Agenda

- Eligibility Concepts
- Service and Age
- Classification Exclusions
- QAB 2006-3
- Changes in Employment Status
 - Changes in Employment Status and the Last Day Allocation Requirement
- Rehires and BIS Rules
- Eligibility and Exclusions Across Various Plan Types
- MEP Plans
- Controlled Groups
- 403(b) Universal Availability Exclusions

Eligibility Plan Design Concepts

- Must design eligibility within legal/regulatory guidelines
 - Law contains rules for eligibility
 - Regulations provide greater details of what is permitted
 - Employer may be more generous
- Law states that a plan must benefit a reasonable number of employees
- Selection criteria must be nondiscriminatory
- Basic three areas: service, age, classification exclusions

Eligibility Overview

- Plan Design
 - When designing plan, employer decides eligibility requirements that an employee must meet to participate
 - Qualified plan is only for employees
 - Individuals who are not employees are not eligible for the plan, for example:
 - Contractors are not employees
 - Form 1099-miscellaneous payments

Eligibility Overview: Standardized and Nonstandardized Prototypes

- Standardized – very limited choices and no room for discrimination
 - Only provide for statutory eligibility exclusions
 - Passes coverage by design
- Nonstandardized – more flexible but watch out for discrimination

Eligibility Concepts: Standardized and Nonstandardized Prototypes

Nonstandardized plans

- Classification exclusions
 - Provided coverage is passed; may exclude on a nondiscriminatory basis
 - More on this later
- Compensation exclusions
 - Provided compensation ratio test is passed

Eligibility for Allocation: Standardized and Nonstandardized Prototypes

Standardized plans: allocations

- All active eligible employees, and
- All terminated eligible employees who worked over 500 hours

Nonstandardized plans: allocations

- Allocation requirements
 - Last day rule and/or 1,000-hour rule
 - Provided testing passed

ELIGIBILITY SERVICE AND AGE REQUIREMENTS

Elapsed Time

- NO counting of hours
- Measure from date of hire to anniversary date
- Advantages:
 - Easier to administer (no counting)
 - Useful for employers who have no way of counting an employee's hours
 - Truck drivers, construction workers
- Disadvantage:
 - Part-timers may enter the plan

Elapsed Time, Service-Spanning Rules, Example 1

Plan has one-year elapsed time period for eligibility

Hours worked in that period do not matter

- Date of Hire = April 15, 2017
- Date Severs = October 26, 2017
- Date Rehired = January 10, 2018
- Anniversary Date = April 15, 2018
- **IRS' service-spanning rules** permit employee to satisfy the elapsed time method, **provided the period of absence is less than 12 months**

Elapsed Time, Service-Spanning Rules, Example 2

Plan has one-year elapsed period for eligibility

- Date of Hire = November 8, 2016
- Date Severs = Sept. 17, 2017
- Date Rehired = February 8, 2018
- Anniversary Date was: November 8, 2017
- Period of absence was less than 12 months.
- A break-in-service has not occurred
 - Service-spanning rule applies
- Entry date = date rehired = February 8, 2018

Elapsed Time, Service-Spanning Rules, Example 3

Plan has one-year elapsed period for eligibility

- Date of Hire = November 8, 2016
- Date Severs = September 17, 2017
- Date Rehired = December 8, 2018
- Anniversary Date was: November 8, 2017
- Period of absence was greater than 12 months
- A break-in-service has occurred
 - Service-spanning rule does not apply
- New anniversary date = December 8, 2019

Hours of Service

- Measure amount of hours employee is working or entitled to be paid
- Harder to administer (counting)
- Prevent part-timers from entering into the plan

Hours of Service

Hours or Equivalencies

- Counting of actual hours, or
- Equivalency method to ease counting
 - Daily equivalency
 - One hour worked in a day, EE credited ten hours
 - Weekly equivalency
 - One hour worked in a week, EE credited 45 hours
 - Semi-monthly payroll equivalency
 - One hour worked in period, EE credited 95 hours
 - Monthly equivalency
 - One hour worked in a month, EE credited 190 hours

Hours of Service:

Plan Provision Is a Period Less Than One Year

- May impose hourly requirement as long as:
 - An employee who works more than 1,000 hours in 12 months enters the plan
 - Credit for one month cannot be more than 1,000 hours when annualized
 - One month = $83 \frac{1}{3}$ hours or less
 - i.e., $1000/12 = 83 \frac{1}{3}$
 - Quarterly = $1000/4 = 250$ hours
- Or, may use elapsed time for periods under 12 months

Hours of Service

Plan Provision Is One Year of Service

- Most hours required can be 1,000
- One-year eligibility is a very common selection
 - One year is the longest eligibility period that permits a vesting schedule
- An eligibility longer than 12 months requires 100 percent vesting

Hours of Service

One Year of Service

- First **eligibility computation period** starts on day of hire and ends on first anniversary of employment
- **Deferral portion of a 401(k) plan cannot have more than one-year eligibility requirement**

Question

1,000 Hours and Enter Plan?

- May a plan that selected the statutory rule of one year and 1,000 hours of service permit employees to become participants as soon as they complete 1,000 hours?

Answer

- Generally*, no
- This is a very common employer mistake, so be careful. Example:
 - Employee hired November 11, 2017
 - Completes 1,000 hours May 15, 2018
 - Employer wrongly enters employee July 1, 2018
 - Employee is ineligible until 12 months and 1,000 hours is completed. For example, 1,000 hours and November 10, 2018. Then, the employee enters on the first entry date after November 10, 2018, i.e., January 1, 2019.
- * A plan could be designed with an eligibility of a total of 1,000 hours, without regard for a plan year. In such a design, as soon as any employee worked 1,000 hours, they could enter the plan. However, employees would have to be tracked to see if they ever reach a total of 1,000 hours.

Hours of Service

Two Years of Service

- Do not have to be consecutive
- But cannot have a break-in-service (BIS) between the two years
 - Note: BIS under hours counting is a 12-month period with less than 501 hours of service
- Remember: whenever the service requirement is more than one year, employees enter the plan 100 percent vested

Eligibility Computation Period

- Period of time during which service to become eligible is computed
 - First eligibility computation period starts on date of hire and runs to the anniversary of date of hire
- If eligibility not satisfied in first year, the second computation period will be defined as either:
 - Anniversary of date of hire, or
 - Plan year (starting at beginning of plan year in which first anniversary of hire date occurs)

Eligibility Computation Period Example

- One-year, hour-of-service example
- Henry is hired June 26, 2015
 - His first eligibility computation = June 26, 2015 to June 25, 2016
 - Henry did not have 1,000 hours on June 25, 2016.
- Second eligibility computation period (as defined in plan)
 - Anniversary option:
 - June 26, 2016 to June 25, 2017
 - Plan year option (calendar year plan)
 - January 1, 2016 to December 31, 2016

Eligibility by Contribution Source

- A plan may be designed to have different eligibility requirements for different sources of money (deferral, match, non-elective)
 - It may complicate administration and participant understanding of plan
- Example
 - One-month deferrals (never more than one year)
 - One-year match
 - Two-year profit sharing

Predecessor Employer Related Employers

- In a merger or acquisition, service must be counted if the acquiring employer is adopting or maintaining the predecessor's plan
- Maintaining the plan
 - Agreement to be successor sponsor
 - Merger of predecessor plan
- Controlled or affiliated service groups
 - Considered same employer, thus each related employer is a predecessor to the other
 - More on controlled groups later

Eligibility Requirements

Age Requirement

- Minimum age
 - 21 or less
 - It is okay not to have any minimum-age requirement
- Maximum age
- Not allowed to exclude anyone by maximum age (only by minimum)
 - Would violate Age Discrimination in Employment Act (ADEA)
 - However, can delay normal retirement date until:
 - Later of age 65 or
 - Five years of participation
 - Example: employee hired at age 63 would wait until 68 for normal retirement date

CLASSIFICATION EXCLUSIONS

Classification Exclusions

- “Statutory exclusions”
- Exclusions permitted under the law; → every qualified plan document, including standardized plans, may exclude:
 - **Collectively bargained employees** where retirement benefits have been the subject of good-faith bargaining
 - **Nonresident Aliens (NRA) with no U.S. source income,**
 - **To be excluded must satisfy full definition**
 - **Thrift savings plans** (very rare) only have to cover those that defer
 - Note: not the case in a 401(k)

Classification Exclusions

Collectively Bargained Employees

- **Collectively bargained employees** where retirement benefits have been the subject of good-faith bargaining
- Plan design concepts
 - May include collectively bargained if desired
 - Separate plan document for union plan is an option
 - Collectively bargained allocations may require attachment of section of collectively bargained agreement to show negotiated allocation
- Collectively bargained employees are employees
 - Change in status considerations:
 - Vesting service
 - Not severed from employment

Classification Exclusions

NRA Example

- Nonresident aliens with no US source income
 - Canadian company in Toronto that is a 100 percent owned subsidiary of a US company.
 - Canadians working for that company in Toronto are paid in Canadian-sourced income, made by the Canadian company
 - Although the parent company in the US has a 401(k), the employees of the Canadian subsidiary live in Canada and thus are NRA that are not paid with US-source income. Thus, they meet the statutory definition and may be statutorily excluded from the 401(k) plan.

Classification Exclusions

Non-Statutory Exclusions

- “Non-statutory exclusions”
 - Employer may exclude nondiscriminatory groups of employees
 - Classifications must be nondiscriminatory
 - Classifications must be defined in the plan
 - Plan must pass coverage test
 - Not available on a standardized prototype plan

Classification Exclusions Regulation*

- Non-statutory, IRS-acceptable classifications
 - Employees working in a particular job category, job description, e.g. cooks, dishwashers, salesperson
 - Employees in a specific geographic location; e.g., exclude the division in Oregon
 - Nature of compensation, hourly versus salaried
 - Bona fide business criteria of a similar nature
 - May not exclude an employee by name
 - Coverage testing, not cross-testing
- * Citation: Treasury Reg. 1.410(b)-4(b)

Treasury Regulation 1.410(b)-4(b)

“(b) Reasonable classification established by the employer.

A classification is established by the employer in accordance with this paragraph (b) if and only if, **based on all the facts and circumstances**, the classification is **reasonable** and is established under **objective business criteria** that identify the category of employees who benefit under the plan. **Reasonable classifications generally include specified job categories**, nature of compensation (i.e., **salaried or hourly**), **geographic location**, and **similar bona fide business criteria**. An **enumeration of employees by name** or other specific criteria having substantially the same effect as an enumeration by name **is not considered a reasonable classification.**”

Classification Exclusions

Bona Fide Business Criteria

Bona fide business criteria of a similar nature; plan documents may be found to have options to exclude:

- HCEs
 - Key employees
 - Employees compensated on a commission basis
 - Leased employees
 - Temporary or seasonal employee whose regularly scheduled service is less than _____ hours. However, if an employee in this classification completes 1,000 hours in an eligibility computation period, then such employee will no longer be part of this excluded class.
 - Other: an employer defined bona fide excluded group
- NOTE: COVERAGE MUST BE PASSED

Waiver of Eligibility Plan Design Choices

Waiver of eligibility for employees employed on plan's effective date

Plan design/amendment as of a certain date to waive the plan's:

- Age, or service, or both
- This may be designed by contribution type

• Plan may waive for:

- All those employed on that date
- An indicated class of employees on the specified date
- A special entry date may be named for those who had the age and/or service requirement waived
- NOTE: these selections will require nondiscrimination testing to prove that the plan operated in a nondiscriminatory method.

• Irrevocable waivers not permitted on prototypes since EGTRRA document

EMPLOYEE PLANS DETERMINATIONS QUALITY ASSURANCE BULLETIN 2006-3

February 14, 2006

QAB 2006-3

- IRS consistently concerned that excluding part-time, temporary, or seasonal employees from a plan would be an indirect violation of Code Section 410(a), which prohibits the use of a definition of a year of service of more than 1,000 hours in a 12-consecutive-month period

QAB 2006-3

- IRS examiners require that the exclusion be removed or clarified, if it possibly could result in the exclusion of an employee with over 1,000 hours of service
- The focus is not limited to the reasons listed on the prior slide
 - “Any exclusion classification, whether it be part-time, seasonal, temporary, or any other classification of employees, should be closely scrutinized and clearly defined.”

QAB 2006-3

Examples

- Plan A
 - Excludes “part-time” or seasonal workers who work less than 1,000 hours in a 12-month period
- Okay with QAB
 - This would not eliminate employees who worked more than 1,000 hours

QAB 2006-3

Examples

- Plan B
 - Excludes “part-time” or season workers who are SCHEDULED to work less than 1,000 hours
- Refinement of exclusion wording is needed
 - It is possible that some of these workers would have over 1,000 hours
 - The plan language must include fail-safe provisions to include them

QAB 2006-3

Examples

- Plan C
 - Excludes hourly employees
- Okay according to QAB
 - This exclusion does not rely on hours for the determination

QAB 2006-3

Examples

- Plan D
 - Excludes hourly employees whose normal employment is less than 20 hours per week
- Refinement of exclusion wording is needed
 - The exclusion language needs to be amended as mentioned for Plan B

QAB 2006-3

Examples

- Plan E
 - Excludes Class F employees
- Refinement of exclusion wording is needed
 - IRS agents instructed to question and challenge whether the determination for Class F employees is based on age or service

Classification Exclusions

QAB 2006-3 - RECAP

- Part-timers and seasonal employees may be excluded; however, beware:
 - Exclusion language may not be based on a service requirement
 - As it could exclude an employee who worked 1,000 hours
 - Example of language not to be used:
 - Employees scheduled to work less than 20 hours per week
 - IRS auditing this
 - 1,000 hours of service completion → plan should have failsafe language to require such an employee to enter

CHANGES IN EMPLOYEE STATUS

Change in Employee Status

- Eligibility Section in Basic Plan Document (BPD)
- Changing to an eligible class; BPD wording example:
 - “In the event an Employee who is not a member of an eligible class of Employees becomes a member of an eligible class, such Employee shall participate immediately if such Employee has satisfied the minimum age and service requirements and would have previously become a participant had he or she been in an eligible class.”

Change in Employee Status

- Eligibility Section in Basic Plan Document (BPD)
- Sharing in ER contributions and change from an eligible class of employees; BPD wording example:
 - “Each Employee will share in Employer contributions for the period beginning on the date the Employee commences participation under the Plan and **ending on the date** on which such **Employee terminates** employment with the Employer **or is no longer a member of an eligible class of Employees.**”

Change in Employee Status

- Eligibility Section in Basic Plan Document (BPD)
- Change in Classification of Employment; BPD wording example:
 - “In the event a Participant becomes ineligible to participate because he or she is no longer a member of an eligible class of Employees (as elected by the Employer in the Adoption Agreement), **Elective Deferrals, Roth Elective Deferrals and/or other Employee contributions will cease as soon as administratively practicable after the Participant becomes ineligible.** Such Participant shall participate for the purpose(s) for which the Participant had previously qualified immediately (or as soon as administratively feasible) upon his or her return to an eligible class of Employees.”
- Check your plan document

CHANGE IN EMPLOYEE STATUS AND LAST DAY ALLOCATION REQUIREMENT

Eligible Participant at Start of Year; Ineligible EE on Last Day Due to Status Change to Ineligible Class of Employees

- Last-day rule looks to see if the employee is employed on the last day, not whether in an eligible class
- The change from eligible class of employees to an ineligible class of employees may affect the amount of the allocation, but not the satisfaction of the last-day rule
 - The allocation may be based on compensation paid for the portion of the year during which the participant was in an eligible class of employees
 - Last-day rule will be satisfied if the ineligible class employee is providing services through December 31 of year of the change

Eligible Participant at Start of Year; Ineligible EE on Last Day Due to Status Change to Ineligible Class of Employees - Example

- Calendar year plan with a last-day rule
- Participant changes from Manhattan Division to Syracuse Division of the company on September 30
- The Syracuse Division is excluded from the plan
- The employee works through December 31 of that year
- The allocation is based on compensation paid from January 1 to September 30, as the last day requirement was satisfied
- Note that a plan may have a provision requiring that the employee be in an eligible class of employees for the entire year in order to receive an allocation
- Check your document

Top-Heavy Plan: Eligible Participant at Beginning of Year; Ineligible EE on Last Day

- A non-key participant is no longer eligible for the plan as a result of an amendment that takes effect on October 1. They are still employed on last day of year.
 - Are they eligible for the top-heavy minimum?
- One answer would have been that since they were no longer eligible for the plan on the last day of the plan year, they don't meet the definition of eligible participant and they would not receive a top-heavy minimum
- 2013 ASPPA Annual "Ask the Experts" workshop question

Top-Heavy Plan: Eligible Participant at Beginning of Year; Ineligible EE on Last Day

- The answer provided at the conference was that since they were a participant during the year and are still employed at the end of the year, they may not receive the normal allocation, but must receive the top-heavy minimum
- The TH would be based on 415 full-year compensation, even though they were only eligible for nine months
 - This is because the definition of compensation for the top-heavy contribution under Code Section 416(i) is 415 Compensation, which is based on all 12 months of the limitation year

Eligible Participant at Start of Year; Ineligible EE on Last Day Due to Status Change to Leased Employee

- An employee has been a plan participant for years
- On September 30, employees are terminated and hired by a leasing company that leases the employees back to the recipient employer
- The change from common-law-employee status to leased employee is not a termination of employment
- Last-day rule will be satisfied if the leased employee is providing services to the recipient employer through December 31 of year of the change

Hiring Leased Employee as Common-Law Employee and the Last-Day Requirement

- An employer hires a leased employee to be its own common-law employee
- For the year of the change, the switch is not a termination of employment
- The last-day rule will be satisfied if the common-law employee works through December 31 of year of the change
- As the last-day requirement was met, the allocation for the plan year will be shared with the common-law employee

REHIRES AND BIS RULES

Basic Rehire Concepts

- Completed years of service (YOS) last forever
 - Once you earn a YOS, it is counted
 - Limited exception for break-in-service (BIS), such as: rule of parity, one-year holdout rule, two-year eligibility rules
- Entry date is a plan document provision
 - First day after or coincident with satisfying the plan's age and service requirements

Basic Rehire Concepts

- Individual enters plan and becomes a participant on his or her entry date
 - Provided the individual is an eligible employee on that date
- Individual who becomes an eligible employee after his or her entry date enters immediately
 - BIS rules can produce different results, however, can be like opening Pandora's box

Basic Rehire Concepts

Rehired Employee Scenario 1

- Former EE satisfied age and service and entered plan, i.e., became a participant
 - EE severed as a participant
 - Upon rehire: enters the plan immediately
 - Subject to a plan's BIS provisions, to be discussed later

Basic Rehire Concepts

Rehired Employee Scenario 2

- Former EE satisfied age and service but severed employment before the plan's next entry date
 - Upon rehire: enters plan immediately, unless original entry date is later
 - Subject to a plan's BIS provisions, to be discussed later

Basic Rehire Concepts

Rehired Employee Scenario 3

- Former EE satisfied minimum service but not minimum age requirement
 - Upon rehire: enters plan immediately, OR
 - On the entry date following the minimum age being attained
 - Subject to BIS rules

Break-In-Service Eligibility Rules

- Permits plan to disregard service
 - Otherwise would have to count service
- BIS = ECP with less than 501 HOS
- Three different rules to know:
 - I. Two-YOS eligibility rule
 - II. One-year BIS rule (aka one-year holdout rule)
 - III. Rule of parity BIS

2 YOS

Hours of Service

- Do not have to be consecutive
- Cannot have a BIS between the two years
 - Hours of service BIS is a 12-month period with less than 501 hours of service
- NOTE: Fully vested when enter the plan, whenever service is more than one year

Example 1

Employee A

<u>Year</u>	<u>Hours of Service</u>
1	750
2	1,820 (1820 = 35 hours x 52)
3	1,820
4	1,820
5	750

Enters in year 4

Example 2

Employee B

<u>Year</u>	<u>Hours of Service</u>
1	1,820
2	399
3	1,820
4	1,820
5	1,820

Enters in year 5

Example 3

Employee C

<u>Year</u>	<u>Hours of Service</u>
1	399
2	1,820
3	1,820
4	1,820
5	479

Enters in year 4

One-Year BIS Rule (aka One-Year Holdout Rule)

- Employee incurs one BIS
- Plan temporarily disregards prior service
- Employee gets service for prior year after completion of a year of service
- Retroactive entry to rehire date

One-Year BIS Rule (aka One-Year Holdout Rule); Example 1

EE severs after ten years of service	November 8, 2013
EE Rehired; > one BIS	April 18, 2016
EE works 2,080 hours during computation period	April 18, 2016 to April 17, 2017
Re-entry date	April 18, 2016, employee must be made whole for missed contributions, missed deferral opportunity, and earnings

One-Year BIS Rule (aka One-Year Holdout rule); Example 2

EE severs after seven years of service	September 17, 2011
EE Rehired; three BIS	July 3, 2015
EE works 650 hours in computation period, (needed 1,000 hours)	July 3, 2015 to July 2, 2016
Computation period changes to plan year, EE works 850 hours	January 1, 2016 to December 31, 2016
EE severs, (didn't complete 2017 ECP) and never re-enters plan	October 12, 2017

One-Year BIS Rule

Usually a Problematic Choice

- It only permanently keeps out part-time rehires or individuals who leave quickly
- Those who become eligible again are due a retroactive contribution, plus earnings, including top-heavy
- Effectively unable to be used for deferrals
 - Can anyone defer retroactively?
 - So requires missed deferral opportunity

Rule of Parity

- Rehired participant treated as a new employee *if all the following apply:*
 - ✓ Employee was participant before DOT, and
 - ✓ Employee was zero-percent vested at DOT, and
 - ✓ Employee has five consecutive one-year BIS or more

Rule of Parity

Five-Year BIS

- Counting hours method
 - Five consecutive BIS = five consecutive eligibility computation periods in which EE has 500 or less hours in each of those periods
 - If computation period shifts to plan year after the initial period, then five BIS occurs if for five plan years in a row, EE has 500 or less hours
- Elapsed time method
 - Five-year BIS = period of 60 months after severance

Rule of Parity Example

Plan vesting → three-year cliff	Plan eligibility → age 21; one year 1,000 hours; computation period switches to plan year
May 15, 2011, severed after 501 hours worked in 2011	Jared: two years of vesting service = zero percent vested
2012, 2013, 2014, 2015, 2016	Jared: five consecutive BIS
July 3, 2017, rehired	Jared rehired, but as new employee
July 3, 2017 to July 2, 2018	Initial computation period, if 1,000 hours, then becomes a participant on next entry date

Vesting Rules After Five-Year BIS

- 1) *Vesting Years of Service AFTER five-BIS will not increase vesting on contributions made PRIOR to five-BIS*

Example:

	Prior Service	Separation Period	Current Service
Years	1 2	3 4 5 6 7	8

- 2) *New contributions after five-BIS; partial or fully vested participants must include prior service for vesting of new contributions*

Example:

	Prior Service	Separation Period	Current Service
Years	1 2	3 4 5 6 7	8

- 3) *Non-Vested participants (0%)*

Prior service will NOT be included in vesting new contributions if BIS exceeds greater of:

five years, or
total service, if < five years

Buyback Rules

- Paid-out employee (who forfeited non-vested amount) may redeposit payout into plan and have forfeitures restored
 - **Must be partially vested (not zero-percent vested)**
 - **Must be rehired within five years, and**
 - **Must return ENTIRE payout within five years of rehire date**
 - **“Cashed-out” participants may buyback**
- ER restoration period until the end of PY following repayment

Buyback Example

- Henry terminates June 1, 2015
 - 40 percent vested
- Receives cash distribution
 - \$12,000 deferrals
 - \$4,000 match (\$10,000 account)
 - \$8,000 NEC (\$20,000 account)
- Rehired September 1, 2018
 - How much does Henry have to repay to buy back the forfeited amount?

Eligibility Change After Participant Severed and Before Rehired

- Plan amended changing eligibility from six months to 12 months
 - Employee rehired and ineligible to participate under the new eligibility rules
 - Re-entry upon new eligibility being satisfied
 - However, if the plan amendment “grandfathered in” those who satisfied eligibility under the old rules, then would re-enter plan as a participant

Rehired; But Now in an Ineligible Class of Employees

- A former participant is rehired but as a union employee and the plan excludes this class
- The former participant would not be able to participate in the plan while in an excluded class; provided coverage is passed
- Note that vesting years of service accrue
- If employee changes classification to a non-union employee, they would be eligible to participate

ELIGIBILITY AND EMPLOYEE EXCLUSIONS ACROSS VARIOUS PLAN TYPES

Employee Exclusions and Safe Harbor 401(k) Arrangements ACP Test Safe Harbor

- May a safe harbor 401(k) make a discretionary match and avoid ACP testing?
 - **Yes, provided:**
 - Discretionary match does not exceed four percent of compensation; *and*
 - Discretionary match is not made on deferrals exceeding six percent of compensation; *and*
 - Rate of match for any HCE is not more than that of any NHCE
- Failure to comply with any of these restrictions will require the plan to run an ACP test
- A SH plan may be exempt from ADP but not ACP (if failure of any of the above items)

ACP Test Safe Harbor - All Matching on Nondiscriminatory Basis

- ALL matching contributions must be on a nondiscriminatory basis -- what does that mean?
 - SH rules require that NO HCE may receive a higher rate of match than ANY NHCE
 - The issue:
 - If a plan has a last day or 1,000-hour requirement on any matching contribution, an NHCE who does not receive the match will have a lower rate of match than an HCE
 - This would violate the ACP safe harbor

All Matching Nondiscriminatory – Example

- Three percent NEC safe harbor contribution
- 35 participants: 30 NHCEs and five HCEs
- Discretionary match 50 cents/dollar up to six percent
 - Within the ACP safe-harbor rules
- Last day and 1,000 hour rule on discretionary match
- Two NHCEs leave before the last day, one NHCEs does not work 1,000 hours, ONLY 27 of 30 NHCEs get match
- All five HCEs work 1,000 hours and the last day
- Final 401(k) regulations state this is a discriminatory rate of match and the ACP safe harbor is not met
- The plan must run the ACP test (but not ADP)

SH Plan Top-Heavy Exemption and Otherwise Excludable Employees

- *Top-heavy exemption is not available in a plan designed with early eligibility for deferrals and statutory eligibility for the safe harbor*
 - To qualify for top-heavy exemption, plan must satisfy safe-harbor rules as a whole
 - **Can't “divide” plan into a plan for statutory participants and a plan for otherwise excludable employees**
 - Failure to provide safe-harbor contributions to otherwise excludable employees renders the whole plan subject to the top-heavy rules
 - **Top-heavy minimum contribution required for all non-key employees, including otherwise excludable employees**

SH Plan: Residual Testing Issues – Otherwise Excludable

- Otherwise excludable employees:
 - Eligible to participate but haven't met statutory requirements
 - Tested separately from “statutory” employees
- Can limit safe-harbor contributions to only those who meet one year and age 21
 - “Restructure,” test short-term group, i.e., the otherwise excludable group
 - Example
 - One-year eligibility to receive safe-harbor matching contribution, immediate entry to defer
 - Plan must run ADP test for all employees not satisfying one-year eligibility or age 21

SH and Otherwise Excludable Employees

- Example: safe harbor plan has three-month eligibility for deferrals and a year of service/age 21 for safe harbor. Plan is “divided” into two plans:
 - Plan #1 – covers statutory group
 - **Receive safe harbor contribution; exempt from ADP/ACP tests**
 - **Typically includes most HCEs**
 - Plan #2 – covers otherwise excludable employees
 - **Do not receive safe harbor contribution**
 - **If no HCEs, automatically pass ADP/ACP tests**
 - **If includes HCEs, ADP/ACP tests must be met**

401(k) Safe-Harbor Requirements

Cross-Tested Plans

- Cross-tested plans
 - Safe-harbor NEC contributions may be counted towards gateway
 - For individuals receiving three-percent NEC, only two percent more allocation necessary to meet the five-percent gateway
 - Caveat: if individual receives no other benefit and then receives the three-percent SH, and plan uses the five-percent gateway, then will need to get two percent more to pass five-percent gateway
 - NOTE: if employee is eligible for the safe-harbor NEC contribution but not the five-percent gateway:
 - Once the three-percent SH NEC is provided, the employee must receive the additional two percent of the five-percent gateway in order to satisfy the gateway for a benefiting employee

Design-Based Safe Harbor Allocations - Permitted Disparity Plan

- Cannot use SH NEC in permitted disparity calculations, for example:
 - Employer is using 5.7 percent to all participants and 5.7 percent above the taxable wage base
 - Three percent SH NEC may not be part of the 5.7 percent to all participants, and then give only 2.7 percent more
 - Three percent SH NEC is in addition to the 5.7 percent to all participants, amount above taxable wage base remains at 5.7 percent
 - For example, 8.7 percent to all participants and 5.7 percent above taxable-wage base
 - Caution: different allocation conditions and/or definitions of compensation affect reliance on 401(a)(4) safe harbor

Employee Exclusions and QACA Arrangements

- Same rules as for safe-harbor plans, except:
 - Two-year vesting
 - Rehires who have no service for an entire plan year after severance may have escalator reset upon rehire: *if the plan document is written to specify this*
 - If rehire is gone for less than that, then the termination is ignored for purposes of the escalator

MEP ISSUES

Employee Eligibility and Exclusions and MEP Arrangements

Basic MEP Definition

Code Section 413(c)

- *Participation rules*
- Section 410(a) and the regulations thereunder apply as if all employees of each of the employers who maintain the plan were employed by a single employer
- Eligibility age and service apply as if all employees were employed by a single employer
 - Thus, if changing from Employer A to Employer B within the MEP, the service at Employer A would count toward satisfying eligibility with Employer B

MEP Issues

- **Combined service for eligibility and vesting, so service with unrelated ERs must be credited**
 - Practical concern on tracking
 - Affects eligibility
 - Reduces amount of forfeitures
- May have to deal with many different payroll providers
- Combined 415 limit

MEP Service Carryover for Eligibility and Vesting

- Eligibility and vesting of a participant is to be carried over to another plan within the MEP
- All service among all employers is counted in an MEP, CG/ASG for vesting and eligibility
- Plans in an MEP or CS/ASG are linked for vesting and eligibility as long as the original hire date stays with the participant
 - EXAMPLE: employee hired in plan A on January 3, 2016. Employee moved to plan B on March 24, 2018. Hire date in plan B is original hire date in Plan A, i.e., January 3, 2016.

If Vesting Different and Employee Changes Employers within MEP

- If the participating employers within the MEP do not follow the same vesting and an employee changes plans:
- A challenge for certain programs, but can be solved as follows:
 - Set up a second group of money-types to handle
 - For example, one money-type for the original money to remain on the original vesting schedule and the other money source for new contributions to the new plan under the new plan's vesting schedule (not pretty, but it is at least able to be done?)

If Vesting Different and Employee Changes Employers within MEP

- An example:
- If Plan A vesting 100 percent in year three and Plan B vesting 100 percent in year one, solution include to either:
 1. Set up two money sources, or
 2. Employer in plan B accelerates vesting on money coming from plan A to be at plan B's one-year 100 percent vesting schedule, or
 3. Leave participant money in plan A under original vesting schedule

Service Carryover for Eligibility and Vesting

- Counting hours of vesting service after employee moves to new ER within MEP
- Payroll credits hours to new employer
- If funds left with original ER, how do we credit vesting hours with original ER, when payroll assigns hours to new ER's plan?

CONTROLLED GROUPS

Employee Eligibility and Exclusions and Controlled Groups

- **Eligibility** – consider all service within control group for eligibility purposes
- **Exclusions for coverage** – must consider all members of control group when performing coverage tests (70 percent and ABT)
- **Vesting** – must consider service with all members of control group when calculating vesting service
- **Compensation limit** – 401(a)(17) compensation limit must consider income from all members of control group
- **Deferrals and ADP** testing combined
- **Severance from employment**
 - Moving a member of a control group to another member does NOT create a distributable event for severance

What Is Impact of Being Control Group?

- ▶ **Deductions** controlled group members who adopt the same plan have a combined deduction limit. Members who have separate plans have separate 404(d) deduction limits.
- ▶ **DB participation** test, §401(a)(26) combine members
- ▶ **Top-heavy rules** – generally, there is required aggregation of all plans of an employer that have a participating key employee
- ▶ **Annual additions and benefit limitations** – must combine all plans of employer
- ▶ **Nondiscrimination rules** – plan maintained by members of a controlled group, one-employer treatment of those in the plan

What Is Impact of Being Control Group?

- Two often overlooked plans:
- SEPs and SIMPLE IRAs
 - All employees of all the controlled group firms must be covered by the SEP or SIMPLE IRA (once eligibility is met)
 - IRS is finding a lot of problems with coverage issues

What Is Impact of Being Control Group?

- If members of controlled group can pass coverage separately:
 - Each may have its own plan with different provisions, if not, then they must be in the same plan or mirror plans
- To pass coverage separately:
 - Each firm must run the coverage test and pass coverage with the denominator containing all nonexcludable employees of the entire controlled group and the numerator containing just the one firm's employees
 - If this is a two-firm controlled group, both the firms must be tested this way and each firm must be able to pass (**see next slide**)

Two-Firm Controlled Group Passing Coverage Separately

Company A and Company B

Company A Test

- NHCE A divided by NHCE A + B; divided by
- HCE A divided by HCE A + B

Company B Test

- NHCE B divided by NHCE A + B; divided by
- HCE B divided by HCE A + B

Both tests would have to pass

Two-Firm Controlled Group One Company Excluded

	A	B	Total
1. Total Employees	256	100	356
2. HCEs	16	4	20
3. HCEs Benefiting	16	0	16
4. EEs Ineligible by Statute			
4a. Age	10	6	16
4b. Service	20	10	30
4c. Union	10	0	10
4d. Non-resident Aliens	0	0	0
5. Testing Total (Subtract 2 and 4 from 1)	200	80	280
6. Other NHCEs Not Benefiting	40	80	120
7. NHCEs Benefiting	160	0	160

Two-Firm Controlled Group One Company Excluded

RESULTS

NHCE = $160/280 = 57$ percent

HCE = $16/20 = 80$ percent

Result 57 percent/ 80 percent = 71 percent passing

403(b) UNIVERSAL AVAILABILITY EXCLUSIONS

What Is Universal Availability?

- The universal availability rule generally provides all employees with the right to defer immediately
 - LRMs 30 to 60 days
 - For Deferrals → No age or service requirement permitted
 - Universal availability applies to all 403(b)s, except church plans
 - Universal ability to defer = **NO ADP TEST**
 - Generally, every employee must be permitted to make salary reduction contributions to a 403(b) plan
 - If one employee can make deferrals, then all employees must have the opportunity to make deferrals

Universal Availability Rule

Allowable Exclusions for Deferrals

Limited exclusions are permitted

- a. **If an individual is eligible to defer under another plan of the employer:**
 - Another 403(b) Plan, 457(b) governmental plan, 401(k) plan of the employer
 - b. **The individual must be expected to defer at least \$200/year**
 - c. **Work-study students**
 - d. **Non-resident alien with no U.S. source income**
 - e. **Normal work week less than 20 hours**
 - Or a lower number as stated in the plan
- **Church plans are exempt by definition** (they report to a higher authority)

Universal Availability Rule – For Deferrals

- **Rules for employees whose normal work week is less than 20 hours:**
 - As of hire date, employer reasonably expects employee to work less than 1,000 hours of service in 12 months, and
 - For each succeeding year (anniversary or plan), the employee worked less than 1,000 hours of service in the preceding year
- **All employees in this category must be excluded**
 - **If one employee in this group becomes eligible, then generally that employee ceases to be a member of that group, and enters the plan**

Universal Availability Exclusions No Longer Allowed by Final Regulations

- **Effective January 1, 2010 the following cannot be excluded:**
 - a. **Collectively bargained employees**
 - Different than 401(a), 401(k)
 - b. **Visiting professors**
 - But they can participate in original school plan
 - c. **Vow of poverty through religious affiliation**
 - d. **Employees who make a one-time election to participate in a governmental plan**

Universal Availability Rule Exception: One-Time Irrevocable Election

- **One-time irrevocable election made at the time of initial eligibility**
 - Such contributions are **not salary reduction contributions** but are deemed to be employer contributions
 - Usually these are **mandatory contributions**.
 - Often the **employer adds a NEC equivalent** to the mandatory contribution
- Example: **Four-percent irrevocable election is required at time of hire and may not be stopped until severance.** Employer also makes four-percent NEC, so total of eight percent contributed.

Universal Availability Rule

Effective Opportunity

- EEs must be provided an **“effective opportunity”** to defer
 - **Annual notice to employees of right to make a salary reduction election, providing:**
 - Time period for making the election
 - No conditions imposed
 - Annual opportunity to make or change election

Universal Availability Rule

- **Universal availability applies separately to:**
 - Each tax-exempt organization covered by a 403(b)
 - Each governmental entity that is not a part of a common payroll, i.e., different states
 - Each employer in the control group
 - Operating units with geographical distinction (facts and circumstances) and not in same SMSA

Recap Eligibility for Salary Reduction Contributions*

- Not at all like 401(k) plans
- “Universal availability” → **All employees must be permitted to defer except those:**
 - Who normally work less than 20 hours/week
 - Who are nonresident aliens
 - Student providing services (usually to a school) described in 3121(b)(1)
 - Eligible to participate by salary reduction in other deferral plans sponsored by the employer
 - Who do not wish to contribute at least \$200 per year to a 403(b) account. §403(b)(12)(A)(ii)
- Check your plan document. **Violation results in plan failure.**
Correction under EPCRS.

* §403(b)(12)

Questions?

2018 ASPPA Spring Virtual Conference

**Thursday, May 10
9:00 am to 5:00 pm**

Five Sessions Including:

**Washington Update and Late-Breaking Regulatory Developments
Ask the Experts Panel**