



Effective Use of the Coverage Testing Rules Who's In & Who's Out

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Coverage is Minimum Participation

- Coverage Rules require a Qualified Plan to BENEFIT:
 - A nondiscriminatory group of employees

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Coverage is Minimum Participation

- Objective Tests Are Mandated (mostly)

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Coverage is Minimum Participation

- Objective Tests Are Mandated (mostly)
 - Not a “facts and circumstances” test
 - Not a smell test

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Coverage is Minimum Participation

- Objective Tests Are Mandated
 - Not a “facts and circumstances” test
 - Not a smell test
 - Except for the “nondiscriminatory classification test” coming up!

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Coverage is Minimum Participation

- Objective Tests Are Mandated
 - Not a “facts and circumstances” test
 - Not a smell test
 - Except for the “nondiscriminatory classification test” coming up!
- Tests measure the *relative* coverage of
 - nonhighly compensated employees (NHCEs), and
 - highly compensated employees (HCEs)

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Coverage is Minimum Participation

- We must ensure that the *disparity* in coverage between the two groups is within the *permissible* statutory range.

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Coverage is Minimum Participation

- We must ensure that the *disparity* in coverage between the two groups is within the *permissible* statutory range.
 - Discrimination between the groups is NOT prohibited.
 - The discrimination must be *legal* discrimination

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Which Plans are Subject to These Rules?

- Basically, ALL plans!
 - Minor exceptions:
 - Government plans (naturally!)
 - Certain church plans
 - Certain pre-ERISA plans
 - But they had to generally meet the old 70%/80% pre-TRA '86 rules
 - Even 403(b) plans are subject if they are:
 - Non-governmental, and
 - Provide for employer contributions

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What Is The Important First Step?

- Figure out who your HCEs are!
 - More than 5% owner during the plan year or preceding year
 - Compensation in preceding year exceeding
 - \$115,000 in 2014 for 2015 year
 - \$120,000 in 2015 for 2016 year
 - **and** in top 20% of employees (if that election was made)

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What Are The Coverage Tests?

- There are three coverage tests

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What Are The Coverage Tests?

- There are **THREE** coverage tests
- The plan must satisfy *one* of the three tests
 - But there are really only **TWO**!

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What Are The First Two Coverage Tests?

- **Percentage Test:**
 - Plan must benefit at least 70% of the includable (or nonexcludable) employees (Code Section 410(b)(1)(A))
 - Don't worry: we'll talk about who is "excludable" later
- **Ratio Test:**
 - Plan must benefit a % of includible NHCEs that is at least 70% of the percentage of the includable HCEs benefitting under the plan (Code Section 401(b)(1)(B))

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What Are The First Two Coverage Tests?

- These first two tests are really just ONE test (mathematically).
- A plan which satisfies the *percentage test*, has to satisfy the *ratio test*.
 - The regs smartly incorporate the two tests into a single *ratio percentage test* – RPT (Reg. 1.410(b)-2(b)(2)(i))

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What Are The First Two Coverage Tests?

- How do you calculate the ratio percentage?
 - It is a RATIO of PERCENTAGES

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 - That means you divide percentage by percentage!



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 - That means you divide percentage by percentage!
 - The % of includable NHCEs benefitting under the plan divided by
 - The % of includable HCEs benefitting under the plan

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What Are The First Two Coverage Tests?

- How do you calculate the ratio percentage?
 - It is a RATIO of PERCENTAGES
 - That means you divide percentage by percentage!
 - The % of includable NHCEs benefitting under the plan divided by
 - The % of includable HCEs benefitting under the plan
 - Plan must have a ratio percentage of at least 70% to meet the *Ratio Percentage* test!

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What Are The First Two Coverage Tests?

- EXAMPLE 1
 - Co. A has 5 includible HCEs and 10 includible NHCEs
 - PS plan benefits 4 HCEs and 6 NHCEs.
 - 6 / 10 NHCEs benefit: 60%
 - 4/5 HCEs benefit: 80%
 - $60\% / 80\% = 75\%$.
 - PLAN PASSES; ratio percentage exceeds 70%

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What Are The First Two Coverage Tests?

- EXAMPLE 2: same employee group
 - Co. A has 5 includible HCEs and 10 includible NHCEs
 - PS plan benefits 4 HCEs and 5 NHCEs.
 - 5 / 10 NHCEs benefit: 50%
 - 4/5 HCEs benefit: 80%
 - $50\% / 80\% = 62.5\%$.
 - PLAN FAILS; ratio percentage less than 70%

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What Are The First Two Coverage Tests?

- Special Rules
 - Plan automatically passes if there are no nonexcludable (includable) NHCEs at any time during the plan year

What Are The First Two Coverage Tests?

- Special Rules
 - Plan automatically passes if there are no nonexcludable (includable) NHCEs at any time during the plan year
 - Plan automatically passes if there are no HCEs benefitting at any time during the plan year
 - Treasury Reg (1.410(b)-2(b)(6)) was written to give us these special rules to avoid a “divide by zero” calculation and an undefined result

What Is The Other Coverage Test?

- The vast majority of plans use the ratio percentage test to satisfy the coverage requirements.

What Is The Other Coverage Test?

- The vast majority of plan use the ratio percentage test to satisfy the coverage requirements.
- The alternative test is called:
THE AVERAGE BENEFIT TEST (ABT)



What Is The Average Benefit Test (ABT)?

- The ABT has more steps than the RPT

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What Is The Average Benefit Test (ABT)?

- The ABT has more steps than the RPT
- The ABT is more *complicated* than the RPT

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What Is The Average Benefit Test (ABT)?

- The ABT has more steps than the RPT
- The ABT is more *complicated* than the RPT
 - So, if you pass coverage using the RPT
 - FORGET ABOUT THE ABT!

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What Is The Average Benefit Test (ABT)?

- So, you failed the RPT!
- Now, let's see if we can show that we have enough NHCEs covered using the ABT.

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What Is The Average Benefit Test (ABT)?

- The ABT consists of two parts:
 - 1) Nondiscriminatory Classification Test (NCT), and
 - 2) The Average Benefit *Percentage* Test (ABPT)
 - We'll get back to the ABPT much later.....
- Both parts must be passed to pass the ABT

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What Is The Nondiscriminatory Classification Test?

- The NCT is itself a two-pronged test, and both parts must be passed to meet the NCT

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What Is The Nondiscriminatory Classification Test?

- The NCT is itself a two-pronged test, and both parts must be passed to meet the NCT
 - First, the classification of employees benefiting under the plan must be *reasonable*

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What Is The Nondiscriminatory Classification Test?

- The NCT is itself a two-pronged test, and both parts must be passed to meet the NCT
 - First, the classification of employees benefiting under the plan must be *reasonable*;
 - And second, the classification must satisfy a numerical nondiscrimination classification requirement.

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What Is A *Reasonable* Classification?

- Ah ha! A facts and circumstances test!
- The classification is *reasonable* if and only if, based on all the facts and circumstances, the plan determines which employees **benefit** under a classification which is..... *reasonable!*

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- Ah ha! A facts and circumstances test!
- The classification is *reasonable* if and only if, based on all the facts and circumstances, the plan determines which employees **benefit** under a classification which is..... *reasonable!*
 - A *reasonable* objective business criterion



What Is A *Reasonable* Classification?

- A *reasonable* objective business criterion
 - Generally includes:
 - Specified job categories
 - Nature of compensation (salaries; hourly)
 - Geographic location
 - Similar bona fide business criteria.

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What Is A *Reasonable* Classification?

- A *reasonable* objective business criterion
 - Doesn't include:
 - Listing excluded OR included employees by name
 - Or a procedure having the same effect
 - This is per se *not reasonable*
 - NOTE: If the plan is relying on the Ratio Percentage Test, then excluding by name should not be an issue

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What Is A *Reasonable* Classification?

- A *reasonable* objective business criterion
 - Note, we are looking for *benefiting*.
 - This will take in both:
 - Eligibility (such as “only hourly employees participate”), and
 - Allocation requirements (such as a last day employment requirement)

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What Is A *Reasonable* Classification?

- Good examples:
 - Employees of ABC Co, year of service, and NOT commissioned salesperson
 - Employees of ABC Co employed at manufacturing facility in Hoboken, NJ
 - Controlled Group of X and Y, but only employees of X are eligible in plan established by X
- All of these are reasonable, objective classifications

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What Is A *Reasonable* Classification?

- Most plans will easily pass the reasonable classification requirement unless it excludes employees by name
- Remember that there was a second prong that needed to be satisfied: the numerical nondiscriminatory classification requirement?

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What Is The Numerical Nondiscriminatory Classification Requirement?

- This is the one that will be the primary concern in satisfying the Nondiscrimination Classification Test; it is a numerical test
- Basically, there are five steps to passing

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What Is The Numerical Nondiscriminatory Classification Requirement?

- Step 1:
 - Determine the plans coverage fraction.
 - This is the same as the Ratio Percentage from the earlier slides
 - The RPT must satisfy either:
 - a safe harbor test, or
 - a facts and circumstances test
 - The plan automatically satisfies the NCT if the RP equals or exceeds the safe harbor percentage (to be explained shortly)

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What Is The Numerical Nondiscriminatory Classification Requirement?

- Step 1:
 - Determine the plans coverage fraction.
 - If the plan's RP does NOT exceed the UNSAFE harbor (explanation coming), then the plan FAILS the NCT
 - If the plan's RP is equal to or higher than the unsafe but less than the safe harbor, we have another facts and circumstances test
 - IRS determination based on relevant facts, including business reasons, % of employer's employees benefiting, and the difference between the plans RP and the safe harbor percentage

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What Is The Numerical Nondiscriminatory Classification Requirement?

- Step 2:
 - Determine the plans Concentration Percentage (CP)
 - The CP determines the values for the safe harbor and unsafe harbor percentages.
 - The CP is equal to:
 - Includable NHCEs / All Includable employees
 - » It's really an NHCE concentration percentage!
 - The lower the NHCE CP, the greater the safe harbor percentage (capped at 50%)
 - Includables include ALL employees included in the coverage test regardless of whether they are eligible to participate in the plan

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What Is The Numerical Nondiscriminatory Classification Requirement?

- Step 2:
 - Example: Corp X has 120 ees; 20 HCEs and 100 NHCEs. All 20 HCEs satisfy min age and service, but only 79 of 100 NHCEs do. No other exclusions apply.
 - There are 99 includible employees of which 79 are NHCEs.
 - The concentration percentage is $79/99 = 79.798\%$
 - Always round down: CP = 79%

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What Is The Numerical Nondiscriminatory Classification Requirement?

- Step 3:
 - Determine the plan's safe and unsafe harbor percentages.
 - Regulations give us the table to determine safe and unsafe harbor percentages.
 - SH % is defined as 50% reduced by 0.75% for each whole % point by which the CP exceeds 60%.

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Nondiscrimination Classification Test Table

NHCE Concentration Percentage	Safe Harbor Percentage	Midpoint Percentage	Unsafe Harbor Percentage
60%	50.00%	45.00%	40.00%
61%	49.25%	44.25%	39.25%
62%	48.50%	43.50%	38.50%
63%	47.75%	42.75%	37.75%
64%	47.00%	42.00%	37.00%
65%	46.25%	41.25%	36.25%
66%	45.50%	40.50%	35.50%
67%	44.75%	39.75%	34.75%
68%	44.00%	39.00%	34.00%
69%	43.25%	38.25%	33.25%
70%	42.50%	37.50%	32.50%
71%	41.75%	36.75%	31.75%
72%	41.00%	36.00%	31.00%
73%	40.25%	35.25%	30.25%
74%	39.50%	34.50%	29.50%
75%	38.75%	33.75%	28.75%
76%	38.00%	33.00%	28.00%
77%	37.25%	32.25%	27.25%
78%	36.50%	31.50%	26.50%
79%	35.75%	30.75%	25.75%
80%	35.00%	30.00%	25.00%
81%	34.25%	29.25%	24.25%
82%	33.50%	28.50%	23.50%
83%	32.75%	27.75%	22.75%
84%	32.00%	27.00%	22.00%
85%	31.25%	26.25%	21.25%
86%	30.50%	25.50%	20.50%
87%	29.75%	24.88%	20.00%
88%	29.00%	24.50%	20.00%
89%	28.25%	24.13%	20.00%
90%	27.50%	23.75%	20.00%
91%	26.75%	23.38%	20.00%
92%	26.00%	23.00%	20.00%
93%	25.25%	22.63%	20.00%
94%	24.50%	22.25%	20.00%
95%	23.75%	21.88%	20.00%
96%	23.00%	21.50%	20.00%
97%	22.25%	21.13%	20.00%
98%	21.50%	20.75%	20.00%
99%	20.75%	20.38%	20.00%

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What Is The Numerical Nondiscriminatory Classification Requirement?

- Step 4

- If plan's coverage fraction (not CP) is at least = to safe harbor percentage, it passes the numerical portion of the NCT

- » NOTE: Since the highest SH % is 50%, if the coverage fraction is at least 50%, the plan will pass the numerical part of the NCT without regard to the concentration %.

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What Is The Numerical Nondiscriminatory Classification Requirement?

- Step 5

- If plan's coverage fraction (not CP) is NOT at least = to safe harbor percentage, but it is at least = to the unsafe harbor percentage (it's in the middle between the safe and unsafe harbor), it passes the numerical portion of the NCT :

- » IF it can also satisfy a fact and circumstances test (Treas Reg 1.410(b)-4(c)(3)(ii))

- Since there is no assurance of having passed the NCT if the facts and circumstances test has to be met, most employers will prefer to cover a sufficient number of NHCEs to satisfy the safe harbor percentage.

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What Is The Numerical Nondiscriminatory Classification Requirement?

- The law permits the coverage fraction to be lower than 70% under the average benefit test because the plan has to take the additional step of comparing the average benefit percentages of the two groups.

Coverage Fraction Summary

If the coverage fraction is:	Then:
At least 70%	The plan passes the ratio percentage test
At least 50%	The plan passes the numerical nondiscriminatory classification test
Less than 20%	The plan fails the numerical nondiscriminatory classification test
At least 20% but is not 50% or greater	Passage depends on the safe and unsafe harbor percentages, which in turn are based on the concentration percentage.



Average Benefit Percentage Test

- Remember this?.....
 - The ABT consists of two parts:
 - 1) Nondiscriminatory Classification Test (NCT), and
 - 2) **The Average Benefit *Percentage* Test (ABPT)**
 - » We'll get back to the ABPT much later.....
 - Both parts must be passed to pass the ABT

- NOW is the later we talked about earlier!

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Average Benefit Percentage Test

- The ABPT is usually the most complex part of the ABT.
 - Especially so if there is more than one plan
 - To pass the ABPT, the average benefit % of the includible NHCEs must = at least 70% of the abp of the includible HCEs
 - $\text{NHCE average benefit} / \text{HCE average benefit} \geq 70\%$

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Average Benefit Percentage Test

- Employee Benefit Percentage (EBP)
 - Employer provided contribution or benefit under all qualified plans of the employer
 - Expressed as a % of the employee's compensation
 - Determined under the rules for determining allocation rates or accrual rates for nondiscrimination testing under 401(a)(4)

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Average Benefit Percentage Test

- Employee Benefit Percentage (EBP)
 - Employer may calculate EBP on the basis of either:
 - Contributions
 - Converted to allocation rates
 - Benefits
 - Converted to accrual rates
 - Conversions done using “cross testing” rules of 1.401(a)(4)-8

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Average Benefit Percentage Test

- Employee Benefit Percentage (EBP)
 - Employer may use any nondiscriminatory definition of compensation
- Plan's ABP for a testing period is determined by dividing the benefit percentage of the NHCEs in the testing group by the benefit percentage of the HCEs in the testing group.

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Average Benefit Percentage Test

- This is NOT a session on the ABP test; that would take at least an entire session by itself.
- So, we will assume that you have some basic knowledge about that process
 - Or that you will get it.

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Otherwise Excludable Employees

- Some plans have eligibility provisions more favorable than the greatest statutorily permissible minimum age and service requirements (age 21 and 1 year of service).

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Otherwise Excludable Employees

- Some plans have eligibility provisions more favorable than the greatest statutorily permissible minimum age and service requirements (age 21 and 1 year of service).
- Such plans are allowed to exclude such employees who would be *otherwise excludable* from the testing of the plan
 - Even though they are covered under the plan

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Otherwise Excludable Employees

- However, the otherwise excludable employee group would have to separately satisfy one of the coverage tests.
 - Employer is basically allowed to treat the single plan as if it were two separate plans.

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General Nondiscrimination Test

- We've passed coverage, but are we discriminating?
- That's where testing for individual rate groups comes in (again, this is not a session on all the rules about nondiscrimination testing).
- However, the testing for nondiscrimination via "rate groups" is very similar to coverage testing

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General Nondiscrimination Test

- If every rate group satisfies the ratio percentage test, the plan passes.
- If a rate group can't satisfy the RPT, then it may meet nondiscrimination if it passes the average benefit test.
 - Rate group must benefit a group of employees that satisfies the numerical nondiscriminatory classification test, and
 - Plan as a whole must satisfy the average benefit percentage test.

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General Nondiscrimination Test

- A rate group satisfies the nondiscriminatory classification portion of the test if the coverage fraction of the rate group equals at least the midpoint between the safe harbor percentage and the unsafe harbor percentage.
- In cross tested plans, we generally use the average benefit test to demonstrate that the equivalent benefit rates satisfy rate group testing.

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Corrective Retroactive Amendments

- Treas Reg 1.401(a)(4)-11(g)!
 - The famous “11g” amendments that fix everything.
- Not all plans use 11g amendments
 - Many plans have plan provisions that automatically satisfy the requirements for coverage and nondiscrimination.

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Corrective Retroactive Amendments

- Treas Reg 1.401(a)(4)-11(g)!
 - The famous “11g” amendments that fix everything.
- Not all plans use 11g amendments
 - Many plans have plan provisions that automatically satisfy the requirements for coverage and nondiscrimination.
 - Often that means “giving away the store”

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Corrective Retroactive Amendments

- Many plans (instead) apply the almost uncountable options in the coverage and nondiscrimination rules to ensure compliance in the annual testing process
- -11g of the regs allows retroactive amendments to correct coverage or nondiscrimination failures that arise in the normal course of plan operations.

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Corrective Retroactive Amendments

- Purpose of a corrective amendment?
 - Correct a discriminatory amount
 - Correct a discriminatory benefit, right or feature
 - Correct discriminatory coverage
 - Correct failure to meet minimum participation requirements (DB plans – 401(a)(26) issues).

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Corrective Retroactive Amendments

- What can a corrective retroactive amendment do?
 - Increase allocations or accruals to a participant or a group of participants sufficient to satisfy nondiscrimination testing

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Corrective Retroactive Amendments

- What can a corrective retroactive amendment do?
 - Increase allocations or accruals to a participant or a group of participants sufficient to satisfy nondiscrimination testing
 - Permit an employee or group of employees to benefit under the plan (or a segment of the plan) sufficient to satisfy coverage or minimum participation testing

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Corrective Retroactive Amendments

- What can a corrective retroactive amendment do?
 - Increase allocations or accruals to a participant or a group of participants sufficient to satisfy nondiscrimination testing
 - Permit an employee or group of employees to benefit under the plan (or a segment of the plan) sufficient to satisfy coverage or minimum participation testing
 - Expand a benefit, right or feature to a larger group of participants sufficient to satisfy nondiscrimination

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Corrective Retroactive Amendments

- What can a corrective retroactive amendment do?
 - Increase allocations or accruals to a participant or a group of participants sufficient to satisfy nondiscrimination testing
 - Permit an employee or group of employees to benefit under the plan (or a segment of the plan) sufficient to satisfy coverage or minimum participation testing
 - Expand a benefit, right or feature to a larger group of participants sufficient to satisfy nondiscrimination
 - Eliminate a benefit, right or feature from the plan completely

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General Conditions for All Corrective Retroactive Amendments

- The Treasury Reg allows an amendment that satisfies the corrective retroactive amendment (CRA) conditions to be taken into account retroactively to the first day of the prior year for purposes of coverage, nondiscrimination, and minimum participation.

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General Conditions for All Corrective Retroactive Amendments

- Examples of correction
 - A CY plan fails the RP test for 2014; 4 of 10 NHCEs terminated before the last day of the plan year (but all of the HCEs benefit that year).

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General Conditions for All Corrective Retroactive Amendments

- Examples of correction
 - A CY plan fails the RP test for 2014; 4 of 10 NHCEs terminated before the last day of the plan year (but all of the HCEs benefit that year).
 - A CRA is adopted on July 1, 2015 to add back in one of the 4 terminees (by name) for an allocation in 2014.

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General Conditions for All Corrective Retroactive Amendments

- Examples of correction
 - A CY plan fails the RP test for 2014; 4 of 10 NHCEs terminated before the last day of the plan year (but all of the HCEs benefit that year).
 - A CRA is adopted on July 1, 2015 to add back in one of the 4 terminees (by name) for an allocation in 2014.
 - If all the CRA conditions are met (see following), the amendment causes only 3 of the 10 to be excluded and the RP is now passed.

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General Conditions for All Corrective Retroactive Amendments

- Examples of correction
 - A CY plan fails the RP test for 2014; 4 of 10 NHCEs terminated before the last day of the plan year (but all of the HCEs benefit that year).
 - A CRA is adopted on July 1, 2015 to add back in one of the 4 terminees (by name) for an allocation in 2014.
 - If all the CRA conditions are met (see following), the amendment causes only 3 of the 10 to be excluded and the RP is now passed.
 - If the employer fails to meet any of the CRA conditions, the amendment will not have retroactive effect for the 2014 year, the coverage test is failed, and the plan will likely need to file under the Voluntary Correction Program (VCP) to correct the demographic failure.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Benefits may not be reduced
 - This includes benefits, rights and features
 - A very stringent rule (even more so than the general anti-cutback rule under IRC 411(d)(6))
 - Thus, a CRA will either expand coverage or increase allocations or accruals sufficient to satisfy coverage, nondiscrimination, or minimum participation requirements

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - The CRA must be effective the first day of the plan year being corrected
 - Correction would apply equally to all eligible participants (including those added back by the CRA)
 - Corrections to make a benefit, right or feature available may be made effective as of the date adopted

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - The CRA must be **adopted and implemented** by 9½ months after the end of the plan year being corrected.
 - Calendar year plan corrections must be adopted and implemented by 10/15 of the following year
 - This period can be extended if the employer files for a determination letter with a CRA in proposed form before the expiration of the initial 9½ month period.
 - Employer may adopt the proposed CRA up to 91 days after IRS issues the determination letter

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - The CRA must separately satisfy coverage and nondiscrimination testing

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Any additional allocations or accruals under a CRA adopted after the end of the year must separately pass coverage and nondiscrimination testing.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Any additional allocations or accruals under a CRA adopted after the end of the year must separately pass coverage and nondiscrimination testing.
 - Those benefiting are tested as a component plan under *coverage* regs

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Any additional allocations or accruals under a CRA adopted after the end of the year must separately pass coverage and nondiscrimination testing.
 - Those benefiting are tested as a component plan under *coverage* regs
 - Additional allocations/accruals under CRA must separately pass nondiscrimination testing

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Any additional allocations or accruals under a CRA adopted after the end of the year must separately pass coverage and nondiscrimination testing.
 - Generally not a problem because CRA is giving additional allocations/accruals only to NHCEs
 - Can't fail; automatically satisfies coverage and nondiscrimination testing because there are no HCEs benefiting in the "component" plan to test against the NHCEs benefiting in the amendment

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - Yes, but be careful.
 - Suppose the testing shows there is still room for an HCE to get an additional allocation and, with the CRA, the plan would still pass all the tests
 - » Can we do it?

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - Yes, but be careful.
 - Suppose the testing shows there is still room for an HCE to get an additional allocation and, with the CRA, the plan would still pass all the test.
 - » Can we do it?
 - » Maybe: only if the CRA *by itself* will pass coverage *and* nondiscrimination
 - Doesn't matter if the plan as a whole would pass with the additional allocations under the CRA.
 - Generally we leave HCEs out of CRAs!

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - Yes, but be careful.
 - Example: An employer has 6 employees, 2 HCEs and 4 NHCEs. Employer profit sharing failed nondiscrimination in the 2014 plan year.
 - To correct, the employer adopts a corrective retroactive amendment to give additional allocations to one of the two HCEs and two of the four NHCEs.
 - The regular and additional allocations are as follows:

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?

Name	HCE	414(s) Comp.	Regular allocations	Additional allocations	Additional nondiscrim. Calculation	Additional allocation rate	General nondiscrim. Calculation	General nondiscrim. allocation rate
Anthony	Yes	230,000	34,500	0	0/230,000	0%	34,500/230,000	15%
Victoria	Yes	250,000	37,500	10,000	10,000/250,000	4%	37,500+10,000/250,000	19%
Michael	No	60,000	7,500	1,500	1,500/60,000	2.5%	7,500+1,500/60,000	15%
Rusty	No	60,000	7,500	3,900	3,900/60,000	6.5%	7,500+3,900/60,000	19%
Daniel	No	50,000	6,250	0	0/50,000	0%	6,250/50,000	12.5%
Jordan	No	45,000	5,625	0	0/45,000	0%	5,625/45,000	12.5%

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - The additional allocations must separately satisfy coverage.
 - One of two HCEs benefit in the additional allocation under the corrective retroactive amendment for a 50% HCE coverage ratio.
 - Two of four NHCEs benefit in the additional allocations for a 50% NHCE coverage ratio.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - The additional allocations must separately satisfy coverage.
 - One of two HCEs benefit in the additional allocation under the corrective retroactive amendment for a 50% HCE coverage ratio.
 - Two of four NHCEs benefit in the additional allocations for a 50% NHCE coverage ratio.
 - Comparing the two, the corrective retroactive amendment has a 100% coverage ratio which satisfies the ratio percentage test under the coverage regulations

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - The additional allocations must also separately be nondiscriminatory in amount.
 - In this case, they satisfy the rate group nondiscrimination test.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - The additional allocations must also separately be nondiscriminatory in amount.
 - In this case, they satisfy the rate group nondiscrimination test.
 - The additional allocation rate group to be tested for nondiscrimination is 4%, Victoria's rate group.
 - Again, the HCEs' ratio at the 4% rate group is 50%.
 - The NHCEs' ratio at the 4% rate group is 25%.
 - Comparing the two, the nondiscrimination ratio is 50%, which fails the ratio percentage test, however, it passes the average benefit test when the NHCE concentration percentage is 66.67%.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - In addition to the nondiscriminatory classification test, the average benefit test must satisfy the average benefit percentage test.
 - The plan can do so either on the basis of the component plan (the additional allocation) or on the basis of the plan as a whole.
 - On a component plan basis, the average NHCE additional allocation rate must be at least 70% of the average HCE additional allocation rate.
 - The average HCE additional allocation is 2% ($4\%/2$) and the average NHCE additional allocation is 2.25% ($(2.5\% + 6.5\%)/4$).
 - The average NHCE additional allocation is 112.5% ($2.25\%/2\%$) of the average HCE additional allocation, which is more than 70% and the plan passes

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - New Example: Same facts, with one change:
 - Victoria does not benefit in the corrective retroactive amendment.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - New Example: Same facts, with one change:
 - Victoria does not benefit in the corrective retroactive amendment.
 - The amendment automatically satisfies coverage and nondiscrimination on a separate basis

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Query: Could we include an HCE in the CRA?
 - New Example: Same facts, with one change:
 - Victoria does not benefit in the corrective retroactive amendment.
 - The amendment automatically satisfies coverage and nondiscrimination on a separate basis
 - See how easy it is when there's no HCEs in the CRA!

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Design-based safe harbor exception
 - If the CRA brings a plan into compliance as a design-based safe harbor under Code Section 401(a)(4):
 - The CRA need not separately satisfy coverage or nondiscrimination.
 - » For DC plans, this includes:
 - Uniform allocation
 - Uniform points
 - Permitted disparity plan design

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Design-based safe harbor exception
 - Example:
 - A profit sharing plan has a discretionary cross-tested design which is funded monthly throughout the year.
 - Changes in the demographics of the participant population make a cross-tested design expensive.
 - After the end of the plan year, the allocations are as follows:

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Design-based safe harbor exception

Name	HCE	414(s) Comp.	Regular Allocation	Nondiscrimination Calculation	General nondiscrimination allocation rate
Anthony	Yes	230,000	34,500	34,500/230,000	15%
Victoria	Yes	250,000	37,500	37,500/250,000	15%
Michael	No	60,000	7,500	7,500/60,000	12.5%
Rusty	No	60,000	7,500	7,500/60,000	12.5%
Daniel	No	50,000	6,250	6,250/50,000	12.5%
Jordan	No	45,000	5,625	5,625/45,000	12.5%

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Design-based safe harbor exception
 - The allocations appear to fail nondiscrimination.
 - After the end of the plan year, the employer adopts a CRA to provide an allocation that satisfies the permitted disparity designed-based safe harbor.
 - The integration level is set at \$60,000 (i.e., the highest paid NHCE's compensation).
 - The allocation rates are 12.5% on all compensation and 4.3% above \$60,000 (both capped by \$260,000, the compensation limit for 2014).
 - The new allocations for 2014 are:

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Design-based safe harbor exception

Name	HCE	414(s) Comp.	Regular previous allocations	Regular Allocations with amendment	Regular Allocation rate	Allocations above \$60,000, the integration level	Allocation rate above integration level	Total allocations	Combined allocation rate
Anthony	Yes	230,000	34,500	28,750/230,000	12.5%	7,310/170,000	4.3%	36,060	15.68%
Victoria	Yes	250,000	37,500	31,250/250,000	12.5%	8,170/190,000	4.3%	39,420	15.77%
Michael	No	60,000	7,500	7,500/60,000	12.5%	No comp	0%	7,500	12.5%
Rusty	No	60,000	7,500	7,500/60,000	12.5%	No comp	0%	7,500	12.5%
Daniel	No	50,000	6,250	6,250/50,000	12.5%	No comp	0%	6,250	12.5%
Jordan	No	45,000	5,625	5,625/45,000	12.5%	No comp	0%	5,625	12.5%

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - Design-based safe harbor exception
 - While only the HCEs participate in the additional contributions under the corrective retroactive amendment, the amendment is proper because it is not required to separately pass coverage and nondiscrimination when the purpose of the amendment is to conform the plan to a designed-based safe harbor

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - CRA Must Have Substance

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - CRA Must Have Substance
 - Example of substance:
 - An employer *may not* allocate amounts to nonvested terminated participants or to part-time employees who would never vest in the allocation.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - CRA Must Have Substance
 - Example of substance:
 - An employer *may not* allocate amounts to nonvested terminated participants or to part-time employees who would never vest in the allocation.
 - These people would not economically benefit from the additional allocation.
 - » Often, this would be the “cheapest” correction
 - adding dollars to NHCEs who terminated in the year of correction or to part-time employees.

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - CRA Must Have Substance
 - How to still do it “cheaply”?
 - These people are generally not vested because they don't have 2 years of service on a 2-20 vesting schedule.
 - » They generally have one year of service or they wouldn't be eligible and wouldn't be a problem

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - CRA Must Have Substance
 - How to still do it “cheaply”?
 - These people are generally not vested because they don’t have 2 years of service on a 2-20 vesting schedule.
 - » They generally have one year of service or they wouldn’t be eligible and wouldn’t be a problem
 - Keep these people in the CRA by changing the plan’s vesting schedule to add a vested benefit at year one of, say 10%.
 - » New vesting schedule: 1-10/2-20.....
 - » AND.... They will forfeit 90% of the correction amount!

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General Conditions for All Corrective Retroactive Amendments

- Required Conditions for a valid CRA
 - CRA Must Have Substance
 - How to still do it “cheaply”?
 - These people are generally not vested because they don’t have 2 years of service on a 2-20 vesting schedule.
 - » They generally have one year of service or they wouldn’t be eligible and wouldn’t be a problem
 - OR, just fully vest the individual as part of the CRA.
 - » But then they get 100% of the amount
 - » But you don’t have a permanent 10% at year 1 vesting

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General Conditions for All Corrective Retroactive Amendments

- Benefits, rights and features corrections
 - BRFs must be currently and effectively available on a nondiscriminatory basis
 - eg: loan provisions, participant direction, installment distributions
 - CRA can fix a discriminatory BRF
 - A CRA for BRF failure may not be a part of a pattern of amendments with respect to a particular BRF

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General Conditions for All Corrective Retroactive Amendments

- Benefits, rights and features corrections
 - BRF correction must either:
 - expand the group to whom the BRF is available to a nondiscriminatory classification that satisfied the applicable safe harbor percentage under the NCT, or
 - Eliminate the BRF with respect to all participants
 - must still comply with anti-cutback rules of 411(d)(6)
 - must be effective on or before the last day of the correction year
 - must remain in effect through the end of the following plan year

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General Conditions for All Corrective Retroactive Amendments

- Benefits, rights and features corrections
 - Example: Company A and Company B form a controlled group but each maintains a separate 401(k) plan for its respective employees
 - the Company A plan has participant loans,
 - the Company B plan does not.
 - The plans are combined to satisfy coverage testing.
 - When performing the 2014 plan year benefits, rights and features nondiscrimination test for the availability of participant loans, the aggregated plan failed

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General Conditions for All Corrective Retroactive Amendments

- Benefits, rights and features corrections
 - CRA Correction:
 - The employer can add a sufficient number of NHCEs from Company B to satisfy the nondiscriminatory classification test by adopting a corrective retroactive amendment in 2015, which must be effective through the end of the 2016 plan year.
 - Alternatively, if the employer identified the failure and adopted a corrective retroactive amendment before the end of the 2014 plan year, the employer may eliminate the availability of participant loans in the Company A 401(k) plan, effective through December 31, 2015.

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General Conditions for All Corrective Retroactive Amendments

- Do you “have to fail” to do a CRA?

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General Conditions for All Corrective Retroactive Amendments

- Do you “have to fail” to do a CRA?
 - NOPE!
 - A corrective retroactive amendment is acceptable even if there’s nothing to correct!

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General Conditions for All Corrective Retroactive Amendments

- Do you “have to fail” to do a CRA?
 - NOPE!
 - A corrective retroactive amendment is acceptable even if there’s nothing to correct!
 - Example: Plan meets all tests for last year on the first pass, but you realize there is room to add some money to one of the HCEs.
 - A properly drafted CRA that meets all the requirements and provides extra dollars to that HCE (and some NHCEs too!) would be perfectly acceptable.

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General Conditions for All Corrective Retroactive Amendments

- Do you “have to fail” to do a CRA?
 - NOPE!
 - A corrective retroactive amendment is acceptable even if there’s nothing to correct!
 - Example: Plan meets all tests for last year on the first pass, but employer wants to give an extra \$10,000 now to his “significant other” who is NOT a spouse!
 - A properly drafted CRA that meets all the requirements and provides extra dollars to that NHCE would be perfectly acceptable.

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Who's In and Who's Out

- Employee makes that “one time” irrevocable election not to participate in a 401(k) plan

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Who's In and Who's Out

- Employee makes that “one time” irrevocable election not to participate in a 401(k) plan
 - He's IN for the coverage testing
 - However, he is OUT for ADP testing

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Who's In and Who's Out

- Otherwise excludable
 - For the “upper group” (those who would have satisfied the one year/age 21 requirements):
 - Those who have NOT met the one year/age 21 are OUT
 - Those meeting certain statutory exclusions are OUT
 - think Union, members of the Borg Collective (that alien thing), etc.

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Who's In and Who's Out

- Otherwise excludable
 - For the “lower group” (those who would NOT have satisfied the one year/age 21 requirements):
 - Those who HAVE met the one year/age 21 are OUT
 - Those who have met the plan's eligibility requirements if they are less than one year/age 21
 - e.g.: plan eligibility is six months and age 18
 - » those who met those requirements are OUT of the lower group for testing
 - Those meeting certain statutory exclusions are OUT
 - think Union, members of the Borg Collective (that alien thing), etc.

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Who's In and Who's Out

- Otherwise excludable
 - What entry dates to use?
 - IRS has said that the plan can use:
 - the plan entry dates
 - the maximum entry dates in the Code
 - or another system consistent with the code (such as semi-annual entry dates)

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Who's In and Who's Out

- Otherwise excludable
 - Employee has satisfied plan's eligibility conditions but has not entered the plan because of its entry dates
 - He's OUT (excludable).
 - Example: Calendar year plan with one year/age 21 and semi-annual entry dates of 1/1 and 7/1.
 - » Employee hired full time 8/15/13.
 - » Completes one year of service in 8/15/14
 - Employee is OUT (excludable) for the 2014 plan year because he/she would not enter the plan until 1/1/15

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Who's In and Who's Out

- Who is “benefiting”?

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Who's In and Who's Out

- Who is “benefiting”?
 - For coverage, an employee is benefiting for a plan year only if, for that plan year:
 - For nonelective DC plan:
 - Employee receives ANY allocation of contributions or forfeitures
 - For DB plan:
 - Employee accrues a benefit
 - » Generally, must be at least ½ of 1% per year to count.
 - A \$1/year accrual won't make it!

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Who's In and Who's Out

- Who is “benefiting”?
 - DC plan requires 1000 hours of service to get a contribution
 - Those who don't receive a contribution due to this requirement are NOT benefiting for purposes of coverage

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Who's In and Who's Out

- Who is “benefiting”?
 - DC plan requires last day of year employment to get a contribution
 - Those who don't receive a contribution due to this requirement are NOT benefiting for purposes of coverage

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Who's In and Who's Out

- Who is “benefiting”?
 - Top Heavy?
 - DC plan requires 1000 hours to get a contribution
 - Plan is Top Heavy
 - As we noted, those who don't receive a contribution due to the 1000 hour requirement are NOT benefiting for purposes of coverage.
 - However, a participant who works less than 1000 hours but receives the Top Heavy minimum is benefiting for purposes of coverage.
 - » Allocation rate will be less than the rate of other participants and general nondiscrimination tests will need to be passed

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Who's In and Who's Out

- Who is “benefiting”?
 - 401(k) and 401(m)
 - An employee is *eligible* to make 401(k) deferral
 - Employee is benefiting for purpose of 401(k)
 - An employee is *eligible* to make an employee contribution or receive an employer matching contribution under 401(m)
 - Employee is benefiting for purposes of 401(m)
 - Doesn't matter if employee *actually* makes a deferral or nondeductible contribution or receives an employer match – they are still benefiting under 401(k)/401(m)
 - Of course, that won't help pass the 401(k) and 401(m) tests!

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Who's In and Who's Out

- Who is “benefiting”?
 - Plan limit on benefits?
 - DB plan provides annual benefit at NRA of 2% times years of service capped at 30 years.
 - Employee is now on his 31st year and gets no additional benefit accrual for that year.
 - Employee IS BENEFITING even though the plan prevents benefit accrual because of the 30 year limitation

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Who's In and Who's Out

- Who is “benefiting”?
 - Frozen Plans?
 - A frozen DC plan automatically satisfies coverage requirements
 - No HCE benefits if the plan is frozen!
 - Allocation of trust earnings is OK
 - A discretionary PS plan with no contributions (or forfeitures) is treated like a frozen plan
 - Automatically satisfies coverage requirements

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Who's In and Who's Out

- Who is “benefiting”?
 - Frozen Plans?
 - A frozen DB plan automatically satisfies coverage requirements
 - A DB plan is frozen only if all benefit accruals have ceased
 - If benefits increase because of increases in employee compensation or because of 415 limit increases
 - » PLAN IS NOT FROZEN

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Who's In and Who's Out

- Who is “benefiting”?
 - Election out
 - While a plan may allow an “election out”, the plan may not disregard that employee for purposes of coverage testing
 - Such an employee is nonexcludable and not benefiting for purposes of coverage testing.
 - » “They count against you”

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Who's In and Who's Out

- Who is “benefiting”?
 - Excluding employee classification that is not a statutory exclusion
 - OK, so long as you pass coverage
 - Those employees are in the coverage test and are NOT benefiting
 - May not base exclusion on age or length of service
 - Example: geographic location is ok

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Who's In and Who's Out

- Who is “benefiting”?
 - Plans for Select Groups

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Who's In and Who's Out

- Who is “benefiting”?
 - Plans for Select Groups
 - Employer with only HCEs
 - Plan will automatically satisfy coverage

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Who's In and Who's Out

- Who is “benefiting”?
 - Plans for Select Groups
 - Employer with only HCEs
 - Plan will automatically satisfy coverage
 - Plan benefiting only NHCEs
 - Plan will automatically satisfy coverage

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Who's In and Who's Out

- Who is “benefiting”?
 - Plans for Select Groups
 - Employer with only HCEs
 - Plan will automatically satisfy coverage
 - Plan benefiting only NHCEs
 - Plan will automatically satisfy coverage
 - Multiple employer plan (not Multiemployer plan)
 - Each employer must separately meet coverage without regard to employees of other participating employers

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Who's In and Who's Out

- Who is “benefiting”?
 - Plans for Select Groups
 - Employer with only HCEs
 - Plan will automatically satisfy coverage
 - Plan benefiting only NHCEs
 - Plan will automatically satisfy coverage
 - Multiple employer plan (not Multiemployer plan)
 - Each employer must separately meet coverage without regard to employees of other participating employers
 - Separate line of business
 - If SLOB requirements are met, employer may separately apply the alternative minimum coverage requirements to each SLOB

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Who's In and Who's Out

- Who is “benefiting”?
 - Top Heavy PS plan; 1000 hour requirement, last day employment requirement
 - Participant employed last day but less than 1000 hours
 - Participant receives top heavy minimum only
 - Is he benefiting?
 - Yes
 - A DC plan participant who receives *any* allocation for a plan year is benefiting
 - For nondiscrimination, plan is not a uniform allocation safe harbor UNLESS plan would satisfy coverage requirements by treating any individual who receive only TH minimum as NOT benefiting.
 - Otherwise, plan will have to pass general nondiscrimination test

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Who's In and Who's Out

- Plan Aggregation
 - For coverage testing, each single plan is a separate plan
 - An employer MAY aggregate two or more plans and test them as a single plan for minimum coverage
 - But the plans must also satisfy nondiscrimination rules as a single plan
 - We're not going into the details of aggregation in this presentation

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Who's In and Who's Out

- Plan Aggregation
 - Mandatory DISAGGREGATION
 - You CAN'T aggregate plans that the regs say you can't aggregate!
 - Collectively bargained with non-collectively bargained
 - 401(k) or 401(m) arrangements with other portions of the plan
 - ESOP with non-ESOP – special rules here
 - » Look them up if you are dealing with ESOPs!

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Who's In and Who's Out

- Sample -11g Amendment
 - see next page

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AMENDMENT TO
401(K) PLAN AND TRUST

BY THIS AGREEMENT, the _____ 401(k) Plan and Trust (herein called the "Plan") is hereby amended as follows, effective as of January 1, 20__:

1. For the plan year ending _____, 201__, in addition to the employer discretionary contribution of \$ _____, which shall be allocated in accordance with the plan document, an additional contribution of \$ _____ shall be made and allocated as follows:

\$ _____ shall be allocated to the account of _____; and
\$ _____ shall be allocated to the account of _____.

1. For the plan year ending _____, 201__, in addition to the employer discretionary contribution of \$ _____, which shall be allocated in accordance with the plan document, an additional contribution of \$ _____ shall be made and allocated as follows:

First, an additional allocation of \$ _____ shall be made so that all participants shall have a minimum allocation (excluding forfeitures) of at least 5% of their Compensation; and in addition:

\$ _____ shall be allocated to the account of _____; and
\$ _____ shall be allocated to the account of _____.

1. For the plan year ending _____, 201__, in addition to the employer discretionary contribution of \$ _____, which shall be allocated in accordance with the plan document as follows:

- (1) \$ _____ to Group A;
- (2) \$ _____ to Group B;
- (3) \$ _____ to Group C, and

an additional contribution of \$ _____ shall be made and allocated as follows:

2. The Vesting Schedule in Article 6.4 (b) shall be modified as follows:

Years of Service	Vesting Schedule Percentage
Less than 1	0 %
1	10 %
2	20 %
3	40 %
4	60 %
5	80 %
6	100 %

2. It is intended that this amendment shall be considered a corrective amendment under Treasury Regulations 1.401(a)(9)-11(g).

IN WITNESS WHEREOF, the Agreement has been executed this ____ day of _____, 201__.

WITNESS AS TO EMPLOYER _____

By _____ EMPLOYER 143

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QUESTIONS?

