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Roth 401(k) Contributions, Safe Harbor 401(k) Plans and Automatic Enrollment

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Roth 401(k) Contributions

Qualified Cash or Deferred Arrangement (CODA)

- An arrangement under IRC 401(k) that involves an election by an employee to either (1) receive compensation in cash or (2) have it deferred into a qualified plan
  - Contributions made at the election of an employee are known as elective contributions (or pre-tax elective deferrals)
  - Participant must have an effective opportunity to make/change an election at least once during each plan year
  - Pre-tax elective deferrals are not included in an employee's federal taxable income at the time they are contributed

Designated Roth Contributions

- Added by EGTRRA and first effective for tax years beginning on or after January 1, 2006
  - Added by IRC 402A; regulations found under Treas. Reg. §1.402A-1, 1.401(k)-1(f) and 1.403(b)-3(c)
  - Elective deferrals under a CODA; also available under 403(b) plans (universal availability applies)
  - Participant must have an effective opportunity to make/change an election at least once during each plan year
  - Designated irrevocably by the employee as designated Roth contributions in lieu of pre-tax elective deferrals
  - Designated Roth contributions are included in the employee's federal taxable income (e.g., treated as wages subject to applicable withholding)
  - Although already included as wages, designated Roth contributions must be reported separately in Box 12 of IRS Form W-2

Requirements for Designated Roth Contributions

- Plan must be drafted to permit designated Roth contributions by the end of the plan year in which the designated Roth contributions are first effective
- Plan must also offer pre-tax elective deferrals (i.e., plan cannot offer only designated Roth contributions)
- Must be maintained by the plan in a separate account, which may also include Roth rollover contributions and earnings (and no other contributions)
- Must satisfy all other requirements applicable to pre-tax elective deferrals

Requirements for Designated Roth Contributions (cont'd)

- Must satisfy all other requirements applicable to pre-tax elective deferrals
  - Immediately non-forfeitable
  - If automatic enrollment is used, the plan must indicate the extent to which the default contributions are pre-tax elective deferrals or designated Roth contributions
  - Includible in ADP test
  - Subject to the rules of IRC 401(a)(9) in the same manner as pre-tax elective deferrals
  - May be treated as catch-up contributions
  - May serve as the basis for a participant loan
  - May serve as the basis for matching contributions
  - Distribution restrictions

Distribution Restrictions

- The same restrictions on distributions that apply to pre-tax elective deferrals also apply to designated Roth contributions
  - Severance from employment, death or disability
  - Attainment of age 59½
  - Hardship
  - Termination of the plan
  - Qualified reservist distributions

Distribution Restrictions (cont'd)

- If a plan permits distributions because of hardship, an employee may choose to receive a hardship distribution from his designated Roth account
- The hardship distribution will consist of a pro rata share of earnings and basis (after-tax portion), and the earnings portion will be included in gross income unless the employee has had the designated Roth account for 5 years and is either disabled or over age 59½

Distribution of Designated Roth Contributions

- No part of payment will be taxed if the payment is a "qualified distribution," even if the payment is not rolled over
- After-tax contributions included in a payment from a designated Roth account are never taxed
- If the distribution is not a qualified distribution and the distribution is not rolled over, earnings will be taxed
- If distributed prior to age 59½, the 10% early distribution penalty tax generally applies (including amounts withheld for income tax)

Qualified Distribution

- Payment is made after the participant has had a designated Roth account in the plan for at least 5 consecutive taxable years and:
  - Made on or after the date the participant attains age 59½;
  - Made because the participant is disabled (as defined under IRC 72(m)(7)); or
  - Made to the participant’s beneficiary or estate after death

Qualified Distribution (cont'd)

- A distribution is not a qualified distribution to the extent it consists of a distribution of:
  - Excess deferrals (deferrals in excess of annual limit);
  - Excess contributions (failed ADP test); or
  - Excess aggregate contributions (failed ACP test)

Qualified Distribution (cont'd)

- If distributed to a beneficiary or alternate payee, the employee's age, death or disability is used to determine if payment is a qualified distribution
- If the surviving spouse or alternate payee rolls over the distribution to his/her own employer's designated Roth account, then his/her own age, death or disability is used to determine whether the distribution is qualified

Qualified Distribution (cont'd)

- Although qualified distributions are not subject to taxation, a distribution from a designated Roth account must be reported on IRS Form 1099-R

Determination of 5-Year Period for Qualified Distributions

- The 5-year rule starts with January 1 of the year the first contribution was made to the designated Roth account
- If the employee makes a direct rollover from a designated Roth account under another plan, the 5-year period for the employee in the recipient plan begins on the first day of the taxable year that the employee made designated Roth contributions to the other plan, if earlier
- If rolled over to a Roth IRA, all Roth IRAs will be considered for purposes of determining the 5-year rule (counting from January 1 of the year for which the first contribution was made to any Roth IRA)
- Additional rules for designated Roth contributions by reemployed veterans

Rollover of Designated Roth Contributions

- Earnings will not be taxed currently and will not be taxed later on payments that are qualified distributions
- Rollover from designated Roth account may only be made in a direct rollover to another designated Roth account that accepts them (i.e., has a designated Roth program) or to a Roth IRA either in a direct rollover or a 60-day rollover
- A designated Roth account and any other accounts are treated as held under two separate plans for purposes of the automatic rollover rules
- Two different Special Tax Notices under 402(f); model issued by IRS in Notice 2009-68

Rollover of Designated Roth Contributions (cont'd)

- If rolled over to a Roth IRA, all Roth IRAs will be considered for purposes of determining the 5-year rule (counting from January 1 of the year for which the first contribution was made to any Roth IRA)
- If rolled over to a Roth IRA, the participant will not be required to take a distribution from the Roth IRA during his lifetime and must keep track of the aggregate amount of the after-tax contributions in all Roth IRAs (in order to determine taxable income for later Roth IRA payments that are not qualified distributions)

Rollover of Designated Roth Contributions (cont'd)

- For direct rollovers, the plan administrator of a plan directly rolling over a distribution is required to provide the plan administrator of the recipient plan with a statement indicating either (1) the first year of the 5-taxable-year period for the employee and the portion of such distribution attributable to basis or (2) that the distribution is a qualified distribution
- For other distributions, the plan administrator must provide to the employee, upon request, the portion of the distribution attributable to basis or that the distribution is a qualified distribution. The statement is required to be provided within a reasonable period following the employee request, but in no event later than 30 days following the employee request

60-Day Rollover of Designated Roth Contributions

- If a distribution from a designated Roth account is made to an employee, the employee is able to roll over the entire amount into a Roth IRA within a 60-day period, and the income limits for contributions to Roth IRAs do not apply for this purpose
- An employee is permitted to roll over the taxable portion of the distribution to a designated Roth account within a 60-day period

60-Day Rollover of Designated Roth Contributions (cont'd)

- 60-day rollovers to Roth IRAs are permitted for both qualified and non-qualified distributions
- If rolled over to a Roth IRA, the participant will not be required to take a distribution from the Roth IRA during his lifetime and must keep track of the aggregate amount of the after-tax contributions in all Roth IRAs (in order to determine taxable income for later Roth IRA payments that are not qualified distributions)

Testing and Annual Limits

- Count toward the annual 402(g) limit ($16,500 for 2010)
  - Plan may offer participant who has exceeded limit to choose whether excess deferrals are pre-tax elective deferrals or designated Roth contributions
- Count toward the annual catch-up limit ($5,500 for 2010)
- Treated as before-tax contributions for purposes of the ADP test
  - Plan may offer HCE who has exceeded the limit to choose whether excess contributions are pre-tax elective deferrals or designated Roth contributions
- Included in 415 testing
- Subject to required minimum distribution requirements

Designated Roth Contributions vs. Roth IRA Contributions

- Similar to Roth IRA contributions
  - Contributions to either type of account are after-tax contributions
  - Qualified distributions from either type of account are excludable from gross income
  - Both designated Roth contributions and Roth IRA contributions offer a distinct benefit of never having to pay taxes on the earnings associated with those contributions provided certain criteria are satisfied

Designated Roth Contributions vs. Roth IRA Contributions (cont'd)

- Dissimilar to Roth IRAs
  - An individual is ineligible to make Roth IRA contributions if his modified adjusted gross income exceeds certain limits; no income limits on an individual's eligibility to make designated Roth contributions
  - Although an individual can contribute to a traditional or Roth IRA on behalf of his spouse based on the individual's earned income, he cannot contribute to a Roth 401(k) or Roth 403(b) on behalf of his spouse
  - Traditional IRA may be converted to a Roth IRA; no conversion of a pre-tax elective deferral account under a CODA to a designated Roth account
  - Specific ordering rule for distributions from Roth IRAs; no ordering rule for distributions from designated Roth accounts (IRC 72 applies to determine character of distributions from designated Roth account)
  - Roth IRAs are not subject to IRC 401(a)(9) while owner is still alive; designated Roth accounts are subject to IRC 401(a)(9) just like pre-tax elective deferrals

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Advantages

- Certain employees may not be eligible for a Roth IRA because of the adjusted gross income (AGI) limits on eligibility for Roth IRAs; however, designated Roth contributions are available to all participants (subject to plan provisions) even if they are not eligible to make Roth IRA contributions
- Participants eligible for Roth IRA contributions can also make designated Roth contributions. Therefore, an employee whose earnings are within the Roth IRA AGI limits will be able to contribute as much as $28,000 for 2010:

Roth 401(k)	**Roth IRA**
$16,500 (not eligible for catch up)	$5,000 (not eligible for catch up)
$22,000 (eligible for catch up)	$6,000 (eligible for catch up)

Disadvantages

- Difficult to communicate to employees (especially with regard to the taxation of distributions and the special ordering rules)
- Additional payroll programming to add designated Roth contributions source to payroll feeds
- Additional payroll programming for employer match
- Additional W-2 reporting, separate accounting and separate tax rules
- Plan administrator is responsible for tracking designated Roth contributions made for each employee and the date of the first designated Roth contribution for calculating an employee's 5-year period (also must report this for direct rollovers to another employer's plan)

Safe Harbor Plans

Types of Safe Harbor Plans

- Safe harbor under IRC 401(k)(12) (added by the Small Business Job Protection Act in 1996) – "traditional" safe harbor plan
- Safe harbor under IRC 401(k)(13) (added by the Pension Protection Act in 2008) – also called a Qualified Automatic Contribution Arrangement (QACA)

Benefits of Safe Harbor Plans

- Used to avoid ADP testing of elective deferral contributions
- May be used to avoid ACP testing of employer matching contributions, if additional requirements are met
- ACP test must still be performed if additional requirements are not met or if after-tax contributions are made
- May be used to help plan satisfy top-heavy testing
- May be added to simplify plan administration and to increase participation, but may be more expensive due to level of required employer contributions and vesting requirements

Safe Harbor Plans - Plan Documentation

- Safe harbor formula must be written into the plan document
- Plan document must generally be amended to reflect the safe harbor plan design before the first day of the safe harbor plan year and remain in effect for an entire 12-month plan year; exceptions exist for:
  - A newly established plan, provided the plan year is at least 3 months long
  - A plan that has a short plan year as a result of changing the plan year (additional requirements apply)
  - A plan that terminates during a plan year (additional requirements apply)
  - A plan amendment adopting “tentative” safe harbor non-elective contributions

Safe Harbor Plans - Withdrawal Restrictions

- Safe harbor employer contributions are subject to the same withdrawal restrictions as elective deferrals
  - Severance from employment, death or disability
  - In-service distributions prior to age 59½ not permitted
  - Not eligible for hardship withdrawal
  - Distributions may not be made as a result of plan termination if the employer sponsors another defined contribution plan within 12 months of the plan termination

Traditional Safe Harbor Plan - Eligibility

- Safe harbor matching contributions must be provided to all NHCEs eligible to make elective deferrals; safe harbor non-elective contributions must be provided to all eligible NHCEs (regardless of deferral election)
- Safe harbor employer contributions may also be provided to HCEs
- Cannot impose an hours of service or last day of the year requirement
- Can exclude employees under age 21 and/or who have not completed a year of eligibility service; however the excluded group is subject to ADP/ACP testing

Traditional Safe Harbor Plan - Employer Contributions

- Must provide for safe harbor employer contributions
  - Safe harbor matching contributions; or
  - Safe harbor non-elective contributions
- Safe harbor definition of compensation required for safe harbor employer contributions
- Safe harbor employer contributions subject to immediate 100% vesting
- No minimum or maximum level of elective deferrals required

Traditional Safe Harbor Plan - Safe Harbor Matching Contribution Formulas

- Provides for one of the following safe harbor matching contributions:
  - Fixed basic matching contribution equal to:
    - 100% match on first 3% of safe harbor compensation deferred, plus
    - 50% match on the next 2% of safe harbor compensation deferred
  - Fixed enhanced matching contribution at least equal to the matching contributions under the basic formula

Traditional Safe Harbor Plan - Safe Harbor Matching Contribution Formulas (cont'd)

- Matching contribution percent for eligible HCEs at any deferral rate cannot be greater than the matching contribution percent for eligible NHCEs
- Must match catch-up contributions
- May be made on a quarterly, monthly or payroll-by-payroll basis
- "True up" not required
- Payroll period matching contributions made during a plan year quarter must be made to the trust no later than the last day of the following plan year quarter

Traditional Safe Harbor Plan - Safe Harbor Non-elective Contribution Formula

- Fixed or tentative non-elective contribution equal to at least 3% of employee's safe harbor compensation for the plan year
  - "Fixed" safe harbor non-elective contribution must be made for a plan year
  - "Tentative" safe harbor non-elective contribution may be made and implemented after the beginning of the plan year

Traditional Safe Harbor Plan - Tentative Safe Harbor Non-elective Contributions

- Tentative safe harbor non-elective contributions may be implemented mid-year:
  - Plan must use current year testing method
  - Must be amended no later than 30 days before the last day of the plan year (effective as of the first day of the plan year)
  - Amendment made solely for that plan year (amendment “self-destructs” at the end of the year); amendment process can be repeated yearly
  - Must provide contingent and follow-up notices

Traditional Safe Harbor Plan - Tentative Safe Harbor Non-elective Contributions Contingent and Follow-Up Notices

- Contingent notice
  - Participants must be notified before the beginning of the plan year of the possibility of a safe harbor non-elective contribution
  - In lieu of describing safe harbor contributions, the notice must state that the plan may be amended during the plan year to include safe harbor non-elective contributions, and, if amended, a follow-up notice will be provided
  - Otherwise satisfies notice requirements applicable to safe harbor plans
- Follow-up notice
  - Provided no later than 30 days before the last day of the plan year
  - Indicates whether the employer has decided to make the safe harbor non-elective contribution for the plan year

Traditional Safe Harbor Plan - Additional Employer Contributions

- May provide additional fixed or discretionary matching or non-elective contributions
- Additional matching contributions may not impose an hours of service and/or last day requirement; may, however impose an age 21 and/or year of eligibility service requirement
- Tracked separately
- Not subject to vesting, eligibility and withdrawal restrictions
- Normal plan rules apply to additional employer contributions

Traditional Safe Harbor Plan - Satisfaction of ACP Test

- Automatically satisfies ACP if basic safe harbor matching contribution is used
- If plan uses matching contributions other than or in addition to basic safe harbor matching contributions, additional requirements apply:
  - Rate of match cannot increase as the rate of elective deferrals increases
  - Matching contributions cannot be based on an employee's elective deferrals in excess of 6% of compensation
  - Matching contribution percent for eligible HCEs at any deferral rate cannot be greater than the matching contribution percent for eligible NHCEs

Traditional Safe Harbor Plan - Satisfaction of ACP Test (cont'd)

- Total dollar amount of any additional matching contributions that are discretionary cannot exceed 4% of an employee's compensation (this limit is not applied to any additional fixed matching contributions)

Traditional Safe Harbor Plan - Top-Heavy Testing

- Generally exempt from top-heavy requirements if it contains ONLY safe harbor contributions (either matching or non-elective) and non-safe harbor matching contributions (either fixed or discretionary) that meet the safe harbor ACP requirements
  - Forfeitures must be used to reduce employer contributions or pay plan expenses; cannot be reallocated to participant accounts

Traditional Safe Harbor Plan - Additional Rules

- May be combined with automatic enrollment but does not need to satisfy QACA requirements
- No 90-day penalty free withdrawal right (unless also an EACA)
- Deemed to be using current year testing for ADP/ACP test if safe harbor is ever discontinued
- Initial and annual notice requirements for each eligible employee

Traditional Safe Harbor Plan - Initial and Annual Notice Content Requirements

- Notices can be provided in writing or delivered electronically
- Written in a manner calculated to be understood by the average employee
- Must describe the safe harbor formula
- Must describe any additional contributions
- Must identify the plan to which the safe harbor contributions will be made
- Must identify the type and amount of compensation that may be deferred

Traditional Safe Harbor Plan - Initial and Annual Notice Content Requirements (cont'd)

- How to administratively make cash or deferred elections
- The periods available for making the elections
- Applicable withdrawal and vesting provisions
- How to obtain additional information about the plan
- May refer to SPD for information other than withdrawals and vesting provisions related to non-safe harbor employer contributions

Traditional Safe Harbor Plan - Initial and Annual Notice Timing Requirements

- Must be provided within a “reasonable period” before the beginning of the plan year
- Reasonable period is deemed to be satisfied if notice is provided to each eligible employee between 30 - 90 days before the beginning of the plan year
- In the year the employee first becomes eligible to participate or for a new plan, notice must be provided 0 - 90 days before the date of entry

Traditional Safe Harbor Plan - Mid-Year Reduction/Suspension of Safe Harbor Matching Contributions

- Safe harbor matching contributions may be reduced/suspended mid-year, provided:
  - Eligible employees are provided with a supplemental notice
  - Reduction/suspension is effective no earlier than 30 days after supplemental notice is provided
  - Eligible employees are given a reasonable opportunity prior to the reduction/suspension to change their cash or deferred election
  - Plan is amended to provide that ADP test will be satisfied for entire plan year using the current year method
  - Plan satisfies safe harbor requirements up to the effective date of the reduction or suspension
  - Annual compensation limit must be pro rated

Traditional Safe Harbor Plan - Mid-Year Reduction/Suspension of Safe Harbor Non-elective Contributions

- Safe harbor non-elective contributions may be reduced/ suspended mid-year on account of substantial business hardship (proposed regulations issued 5/15/2009)
  - Substantial business hardship depends on a number of factors:
    - whether employer is operating at an economic loss
    - whether there is substantial unemployment/underemployment or declining sales and profits in employer's industry
    - whether it is reasonable to expect that the plan will be continued only after the planned reduction or suspension of contributions
  - Mirror rules for mid-year reduction/suspension of safe harbor matching contributions

QACA – General

- First effective for plan years beginning on or after 1/1/08
- A CODA that automatically enrolls eligible employees where the default deferral election is a contribution equal to a “qualified percentage” multiplied by the eligible employee’s compensation

QACA - Eligibility

- Must cover all eligible employees hired on or after effective date of the QACA
  - Previously hired employees who made an affirmative investment election (including 0%) do not need to be automatically enrolled
  - Previously hired employees who did <u>not</u> make an affirmative election must be auto enrolled under the QACA unless they were previously auto enrolled at a contribution rate that is at or above the initial QACA percentage (the auto-escalate will, however, apply to this group)

QACA - Qualified Percentage

- The "qualified percentage" of the default deferral election must be at least:
    - 3% for 1st plan year
    - 4% for 2nd plan year
    - 5% for 3rd plan year
    - 6% for each year thereafter
- Must use a safe harbor definition of compensation (effective January 1, 2010)
- Must be applied uniformly
- Cannot exceed 10% of compensation
- Must provide for auto-escalation

QACA - Automatic Escalator

- Automatically increases deferral percentage by 1% each year until a maximum deferral percentage is reached
  - Takes advantage of employee inertia
  - Available to any 401(k) plan
  - Increases can be at beginning of year or can coincide with individual pay increase dates (e.g., anniversary dates)

QACA - Automatic Escalator (cont’d)

- Initial contribution period begins when the employee has first made contributions and ends with the last day of the following plan year
- Minimum increases by 1% each year
- The schedule for implementing automatic increases must be uniform
- Exception to the uniformity requirement by allowing qualified percentages to vary based on the number of years or portions of years since the "initial period" began; thus, employers may implement automatic increases in the middle of a plan year so long as the adjustments occur no later than the first day of the plan year called for under the minimum schedule

QACA - Automatic Escalator (cont’d)

- Employees auto-enrolled under a QACA must be subject to increases as though the employee were actively participating during a hardship withdrawal suspension period, LOA, etc.
- Plan may disregard an employee's prior participation in a QACA (giving the employee a new start) if no default contributions are made on the employee's behalf for at least an entire plan year (not just 12 months)

QACA - Employer Contributions

- Must provide for safe harbor employer contributions
  - Safe harbor matching contributions; or
  - Safe harbor non-elective contributions
- Safe harbor definition of compensation required for employer contributions (effective January 1, 2010)
- Safe harbor employer contributions subject to 2-year cliff vesting

QACA - Safe Harbor Matching Contributions

- Provides for one of the following safe harbor matching contributions:
  - Fixed basic safe harbor matching contribution equal to at least:
    - 100% match on first 1% of safe harbor compensation deferred, plus
    - 50% match on next 5% safe harbor compensation deferred
  - Fixed enhanced matching contribution at least equal to the matching contributions under the basic formula

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QACA - Safe Harbor Matching Contributions (cont'd)

- Matching contribution percent for eligible HCEs at any deferral rate cannot be greater than the matching contribution percent for eligible NHCEs
- Must match catch-up contributions
- May be made on a quarterly, monthly or payroll-by-payroll basis
- "True up" not required
- Payroll period matching contributions made during a plan year quarter must be made to the trust no later than the last day of the following plan year quarter

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QACA - Safe Harbor Non-elective Contribution

- Fixed or tentative non-elective contribution equal to at least 3% of employee's safe harbor compensation for the plan year (unless a new plan or new 401(k) provision)
  - "Fixed" safe harbor non-elective contribution must be made for a plan year
  - "Tentative" safe harbor non-elective contribution may be made and implemented after the beginning of the plan year
- Mid-year implementation available only for tentative safe harbor non-elective contributions; same rules and notice requirements as under IRC 401(k)(12) safe harbor plans

QACA - Additional Employer Contributions and Satisfaction of ACP Test

- Same rules as for traditional safe harbor plans

QACA - Additional Rules

- No 90-day penalty free withdrawal right (unless also an EACA)
- Deemed to be using current year testing for ADP/ACP test if safe harbor is ever discontinued
- Top heavy testing not required
- May require additional notification if a QDIA is used as default investment vehicle
- Initial and annual notice requirements for each eligible employee

QACA - Initial and Annual Notice Content Requirements

- Same general rules as for traditional safe harbor plans
- Additional content rules:
  - Must include the level of elective contributions that will be made on the employee's behalf if the employee does not make an affirmative election
  - Must include the employee's right under the QACA to elect not to have elective contributions made on the employee's behalf
  - Must describe how contributions under the QACA will be invested in the absence of an election by the employee

QACA - Initial and Annual Notice Timing Requirements

- Same general rules as for traditional safe harbor plans
- Additional timing rules:
  - Must be provided early enough that the employee has a reasonable period of time to make an affirmative deferral election
  - However, default election must be effective no later than the earlier of (1) the pay date for the 2nd payroll period that begins on the date notice is provided and (2) the first pay date that occurs at least 30 days after the notice is provided

QACA - Mid-Year Reduction/Suspension of Safe Harbor Matching Contributions

- Same rules as for traditional safe harbor plans

Automatic Enrollment

General Enrollment

- Eligible employees generally participate by either:
  - Completing a salary reduction agreement in order to participate, or
  - Becoming “automatically enrolled”
- Plan design dictates how participation occurs

Automatic Enrollment

- Automatic Enrollment
  - Employee is enrolled at a default deferral rate unless employee opts not to participate or to participate at a different percentage
  - Designed to encourage additional and/or increase participation in the plan and to improve nondiscrimination testing results
  - May be combined with a QDIA into which participants are defaulted if no affirmative investment election is made (requirement eliminated 1/1/08)
  - Available to 401(k), 403(b) or governmental 457(b) plans

Types of Automatic Enrollment

- Three types of automatic enrollment arrangements
  - “Traditional” Automatic Contribution Arrangement (ACA)
  - Eligible Automatic Contribution Arrangement (EACA)
  - Qualified Automatic Contribution Arrangement (QACA)

Purposes of Automatic Enrollment Arrangements

- ACA – To guarantee ERISA preemption of state withholding laws that prohibit involuntary wage withholding, to encourage participation by employees and to make it easier for plans to pass annual nondiscrimination testing
- EACA – To permit penalty-free withdrawal of "accidental" automatic contributions and provide 6-month period to distribute excess contributions/excess aggregate contributions without imposition of 10% excise tax
- QACA – To provide a safe harbor plan design that exempts plans from ADP/ACP testing and top-heavy testing

ACA

- Any group or subset of employees may be covered
- No minimum deferral percentage required (2%-3% common)
- No maximum deferral percentage
- No 90-day withdrawal right (unless also an EACA)
- Auto-escalator provision optional
- May be adopted any time during the plan year

ACA (cont'd)

- ADP/ACP testing required
- No safe harbor definition of compensation required
- Initial and annual notice required for each eligible employee coved by the ACA – no specific time frame but reasonable to adopt rules for EACAs and QACAs

EACA

- First effective for plan years beginning on or after 1/1/08
- Any group or subset of employees may be covered (e.g., employees hired on or after the effective date of the EACA)
- Plan must state whether an employee who makes an affirmative election remains covered under the EACA; if so, the employee must continue to receive the required annual notice before each plan year
- No minimum deferral percentage required
- No maximum deferral percentage
- May provide a 90-day penalty free withdrawal right for automatic contributions/related earnings; forfeiture of associated matching contributions

EACA (cont'd)

- Auto-escalator provision optional
- Must adopt effective as of the first day of a plan year
- ADP/ACP testing required
- No safe harbor definition of compensation required
- 6-month extension (normally 2½ months) to refund ADP/ACP corrections if EACA covers <u>all</u> eligible employees
- Initial and annual notice required for each eligible employee covered by the EACA

EACA - 90-Day Permissible Withdrawal

- Election by participant to withdraw any default elective contributions made under the EACA
- Must be specified in plan document
- Election period must be at least 30 days
- Must be made no later than 90 days after the date of the first default elective contribution
- Not subject to the 10% early distribution penalty tax
- Includible in gross income for the taxable year the distribution is made; any portion consisting of designated Roth contributions is not included
- Reported on Form 1099-R as a corrective distribution

EACA - 90-Day Permissible Withdrawal (cont'd)

- Requires forfeiture of associated matching contributions
- Does not require spousal consent
- May be reduced by fees that generally apply to any other distributions of cash under plan
- Not an eligible rollover distribution
- Disregarded when performing the ADP test and applying the annual deferral limit

QACA

- Already discussed

Initial and Annual Notice Content Requirements

- May be provided in writing or delivered electronically
- Written in a manner calculated to be understood by the average employee
- Level of default elective contributions that will be made if the employee does not make an affirmative election
- Employee's right to make a different deferral election (including 0%)
- How to make deferral elections
- Periods available for making deferral elections

Initial and Annual Notice Content Requirements (cont’d)

- The type and amount of compensation that may be deferred
- How default contributions will be invested
- Vesting and withdrawal provisions for the various types of plan contributions
- How to obtain additional information about the plan
- Generally, requirements cannot be satisfied by cross-referencing the SPD

Initial and Annual Notice Content Requirements – EACAs and QACAs

- Types of employer contributions made under the plan and the eligibility requirements for receiving employer contributions (EACA)
- Availability of permissible withdrawals and the procedures for requesting one (EACA)
- Notice requirements for QACAs already discussed

Initial Notice Timing Requirements

- Initial notice no earlier than 90 days before eligibility date and no later than eligibility date (Note: participants should have time to revoke the election after receipt of the notice)
  - If not possible to provide notice before eligibility, can provide notice prior to first pay date for eligible employee provided employee is able to elect to defer from all types of compensation eligible for deferrals beginning on the eligibility date
  - For plans with immediate eligibility, sponsors could elect to impose a waiting period or to delay a reasonable period after an election so long as the "reasonable period" doesn't cause the default election to take place any later than the earlier of (i) the pay date for the second payroll period beginning after the notice is given, and (ii) the first pay date that occurs at least 30 days after notice is given

Annual Notice Timing Requirements

- Annual notice at least 30 days and no more than 90 days prior to the beginning of the plan year
- $1,100/day penalty for failure to provide annual notice
- Can be combined with annual QDIA notice (model combined notice on IRS website)

Questions?

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