

Advanced Plan Design

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Retirement & Benefits Compliance
Customer Conference

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Agenda

- Cross-tested plans
 - Making a failed rate group test work
 - Omnibus design strategy
- Issues in working with aggregating multiple plans
- Defining compensation

Cross Tested Plans

- WARNING ABOUT AGE
 - Code section 411(b)(2)(A)
 - A defined contribution plan satisfies the requirements of this paragraph if, under the plan, allocations to the employee's account are not ceased, and the rate at which amounts are allocated to the employee's account is not reduced, because of the attainment of any age
 - Age Discrimination in Employment Act

Cross Tested Plans

- WARNING ABOUT AGE
 - Age Weighted Plans
 - 1.401(a)(4)-8(b)(1)(ii) Allocations after testing age.
 - A plan does not fail [cross testing] merely because allocations are made at the same rate for employees who are older than their testing age ... as they are made for employees who are at that age.

Cross Tested Plans

- Making a failed test work
 - All samples assume rate group failure only

Tim Testing Company 401(k) Plan General Test - Rate Group Test 2012-12-31

Non Excludable Employees

<u>Participant Name</u>	<u>Employee Number</u>	<u>HCE</u>	<u>EAR</u>	<u>Grp</u>	<u>NHCE Percent</u>	<u>HCE Percent</u>	<u>Ratio Percent</u>	<u>Result</u>
HCE, Two	2	Yes	9.21%	1	0.00%	50.00%	0.00%	FAIL
NHCE, One	3	No	7.27%	2				
NHCE, Two	4	No	4.11%	2				
NHCE, Three	5	No	4.11%	2				
NHCE, Four	6	No	4.11%	2				
HCE, One	1	Yes	2.12%	2	80.00%	100.00%	80.00%	PASS
NHCE, Six	8	No	0.00%	3				

Midpoint Percentage: 36.75%



Cross Tested Plans

- Who do I increase?

<u>Participant Name</u>	<u>Employee Number</u>	<u>HCE</u>	<u>EAR</u>	<u>Grp</u>	<u>NHCE Percent</u>	<u>HCE Percent</u>	<u>Ratio Percent</u>	<u>Result</u>
HCE, Two	2	Yes	9.21%	1	0.00%	50.00%	0.00%	FAIL
NHCE, One	3	No	7.27%	2				
NHCE, Two	4	No	4.11%	2				
NHCE, Three	5	No	4.11%	2				
NHCE, Four	6	No	4.11%	2				
HCE, One	1	Yes	2.12%	2	80.00%	100.00%	80.00%	PASS
NHCE, Six	8	No	0.00%	3				

Midpoint Percentage: 36.75%

- Each NHCE at or above HCE, Two = 20%
- Adding one NHCE makes ratio % = 40%
 - (20%/50%)
- Increase allocation % of NHCE, One by 26%
 - Or have ftwilliam.com autosolve do it for you



Cross-Tested Plans

- Common Cross Test Design
 - Eligibility
 - One year
 - Age 21
 - Allocation conditions
 - 1,000 hours
 - Last day
 - Two groups
 - HCEs
 - Others

Cross Tested Plans

Census for 2012:

Last Name	First Name	Birth Date	Hire Date	Term Dt	%Own	Hrs	Comp	401(k)	Group
HCE	One	4/5/1950	5/3/2000		50	2000	300000	22500	Group 1
HCE	Two	6/7/1968	5/3/2000		50	2000	300000	17000	Group 1
NHCE	One	6/7/1977	5/3/2000		0	2000	100000	8000	Group 2
NHCE	Two	6/7/1970	5/3/2000		0	2000	40000	8000	Group 2
NHCE	Three	6/7/1970	5/3/2000		0	2000	40000	8000	Group 2
NHCE	Four	6/7/1970	5/3/2000		0	2000	40000	8000	Group 2
NHCE	Five	2/2/1995	5/3/2012		0	1100	5000	0	Group 2
NHCE	Six	2/2/1995	5/3/2000	5/3/2012	0	1100	20000	0	Group 2

Cross Tested Plans

- Who do I increase?

<u>Participant Name</u>	<u>Employee Number</u>	<u>HCE</u>	<u>EAR</u>	<u>Grp</u>	<u>NHCE Percent</u>	<u>HCE Percent</u>	<u>Ratio Percent</u>	<u>Result</u>
HCE, Two	2	Yes	9.21%	1	0.00%	50.00%	0.00%	FAIL
NHCE, One	3	No	7.27%	2				
NHCE, Two	4	No	4.11%	2				
NHCE, Three	5	No	4.11%	2				
NHCE, Four	6	No	4.11%	2				
HCE, One	1	Yes	2.12%	2	80.00%	100.00%	80.00%	PASS
NHCE, Six	8	No	0.00%	3				

Midpoint Percentage: 36.75%

- Each NHCE at or above HCE, Two = 20%
- Adding one NHCE makes ratio % = 40%
 - (20%/50%)
- Increase ALL of Group 2 by 26% - ouch

Cross Tested Plans

- Other issues with defined groups:
 - Never use “HCE”
 - Brings in the owner’s children
 - Don’t use “Owner”
 - Actual or deemed ownership?
 - Be precise

Cross Tested Plans

- Lesson #1 - Don't do specified groups
- Put each person in own group.
 - It does NOT mean each participant gets a different allocation
 - In this example we started out with two different allocation % and just created a third to help pass the test
- Cost of increasing NHCE One is \$1,300
 - ($\$5,000 * 1.26$)

Cross Tested Plans

- Who do I increase?

<u>Participant Name</u>	<u>Employee Number</u>	<u>HCE</u>	<u>EAR</u>	<u>Grp</u>	<u>NHCE Percent</u>	<u>HCE Percent</u>	<u>Ratio Percent</u>	<u>Result</u>
HCE, Two	2	Yes	9.21%	1	0.00%	50.00%	0.00%	FAIL
NHCE, One	3	No	7.27%	2				
NHCE, Two	4	No	4.11%	2				
NHCE, Three	5	No	4.11%	2				
NHCE, Four	6	No	4.11%	2				
HCE, One	1	Yes	2.12%	2	80.00%	100.00%	80.00%	PASS
NHCE, Six	8	No	0.00%	3				

Midpoint Percentage: 36.75%

- One NHCE needed @ 9.21%
- What about NHCE, Six?
- Can't use because not eligible – but still in the test

Cross Tested Plans

- Lesson #2 - Get rid of allocation conditions

Non Excludable Employees

<u>Participant Name</u>	<u>EmployeeNumber</u>	<u>HCE</u>	<u>EAR</u>	<u>Grp</u>	<u>NHCE Percent</u>	<u>HCE Percent</u>	<u>Ratio Percent</u>	<u>Result</u>
NHCE, Six	8	No	31.57%	1				
HCE, Two	2	Yes	9.21%	1	20.00%	50.00%	40.00%	PASS
NHCE, One	3	No	7.27%	2				
NHCE, Two	4	No	4.11%	2				
NHCE, Three	5	No	4.11%	2				
NHCE, Four	6	No	4.11%	2				
HCE, One	1	Yes	2.12%	2	100.00%	100.00%	100.00%	PASS

- Added cost of NHCE, Six = \$1,000
– \$20,000 * 5%

Cross Tested Plans

- Get rid of allocation conditions
 - It ***doesn't*** mean terminated or low hour Participants get a allocation
 - It ***does*** mean you can choose to give an allocation to a non-excludable part-time employee rather than a full time employee

Cross Tested Plans

- Lesson #3 - Get rid of eligibility conditions

Non Excludable Employees

<u>Participant Name</u>	<u>Employee Number</u>	<u>HCE</u>	<u>EAR</u>	<u>Grp</u>	<u>NHCE Percent</u>	<u>HCE Percent</u>	<u>Ratio Percent</u>	<u>Result</u>
NHCE, Five	7	No	31.57%	1				
HCE, Two	2	Yes	9.21%	1	16.67%	50.00%	33.34%	FAIL
NHCE, One	3	No	7.27%	2				
NHCE, Two	4	No	4.11%	2				
NHCE, Three	5	No	4.11%	2				
NHCE, Four	6	No	4.11%	2				
HCE, One	1	Yes	2.12%	2	83.33%	100.00%	83.33%	PASS
NHCE, Six	8	No	0.00%	3				

- Added cost of NHCE, Five = \$250 ($\$5,000 * 5\%$)
- May not work with high turnover because **all** employees will be non-excludable
 - If 5 NHCEs each NHCE = 20%
 - If 50 NHCEs each NHCE = 2%
 - Way to counter this issue??



Cross Tested Plans

- Get rid of eligibility conditions
 - It ***doesn't*** mean all newly-hired employees get a allocation
 - It ***does*** mean you can choose to give an allocation to a newly-hired employee rather than a full time, longer service employee
 - Code section 410(a) still applies
 - Can't use this technique as a way to impose an impermissible service or age condition

Aggregating Plans

- Failed ADP/ACP
- Failed cross test
- Failed coverage test
- Let's aggregate!

Aggregating Plans

- 1.410(b)-7(d)
 - Can't aggregate plans that are mandatorily disaggregated
 - E.g., union with non-union
 - Plans must be treated as a single plan for all purposes under sections 401(a)(4) and 410(b)
 - ADP
 - Cross test
 - A plan may not be combined with two or more plans to form more than one single plan
 - Must have same plan year



Aggregating Plans

- 1.401(k)-1(b)(4)(iii)
 - An employer may not aggregate plans that apply inconsistent testing methods
 - Current year testing/prior year testing method
 - May not aggregate a plan using the ADP safe harbor provisions of section 401(k)(12) and another plan that is using the ADP test of section 401(k)(3)
 - Not an exclusive list

Aggregating Plans

- Non – Excludables
 - Lowest eligibility rule
 - May test as two plans if aggregating
- HCEs
 - No issue – must use uniform definition
- Average benefits test
 - No effect as all benefits are aggregated
- Only plans of related employers (414)



Aggregating Plans

- ADP/ACP
 - Just add deferrals/match
 - Can use any compensation
 - Hopefully plan does not define
- Non Electives
 - Meet rules for multiple formulas or X-test
- Benefits, Rights and Features
 - Loans
 - Matching Formulas



Compensation

- All 3 base (safe harbor) definitions are used for 415 and 414(s)/non-discrimination purposes
 - W-2
 - Withholding
 - 415 safe harbor

Compensation

- W-2

For Official Use Only ▶ OMB No. 1545-0008	
1 Wages, tips, other compensation	2 Federal income tax
3 Social security wages	4 Social security tax
5 Medicare wages and tips	6 Medicare tax withheld
7 Social security tips	8 Allocated tips

- Withholding

- Presumably available from payroll provider

Compensation

- 415 safe harbor
 - Wages, salaries, commission, bonuses
 - Includes tips under \$20 (W-2 and withholding exclude)
 - Includes pre-tax elections
 - Employer contributions to a plan deferred compensation to the extent not includible in income
 - Distributions from a plan of deferred compensation (whether or not qualified) - regardless of whether such amounts are includible in the gross income of the employee when distributed.
 - Amounts realized from the sale, exchange, or other disposition of stock acquired under a statutory stock option
 - Amounts realized from the exercise of a non-statutory stock option
 - When restricted stock or other property held by an employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture
 - Other amounts that receive special tax benefits:
 - premiums for group-term life insurance (to the extent not includible in gross income and not 125 salary reductions).
 - Other similar items
- Clients running a small business have no problem with figuring that out

Compensation

- Which to use
 - W-2
 - W-2 - excluding moving expense reimbursement
- Can't resist gettin' fancy but definition compensation for allocation fails
 - 1.401(a)(4)-11(g)
 - Cross test



Compensation

- Post Severance and Year-End
 - Post Severance compensation is the **TYPE** of compensation.
 - Post Year-End compensation is concerned with **WHEN** the compensation is counted in the plan.
 - NOTE: Severance pay is never included in the definition of compensation
 - For more examples/details:

- <http://www.ftwilliam.com/articles/415Comp2008081>



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Compensation

- Recommendations
 - Do employers report comp when actually paid? If so, do not use Post Year-End Comp
 - Optional Post Severance Comp – unknown how this impacts 414(s), assume it may be simpler for employers to include

Continuing Education

Please – before you leave:

1. Sign in

- Verify your attendance
- Check the box if you want your attendance reported to IRS (for ERPA reporting and those with a PTIN only)

2. Pick up your certificate of attendance

- Certificates will not be emailed after the conference



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