Plan Sponsor Need-to-Know Guide

This guide is for your reference. Contact your relationship manager or retirement plan specialist with any questions.

ADP and ACP Tests

What is the ADP test?

The IRS limits how much HCEs can contribute relative to the contributions of NHCEs. The Actual Deferral Percentage (ADP) test ensures that the ADP for HCEs, including both pre-tax and Roth deferrals, does not exceed the ADP of NHCEs by more than a certain margin.

To calculate the ADP, each participant's deferral rate must first be figured by dividing deferrals by compensation. The Plan then calculates an average for each group – HCEs and non HCEs. The maximum HCE average is based on the actual NHCE average. If the NHCE average is:

- Less than 2%, the maximum HCE average is the NHCE rate multiplied by 2;
- Between 2% and 8%, the maximum HCE average is the NHCE rate plus 2 percentage points; or
- More than 8%, the maximum HCE average is the NHCE rate multiplied by 1.25.

What is the ACP test?

This test is very similar to the ADP test except it reviews company matching contributions and traditional after-tax contributions (not Roth) instead of 401(k) deferrals.

For more information on the ADP and ACP tests, please visit the Knowledge Center.

How do I read the test results?

There are several options for performing the tests.

- **All participants.** This option includes every participant (HCE and NHCE) who was eligible for the Plan at any time during the year.
- **Non-excludable participants.** If a Plan's eligibility terms are more generous than the legal maximums (i.e., completion of one year of service and attainment of age 21), any NHCEs who enter the plan under these provisions may be excluded from certain nondiscrimination tests. This option often provides more favorable test results.

Since this is an operational election, you can simply rely on the more favorable results.

Another option is to base this year's results on the NHCE average from either the current year or the prior year. Since the Plan document must specify which of these two options is selected, the chart indicates which method was used in performing the test. In addition, the previous year test results have been included for comparison.

How can I correct a failed ACP test?

If the plan uses the current year testing method, you have three options:

- Refunds to HCEs,
- Additional contributions (called Qualified Nonelective Contributions or QNECs) to the NHCEs, or
- A combination of refunds and QNECs.

For plans that use the prior year testing method, corrective refunds to HCEs are the only option.

How do refunds work?

The Plan can issue refunds to HCEs for the excess amounts. Amounts related to the ACP test are called excess aggregate contributions, and all or a portion of the excess amounts may need to be forfeited rather than refunded depending on the vested percentage of the HCE(s) in question.

These amounts must be adjusted for investment gains or losses and are taxable to the individuals in the year of distribution. The custodian will issue Forms 1099-R for the refunds in January of the following year.

If refunds are not postmarked by within 2 ½ months following the plan year end, you are required to pay an excise tax to the IRS equal to 10% of the principal amount of the refunds. Recordkeepers may require up to five business days to complete the refund process, so please build in that additional time when requesting to issue refunds.

How to read the correction information?

We provide the corrective refunds with applicable earnings below. If your Plan uses the current year testing method, we also include the total corrective QNEC amount. If you would like to correct using a combination of the refund and QNEC, please contact us.

Annual Additions Limit

What is the annual additions limit?

This is the maximum amount of total contributions a participant can receive to their account in a plan year. This includes all company contributions and employee deferrals but excludes investment earnings in a Plan year. Any amounts exceeding these limits must be refunded or forfeited.

Additional information regarding plan year specific limits can be found on the Knowledge Center.

Attributed Ownership

What is attributed ownership?

IRS rules require thatownership be attributed to certain related parties when determining related company status. Specifically, an individual's ownership may need to be attributed to family members, and in some cases, a company's ownership of another entity must be attributed to its shareholders. Additional information regarding these rules is available on the Knowledge Center.

Business Transactions and Retirement Plans

What is a stock sale?

In a stock sale, the buyer acquires the "ownership" of thetarget company. That means the buyer assumes ownership of the company's equity, including any company-sponsored retirement plans.

What is an asset sale?

In an asset sale, the buyer purchases some or allassets of the business, but not the company itself. This may include physical property such as equipment, or less tangible items such as intellectual property or client lists. The seller continues to own the company, only with fewer or no assets after the sale.

What happens to the employees of stock sales and asset sales?

It depends. In an asset sale, seller's employees who go to work for the buyer are treated as terminated from employment with the seller and newly hired with the buyer. The buyer may givethose employees past service credit in the retirement plan, in which case a plan amendment is generally required. In a stock sale, the buyer is generally required to recognize service with the seller for purposes of its benefit plans.

Who is responsible for the seller's plan?

In an asset sale, the seller generally retains responsibility to either continue or terminate its retirement plan.

In a stock sale, there are several options to be worked out by the parties, including:

- Terminating the seller's plan *prior to* the date the sale closes
- Merging the seller's plan into the buyer's Plan
- Maintaining the seller's plan alongside the buyer's Plan

If both plans are maintained, they must be combined for annual nondiscrimination testing and contribution limits.

Transition timeline.

The plans may continue to operate independently through the end of the year following the year of the business transaction, unless the plan is amended in any substantive way. Then, the transition period ends immediately and the plans must be tested together.

The rules around business transactions and retirement plans are complex. You can find more information in the Knowledge Center.

Coverage Test and General Non-Discrimination Test

What is the coverage test?

The coverage test is a foundational nondiscrimination test that ensures the Plan benefits a sufficient number of non-HCEs relative to the number of HCEs. The test is performed separately for each contribution type and if a plan feature is not uniformly available to all participants, it must be tested individually as well.

There are two versions of the coverage test: the ratio percentage test and the average benefits test. Most Plans will pass the ratio percentage test. If that test fails, the average benefits test may still pass.

- **Ratio percentage test.** This test counts the number of participants receiving benefits under the plan, not necessarily the amount of those benefits. Generally, the Plan passes the ratio percentage test if it benefits at least 70% of the non-HCEs. For a more detailed description of the ratio percentage test, visit the Knowledge Center.
- **Average benefits percentage test.** This test compares the benefits received by HCEs to those received by NHCEs, expressed as a percentage of compensation. It is typically required when a plan provides different levels of benefits to different groups of participants. The Plan passes when the average benefits provided to NHCEs is at least 70% of the average benefits provided to HCEs.

What if the plan fails the coverage test?

Coverage failures are uncommon, but when they do occur, it tends to be in smaller Plans that require participants to be employed on the last day of the year to receive a profit sharing contribution. Failures may also arise in situations where there are related companies and employees in one of those companies are excluded from participating. The correction depends on the facts and circumstances, but usually involves either increasing benefits to participating non-HCEs or extending benefits to non-HCEs who were previously excluded.

Compensation Ratio Test

What is the compensation ratio test?

When calculating benefits for a Plan that excludes certain types of pay, such as bonuses, commissions or overtime, the definition of "compensation" must not discriminate in favor of HCEs. A definition of compensation is considered nondiscriminatory if the average compensation ratio (included compensation/total compensation) for the HCEs does not exceed that of the NHCEs by more than a *de minimus* amount. Although "de minimus" is not defined, the rule of thumb based on anecdotal evidence and actual IRS enforcementsuggests a spread of three percentage points or less is acceptable. We have provided a detailed description of the compensation ratio test in the Knowledge Center.

What if the compensation ratio test fails?

Corrections can be complicated and typically involve retroactive plan amendments that add back previously excluded compensation, requiring benefits to be recalculated.

Contribution Limits

What is the maximum amount a participant can defer in a calendar year?

The maximum amount a participant can defer for the current calendar year calendar year is limited by the IRS. Participants aged 50 or older may defer an additional amounts in the form of catch-up contributions. Although payroll providers typically monitor these limits, an employee eligible to participate in more than one plan may be below the limit in each individual plan but over the combined limit. Employees who participate in multiple, unrelated plans are responsible to monitor the overall limit themselves. If a participant exceeds this limitation, the refund is due by April 15 following the calendar year end.

If a participant exceeds this limitation solely in your Plan, the excess deferral must be refunded regardless of the date to avoid negative tax consequences for the company and the Plan. However, any refunds made after April 15 are subject to double taxation for the participant – first in the year of the excess and second in the year of distribution.

Additional information regarding plan year specific limits can be found on the Knowledge Center.

Eligibility

How is eligibility determined for elective deferrals?

Regulations generally require that 403(b) plans allow for immediate eligibility for salary deferrals. In addition, 403(b) plans are not permitted to exclude any classifications of employees from making deferrals. There is an exception to that rule that allows a Plan to exclude the following four classes of employees:

- Employees who are eligible to participate in another elective deferral plan or 457 plan sponsored by the same employer,
- Nonresident aliens,
- Students, and
- Employees who are scheduled to work fewer than 20 hours per week (must be included if actual hours for a given year exceed 1,000)

If an organization improperly permits one employee in an excludable group to participate, then all similarly situated employees must be permitted to participate in the Plan.

How is eligibility determined for other contributions?

The Plan document must specify the employee eligibility requirements. Provisions typically include some combination of minimum age and service conditions.

The most restrictive option allowed in a 401(k) plan is attainment of age 21 and completion of 1 year of service (12 months and 1,000 hours of service). In certain limited circumstances, a plan can require up to 2 years of service to be eligible for the nonelective contribution component. Plans can be more lenient but not more restrictive.

An age requirement is fairly straightforward, but there are two general options for counting service:

- **Elapsed time.** This option uses an employee's hire date and the prescribed eligibility period, e.g. 6 months. If the employee is employed on the last day of the eligibility period, e.g. 6 months after the initial date of hire, he or she has met the service requirement, regardless of the number of actual hours worked.
- **Actual hours.** This method requires an employee to complete a certain number of work hours during the eligibility period to become eligible. The employee must meet both the service length and hours requirements, e.g. 12 months and 1,000 hours, to be considered eligible.

For additional information about counting service, visit the Knowledge Center.

What is the entry date?

This is the date on which an employee who has met the eligibility requirements actually becomes a plan participant. The Plan document must specify entry dates such as the first of the month, quarter or semi-annual period on or after the date the employee satisfies the age and service conditions.

Are rehired employees required to satisfy the eligibility requirements again after they are rehired?

In most situations, rehired employees must be given credit for all service with the company, including service before they terminated and rehired. If an employee was a previous participant, he or she would generally be eligible immediately on the date of rehire. If the employee had not satisfied the eligibility requirements prior to terminating employment, he or she would have to complete those requirements upon rehire, but the service requirement would be measured from the initial hire date. Visit the Knowledge Center for additional information.

Is it possible to exclude certain classifications of employees from ever becoming eligible for the plan ?

Yes, it is possible to exclude groups of employees from any employer matching or nonelective contributions, within certain parameters. Generally, the plan must cover at least 70% of the non-highly compensated employees to satisfy the minimum coverage test. Beyond that, any exclusion must be written into the Plan document and must clearly describe the employees to be excluded based on a valid business classification such as job title, duties, or location and not the amount of service an employee performs. For example, you may not exclude an employee based on part-time, temporary, or seasonal status. Visit the Knowledge Center for additional information.

Elective Deferral Deposit Timing

When must plan sponsors deposit employee deferrals and loan repayments?

Department of Labor regulations require employee deferrals and loan payments to be deposited no later than seven (7) business days after each pay date. Plans with more than 100 eligible participants are generally expected to make deposits even more quickly (usually within one to three business days). Deposits made beyond these deadlines are treated as impermissible loans of plan assets to the plan sponsor.

Late deposits must be reported to the Department of Labor on the financial schedule filed with Form 5500 and are required to be reported again each year until fully corrected. To correct these delinquencies, lost earnings must be calculated and deposited to the accounts of the affected participants. In addition, the plan sponsor must pay an

excise tax equal to 15% of the "amount involved" (generally, the lost earnings not the late deferrals themselves). The excise tax is paid by filing Form 5330.

Visit the Knowledge Center for additional information.

Employee Deferral Elections

What is the entry date?

This is the date on which an eligible employee becomes a plan participant. The Plan document must specify entry dates such as the first of the month, quarter, or semi-annual period on or after the date the employee satisfies the eligibility conditions .

Are rehired employees required to satisfy the eligibility requirements again after they are rehired?

In most cases, rehired employees must receive credit for all prior service with the company, including time worked before their exit. If the employee was a plan participant before leaving, they are generally eligible to rejoin the plan immediately upon rehire. However, if they had not met the plan's eligibility requirements before terminating, they will need to satisfy those requirements after rehire, though service would be measured from their original hire date. Additional information is available on the Knowledge Center.

Is it possible to exclude certain classifications of employees from ever becoming eligible for the plan ?

Yes, but only within specific limits. To meet the minimum coverage test, the plan must cover at least 70% of non-HCEs. Any exclusions must be clearly defined in the Plan document and based on a valid business classification such as job title, duties, or location. Exclusions based on the amount of service performed, such as part-time, temporary, or seasonal, are generally not allowed.

Visit the Knowledge Center for more information .

When must employees be permitted to defer?

Employees must be given the opportunity to defer as soon as they become eligible for the Plan.
This means both the deferral feature and the process for making an election must be clearly communicated to each eligible employee prior to their entry date and with enough time to allow them to make an informed decision. If the Plan was not offered to eligible participants in a timely manner, this is considered a missed deferral opportunity (MDO). Please contact your dedicated relationship manager or retirement plan specialist immediately to address the issue.

How is an MDO corrected?

The correction depends on a number of factors including how much time has passed between the initial missed deferral and when the correct withholding is implemented. Based on the Plan's specific design and the timing of discovery, the plan sponsor must make a Qualified Non-Elective Contribution (QNEC) ranging from 0% to 50% of the amount the affected participant(s) would have deferred. Please see the chart on our website to see how the QNEC is determined. The plan sponsor must also makeup for any missed company matching contributions to ensure the participants are made whole. For an in-depth review of MDOs and the correction process, visit the Knowledge Center.

For plans with automatic enrollment/required annual escalators, what is the required timing ?

For newly eligible employees who do not opt out, you must begin withholding their automatic deferrals from the first paycheck issued after their plan entry date. If the plan includes automatic deferral escalations, the Plan document specifies when they occur. Most plans apply the increase at the start of each plan year, beginning with the year *after* initial enrollment. For example, if a participant is automatically enrolled at any time during 2025, the first escalation would generally occur as of January 1, 2027, and each January 1 thereafter.

Fidelity Bond

What is a fidelity bond?

A fidelity bond is a type of insurance that protects the Plan from losses caused by fraud, misuse, or misappropriation by people handling Plan assets. A fidelity bond is required for each person who handles Plan assets. An individual is considered to "handle" assets if their responsibilities create a risk of loss due to potential fraud or dishonesty.

The minimum required coverage is the greater of $1,000 or 10% of Plan assets (as of the first day of the plan year) up to a maximum bond amount of $500,000. For Plans holding company stock or certain illiquid assets, a larger bond may be required. The amount of the bond for the year must be reported on Form 5500.

Please visit the Knowledge Center for additional information.

Form 5500

When is the deadline to electronically file the Form 5500?

The Form 5500 is due seven months after the end of your plan year. You may request an automatic 2½ month extension by filing Form 5558 on or before the original due date.

Because our team can see your real-time filing status in our Form 5500 system, we will automatically file an extension on your behalf if your Form 5500 has not been electronically submitted within 10 business days of the original deadline. This helps ensure your plan remains in good standing while final items are being completed.

How do I electronically file the Form 5500?

You must e-file your form using the Department of Labor's EFAST2 system, which you can access using the Portal.

The Department of Labor requires you to sign the Form 5500 under "penalties of perjury." As such, it is imperative that you verify the accuracy of all answers and financial information on the form and related schedules. If you prefer to review the forms line-by-line prior to signing and submitting, please contact your dedicated relationship manager to schedule a call.

What is EFAST2?

EFAST2 is the U.S. Department of Labor's electronic filing system used to submit all Forms 5500. While our Portal connects directly to EFAST2 to prepare and transmit your filing, you must have your own EFAST2 signing credentials in order to electronically sign and submit your Form 5500.

How to create your EFAST2 signing credentials

If you have not already registered, visit secure.login.gov and click "Create an account." During the registration process, select "Filing Signer." The process typically takes 5–10 minutes. Once completed, you will enter your User ID into our system so we can submit your Form 5500 on your behalf.

Forgot your credentials?

If you cannot remember your User ID or password, go to secure.login.gov and click "Forgot your password?" using the email address associated with your account.

For additional help, you may also contact the EFAST Help Desk at 844-875-6446.

What is the Summary Annual Report and when must it be distributed?

The Summary Annual Report (SAR) must be delivered to all eligible participants. The deadline for distributing the SAR is two months after the deadline to file Form 5500. If we were able to complete the Form 5550 at the time of delivery, the SAR is attached with this report. Otherwise, the SAR will be attached with the Form 5500 upon completion.

What accounting methodology is used when preparing the Form 5500?

For small plan filers, the forms are prepared using cash basis accounting with all entries derived from the recordkeeping system. To request preparation of accrual-based forms at our standard hourly rates, please contact your relationship manager or retirement plan specialist.

Form 8955-SSA

What is the Form 8955-SSA?

Form 8955-SSA reports former employees who still have a balance in the Plan, as well as participants who were previously reported but have since received a full distribution. Specifically, it includes:

- Participants who terminated during the prior year and still have a balance as of the end of the current plan year
- Participants who were listed on earlier filings but have now been fully paid out

For more information about Form 8955-SSA, please visit the Knowledge Center.

At this time, plan sponsors cannot electronically file Form 8955-SSA themselves. Our team will submit this filing electronically on your behalf at no additional cost. While the IRS does not provide plan-specific filing confirmations for this form, we retain a record of the successful transmission for your plan.

Forfeiture Account

How must forfeitures be handled?

When a partially vested participant receives a distribution of the vested portion of his/her account, the non-vested portion is forfeited. The Plan allows these forfeitures to be used to:

- Pay allowable Plan operational expenses;
- Offset employer contributions; or
- Re-allocate to eligible participants.

For more information regarding this requirement, visit the Knowledge Center.

Do I have to allocate forfeitures if they are a small amount?

Yes. The rules do not provide any sort of materiality threshold, so it is up to each plan sponsor to determine how and when to use these amounts within the parameters of the Plan document. For example, although you might normally allocate forfeitures as additional contributions, it might be less burdensome to apply small balances below a certain level such as $25 to offset fees.

Highly Compensated Employees

Who is considered a Highly Compensated Employee (HCE)?

An HCE for the plan year is anyparticipant who:

- Owned *more than* 5% of the company (or a related company) at any time during the current year or the previous year, or
- Had actual compensation from the company / a related company *of more than the* HCE determination compensation limit in the previous year

For purposes of the ownership test, the ownership of certain family members may count and could render an individual an HCE even without any direct ownership.

Plans with a significant number of employees earning more than the HCE determination compensation limit per year can make a special election to limit the number of HCEs based on compensation to no more than 20% of the overall number of participants.

There are other nuances, exceptions, and complexities that cancomplicate the HCE determination. We have included a more detailed description in the Knowledge Center.

Inactive Participants

Why is tracking inactive participants important?

There are several important reasons to be aware of former employees with remaining balances in the Plan.

- Most Plans include a provision requiring forced distributions to former employees with vested balances below a certain threshold – usually $1,000 or $5,000 (increased to $7,000as of January 1, 2024).
- Recordkeeping and other Plan-related fees are often based on the number of participants with account balances.
- Many formal Plan disclosures must continue to be provided to former employees until they take a full distribution from the Plan.
- Plans with more than 100 participants with balances on the first day of the year are generally required to hire a CPA to audit the Plan's financial statements as they are considered large Plan filer. That count includes inactive participants with remaining balances. Please note if the Plan is not currently a large Plan filer, the new threshold to be considered a large Plan filer is 120 participants on the first day of the plan year.
- For participants who terminated five or more years ago, it is necessary to track and forfeit non-vested balances. If any participants fall into this category, please contact your dedicated relationship manager or retirement plan specialist immediately.
- The Plan is required to submit Form 8955-SSA to the IRS to report terminated participants who maintain balances for more than a year.

Can I force out inactive participants without their consent?

The Plan can force out any terminated participants with vested balances under $200 without prior notification (and no withholding). If the account balance is less than the applicable distribution fee, it is common practice for these amounts to be paid to the recordkeeper as an account-processing fee and the accounts to be closed.

To initiate these transactions, simply instruct your recordkeeper to process the payments and be sure to notify them that these are force-outs with no distribution forms.

What is the Plan document force-out provision?

Your Plan document must indicate whether you have elected a force-out (or mandatory distribution) provision. Each Plan can set its own threshold within certain parameters. The regulations allow it to be set as high as $7,000 or as low as $0. Plans that set the threshold higher than $1,000 must process the cash-outs in one of two ways:*

- **Vested balances below $1,000.** Cash-outs are made by check with the appropriate taxes withheld.
- **Vested balances between $1,000 - $7,000.** Cash-outs must be made through direct rollover into an IRA established on behalf of the former employee.

** Note that some Plans set this threshold for cash payout vs. rollover at a lower level (potentially as low as $200 or even $1) to facilitate rollovers over smaller balances when a former participant is missing or non-responsive.*

If the Plan document allows for these force-outs, terminated participants must first be provided with distribution packages as soon as administratively possible following their dates of termination. If they do not make distribution elections within 30 days of being provided that information, the force-out must be processed. This process should be completed as soon as possible but no later than 180 days after the original distribution package was sent.

If the Plan document does not allow the force-out, the terminated participant must complete a distribution form.

What if the participant has a zero vested balance?

For any terminated participant with a vested balance of $0, please notify your recordkeeper to transfer the non-vested balance to the Plan's forfeiture account immediately.

What if the participant listed is only partially vested? Can we forfeit the non-vested portion?

Non-vested balances should be forfeited concurrently with the distribution of the vested portion. If no distribution is paid, the Plan can forfeit non-vested balances once a participant incurs five one-year breaks in service (usually six years after employment termination).

Key Employees

Who is a key employee?

Key employees are generally the owners and officers of the company. Specifically, a key employee is anyone who met any of the following criteria at any time during the plan year:

- Owned *more than* 5% of the plan sponsor or a related employer;
- Owned *more than* 1% of the plan sponsor or a related employer **and** had annual compensation *exceeding* key employee determination compensation limit or
- Had annual compensation of *at least* key employee determination compensation limit and was an officer of the plan sponsor or related company.*

* An individual who simply has an officer title without the corresponding job duties is not considered an officer for this purpose. Also, no more than 10% of the company's employees can be considered officers for key employee purposes.

As with the HCE determination, attributed family ownership is considered when determining which employees are key employees.

For more information on key employees, visit the Knowledge Center.

Large Plan Filer Status

What triggers large-plan filer status?

A Plan that has 100 or more participants with account balances on the first day of the year is required to file as a large plan filer. However, there is an exception: Under the "80-120" rule, if the number of participants on the first day of the plan year is between 80 and 120, plans (other than startups) may complete Form 5500 using the same status that was used for the previous return/report, i.e., small plan or large plan.

If the participant count does not exceed 120 as of the first day of the next plan year, the Plan may continue to file as a small plan. Otherwise, the Plan must file as a large plan and engage an Independent Qualified Public Accountant to audit the Plan's financial statements.

What is the definition of a participant used to determine the count?

The answer changes depending on the year in question. For plan years *beginning before January 1, 2023*, the participant count includes:

- All employees eligible for the plan (even if they don't have an account balance)
- All former employees with remaining Plan balances
- Beneficiaries and alternate payees with Plan balances

For plan years *beginning on or after January 1, 2023*, the count is based solely on those with account balances, including terminated participants, beneficiaries and alternate payees.

Is it possible to transition back to a small plan filer?

Yes. A Plan's filing status is determined each year, so once a large plan filer drops to fewer than 100 participants on the first day of a year, that Plan becomes a small plan filer.

Do inactive participants count?

If they have a balance on the first day of the plan year, they count. We provide a count of inactive participants (former employees) in this report (including a list of those who can be forced out with vested account balances less than $5,000, (Plan document permitting). It is recommended that efforts be made to pay out all terminated participant accounts as soon as possible.

Visit the Knowledge Center for information about filing status.

Matching Contributions

When must the company matching contribution be deposited?

To deduct the contribution for the current year, you must complete the deposit no later than the due date of the company tax return, including extensions. Additional information on due dates is available on the Knowledge Center.

We pre-funded the match and have overfunded or underfunded a few participants. What is the next step?

These participants are identified in the variance column on the Contribution Report and in a separate chart below.

For participants who were overfunded, the excess must be adjusted for investment gains or losses, transferred to the Plan's suspense account, and reallocated to the other participants.

If a participant is underfunded, the action step depends on the period during which the match must be calculated, as follows:

- **Annually.** The additional contribution must be funded as soon as possible.
- **All others.** If the Plan requires the match be calculated on any other periodic basis such as quarterly, monthly or each pay period, an additional contribution can only be made if the Plan document allows for a "true-up." If you choose to make the optional true-up contribution, it must be made to all participants. If your Plan does not include a true-up provision, please review all larger variances, especially for participants who have deferred all year, to ensure correct matching contributions have been made.

Maximum Deductions Limit

What is the maximum deduction limit?

The maximum employer contribution that can be deducted for tax purposes for the year is limited to 25% of compensation of all employees eligible for the plan. Employee salary deferrals do not count against this limit and are always fully deductible by the company.

What happens if contributions exceed this limit?

Any company contributions exceeding the deduction limit are subject to a 10% excise tax payable to the IRS. They also carry forward to reduce the maximum deduction limit in the subsequent year.

For company contributions to be deductible, they must be deposited into the Plan no later than the due date of the company tax return (with extensions).

Partial Plan Termination

What is a partial Plan termination?

When plan turnover exceeds 20%, the IRS presumes a partial plan termination has occurred and requires full vesting of the accounts of the affected participants. However, the final determination must be made based on all relevant facts and circumstances, including:

- Nature of the turnover, e.g. voluntary resignation, layoff, dismissal for cause
- Normal turnover for the industry
- Normal turnover for the company
- Whether the employees who are no longer covered by the Plan are covered by a replacement plan

The turnover percentage may need to be calculated across multiple years if it's part of a series of reductions tied to the same corporate or economic event. Turnover includes not only employees who terminated employment, but also those still employed who lost plan eligibility due to an amendment, reclassification, or similar change. The turnover percentage is calculated using this formula:

$$\frac{\text{Total Employees Who Lost Plan Participation During the Period}}{\text{Total Participants at the Beginning of the Period + Employees Who Became Participants During the Period}}$$

What happens if the Plan has experienced a partial plan termination?

If the Plan experienced a partial termination, all affected participants must become fully vested in their account balances. If any partially vested participants took distributions before the partial termination, any previously forfeited amounts must be reinstated, vested, and paid to those former participants.

Additional information is available in IRS Revenue Ruling 2007-43 and Treasury Regulation Section 1.411(d)-2(b). Please contact your dedicated relationship manager, retirement plan specialist, or your attorney to discuss any questions.

Participant Loan Defaults and Deemed Distributions

When is a participant loan in default?

A participant loan is in default as soon as a regularly scheduled payment is missed. If a defaulted loan is not cured by the end of the next calendar quarter following the one in which the default occurred, the participant is "deemed" to have taken a taxable distribution equal to the outstanding loan balance.

Participants incurring so-called deemed distributions during the plan year should have received a Form 1099-R from the trustee/custodian in January of the following year and must include the amount reported as taxable income on their individual tax return.

Are there any exceptions to a loan default?

Loan defaults and deemed distributions occur automatically under IRS regulations based on the passage of time regardless of the reason for the missed payments, e.g. payroll error, termination of employment. However, in limited circumstances, such as qualified military leave, participants may be temporarily permitted to suspend loan payments without triggering defaults or deemed distributions.

How is a loan defaulted?

While loan defaults and deemed distributions occur automatically under IRS rules when payments are missed for a certain period, only the Plan Administrator - as defined in the Plan document - can authorize the processing of related transactions. This means that authorization to process a deemed distribution must come directly from you, the Plan Administrator, not from an auditor, advisor, or third-party administrator.

Plan Eligibility

How is eligibility determined?

The Plan document must specify the conditions of employee eligibility, which usually include some combination of minimum age and service. The most restrictive option allowed in a 401(k) plan is attainment of age 21 and completion of 1 year of service (12 months and 1,000 hours of service). In certain limited circumstances, a plan can require up to 2 years of service to be eligible for the profit sharing component. Plans can be more lenient but not more restrictive.

An age requirement is straightforward. There are two options for counting service:

- **Elapsed time.** This option considers the employee's hire date and the prescribed eligibility period, e.g. six months. As long as the employee is employed on the last day of the eligibility period, they've met the service requirement.
- **Actual hours.** This method requires an employee complete a designated number of hours during the eligibility period in order to be eligible. The employee must meet both the service length and hours requirements, e.g. 12 months and 1,000 hours, to participate.

For additional information about counting service, please visit the Knowledge Center.

Profit Sharing

How do the most commonly used profit sharing allocation methods work?

There are three popular profit sharing allocation methods:

- **Salary proportional (a.k.a. Pro-rata).** Provides a uniform percentage of compensation to each eligible participant.
- **Integrated (a.k.a. Permitted Disparity.** If compensation exceeds a certain level, usually the social security wage base, it is considered excess compensation.
- **New comparability (a.k.a. cross-tested).** This method allows the plan sponsor to classify participants for purposes of allocating profit sharing contributions. If nondiscrimination requirements are met, the company can allocate a greater share of the total contribution to specific target groups such as key employees or owners. The minimum amount allocated to each NHCE must be equal to the lesser of 5% of pay or 1/3 the highest percentage allocated to any HCE. The Plan document must specify which method will be used. Additional information about these allocations methods, including a discussion of when and how to change methods, is available on the Knowledge Center.

What flexibility do we have in allocating the profit sharing contribution to participants?

The Plan document will dictate. It is not uncommon for plans to require that participants work at least 1,000 hours during the year and remain employed on the last day of the year in order to share in the allocation. However, adding these requirements can trigger additional nondiscrimination testing. Plans that use the new comparability allocation method can often impose these types of requirements operationally.

When must the contribution be deposited?

To deduct the contribution for the current year, you must complete the deposit no later than the due date of the company tax return, including extensions. Additional information on due dates is available on the Knowledge Center.

Can I pre-fund the profit sharing contribution during the year?

Yes, but with important restrictions to your Plan's eligibility requirements.

For Plans without an hours-worked or last-day requirement, you may pre-fund and allocate contributions during the year as participants become eligible. However, to reduce the risk of overfunding, we generally suggest you do not pre-fund any more than 80% of your total expected contribution before year end.

For plans with a last day rule, pre-funding is only permitted to a suspense account. These funds may not be allocated to participant accounts until after the plan year ends, once eligibility is confirmed. Two important points to keep in mind:

- All prefunded amounts must be allocated to eligible participants as of the last day of the Plan year. *No carryover is permitted.*
- Investment gains on suspense accounts must be allocated to participants as earnings, not additional contributions. Because of this, it is generally best practice to hold suspense amounts in non-interest-bearing cash to avoid unintended allocations.

Required Minimum Distributions

At what age must RMDs begin?

The SECURE Act (signed into law in December 2019) and SECURE 2.0 (signed in December 2022) created a staggered schedule based on a participant's date of birth.

Date of Birth	RMD age
Before July 1, 1949	70½
July 1, 1949 - December 31, 1950	72
January 1, 1951 – December 31, 1959	73
January 1, 1960 or later	74

What are required minimum distributions or RMDs?

Qualified plans are required to pay annual minimum distributions to the following types of participants who have reached the minimum age:

- Active participants who own *more than* 5% of the company, and
- Terminated participants, regardless of ownership

When are RMDs due?

RMDs must be paid to participants by December 31 each year. First-year RMDs can be extended to April 1 of the following year, so participants may have two RMDs for that year.

Taxpayers are subject to a 25% excise tax if they fail to timely take RMDs; therefore, we recommend that all RMDs be processed as early as possible instead of waiting until the last month of the year. Taxpayers who correct their mistake in a timely manner (Form 5329 filing deadline typically tied to tax filing deadlines) can have the penalty reduced to 10% (definition of timely has not been clarified as of this writing).

How are the RMD amounts determined?

The current year RMD calculation is based on two components:

- The value of the account as of December 31, and
- A life-expectancy factor derived from the Uniform Lifetime Table found in IRS regulations.

The RMD is simply the account balance divided by the life-expectancy factor.

Please note, a service provider can only calculate the RMD if they have a balance available. If a service provider does not have access to the recordkeeping system that held the participant accounts as of that date, they cannot provide the calculation. This may be the case if you switched recordkeepers during this period or the participant has assets held outside of the recordkeeping system, such as life insurance or in a self-directed brokerage account.

Depending on the age and relationship of a participant's primary beneficiary, the participant may be able to satisfy the RMD requirement with a smaller distribution amount than reflected above. Participants in this situation should contact his or her tax advisor or estate planning attorney for further guidance.

What are the next steps if we have participants with balances who have reached the applicable RMD age? How are RMDs processed?

Step 1. Provide the applicable RMD age participants with an electronic or paper distribution or RMD form and cover letter. A sample cover letter is available in the Knowledge Center.

Step 2. Collect completed/signed forms from participants.

Step 3. Approve/authorize the distribution forms and deliver to the recordkeeper.

You, as plan sponsor, must initiate the RMD process.

If a participant does not return a signed form authorizing the distribution, simply authorize the distribution without the participant's signature by signing and forwarding the RMD election form directly to your recordkeeper.

To guarantee RMDs are processedon time, please provide authorization to your recordkeeper no later than December 1. The Plan's recordkeeper/custodian will mail Forms 1099-R to participants no later than January 31, of the following year.

What RMD distribution options do the participants who have reached the applicable age have?

- A terminated participant has the following options:
  Option 1: Complete the distribution form, requesting a full distribution. The RMD amount must be paid in cash, and any additional amount is eligible to be rolled over into an IRA.
  Option 2: Complete the distribution form, requesting only the required minimum distribution.

- An active participant who owns more than 5% has the following options:
  Option 1: Complete the distribution form, requesting a full distribution (if the Plan permits).
  Option 2: Complete the distribution form, requesting only the required minimum distribution.

- An active participant who is a non-owner has the following options:
  Option 1: Decline the distribution.
  Option 2: Complete the distribution form, requesting a full distribution (if the Plan permits).
  Option 3: Complete the distribution form, requesting only the required minimum distribution (if Plan permits).

Related Company

What is a related company?

The Internal Revenue Code (IRC) and related regulations describe special rules for companies under common ownership. Such entities must be aggregated for purposes of satisfying the qualified plan rules regardless of whether they may be disregarded for other tax or financial purposes.

While the details are quite lengthy and extremely complex, there are two general ways in which multiple companies are part of the same "controlled group" and are required to be treated as a single entity.

- **Parent-subsidiary controlled group.** This type of group exists when one entity owns 80% or more of another entity.
- **Brother-sister controlled group.** This type of group exists when the same five or fewer individuals have common ownership of at least 80% and identical ownership of more than 50% of the entities in question.

In addition, entities with common ownership below that threshold which provide services for each other or join together to provide services to common clients represent an affiliated service group (ASG). Although also quite complex, some of the key variables in determining whether an affiliated service group exists include the following:

- **Working relationship.** Does one entity provide services to the other that are customarily provided by employees? Alternatively, do the entities involved join to provide services to the same clients?
- **Ownership.** Is there any common ownership among the entities? Unlike the controlled group rules, as little as 10% common ownership is enough to trigger an ASG.
- **Management.** Does one entity provide management oversight over the other entity? In management-related affiliated service groups, no common ownership is necessary.

Unfortunately, there is no "bright line" test. The ASG determination is based on all the relevant facts and circumstances. Given the complexity of the rules and the fact-specific nature of the determination, we generally recommend engaging a benefits attorney to review the relationship and provide an opinion.

Visit the Knowledge Center for more information about:

- Controlled groups
- Affiliated service groups

What are the ramifications of a controlled group or affiliated group?

All companies within the controlled or affiliated group are treated as one single entity for compliance testing purposes.

Safe Harbor Matching Contributions

When is the safe harbor matching contribution due to the trust?

The deposit deadline depends on how often the Plan document requires the match to be calculated. If the match is based on annual compensation and deferrals, it must be deposited no later than the last day of the following plan year. However, to deduct the contribution for the current year, it must be deposited by the due date of the company tax return, including extensions.

If the match is calculated more frequently (such as each pay period, month or quarter), it must be deposited by the end of the calendar quarter following the period it applies to; e.g. by the end of the third quarter for a match related to the second quarter.

Can I prefund the safe harbor match during the year if the required calculation frequency is based on annual deferrals and compensation?

Yes.

We funded the safe harbor matching contribution during the plan year and have overfunded or underfunded a few participants. What is the next step?

Any such participants are identified in the variance column on the Contribution Report.

For participants who received too much, the excess amount must be adjusted for investment gains or losses, transferred to the Plan's suspense account, and reallocated to the other participants for the current year or the following year depending on when the initial deposit occurred.

For participants who are underfunded, the correction is based on the required calculation frequency:

- **Full-year compensation/Deferrals.** The additional contribution should be funded as soon as possible.
- **Per-payroll or quarterly.** An additional true-up contribution is not permitted. However, since we have only been provided with annual deferral and compensation information and cannot verify the periodic match calculations, we recommend that you confirm that the formula has been properly applied throughout the year, especially for participants who deferred at a uniform rate throughout the year.

To avoid potential underfunding in the future, we recommend you amend your Plan to change the calculation frequency to annual.

Suspense Account

What is a suspense account?

A suspense account holds amounts that have been deposited as company contributions that have not yet been allocated to individual participant accounts. This could result from pre-funding contributions throughout the year that cannot be allocated until year end, certain participants accidentally receiving excess allocations, or participants exceeding the annual additions limit.

How and when do suspense accounts get used?

Unlike forfeitures, suspense accounts represent company contributions to the Plan and must be allocated to participants as a match or a nonelective contribution as specified in the Plan document. Amounts in the suspense account must generally be allocated to participants no later than the last day of the plan year in which the deposit occurred. For example, if the amount in the suspense account was first deposited to the Plan in November of the current year, it must be allocated as a contribution for the current year. However, if the deposit occurred in January of the following year (after year-end but no later than 30 days following the due date of the company tax return), it can be allocated as a contribution for either the current or the following year.

How to read the suspense account report?

If there is a balance in the Plan's suspense account, you will find a chart in your Annual ERISA Compliance Review indicating the balance to date. The chart notes the plan year(s) in which the amounts were deposited so you can determine how to use them. The *Action steps* column provides additional details regarding your options.

Do I have to allocate the suspense account amount if it is a small amount?

Yes. The rules do not provide a materiality threshold, so it is up to each plan sponsor to determine how and when to use these amounts within the parameters contained in the Plan document.

Taxation of Distributions

What are the Distribution Requirements?

Section 457(b) plans are subject to the distribution restrictions of IRC §457(d)(1), which permits distributions in the following circumstances: (1) severance from employment, (2) attainment of age 70½, or (3) unforeseeable emergency. All the above are not required. The Plan document will dictate permissible distribution events, and 457(b) plans that permit distributions only upon severance from employment apply to the entire account balance (including deferrals and company contributions). Note: QDROs and any rollover monies are the exception.

What are unforeseeable emergencies?

An unforeseeable emergency must be defined in the Plan document as a severe financial hardship resulting from:

- An illness or accident of the participant or beneficiary, or the participant's or beneficiary's spouse or dependent
- Loss of the participant's or beneficiary's property due to casualty, including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance
- Other similar extraordinary and unforeseeable circumstances arise because of events beyond the control of the participant or beneficiary. These can include:
  - The imminent foreclosure of or eviction from a primary residence
  - The need to pay for medical expenses (including non-refundable deductibles or costs for prescription drug medication)
  - Funeral expenses of a spouse or dependent

The Plan document may not include all the above options.

Top Heavy Determination

When is a plan considered top-heavy?

A plan is considered top-heavy if, as of the last day of the preceding plan year, more than 60% of the assets are held in the accounts of key employees. Sponsors of top-heavy plans are required to provide non-key employees with a minimum contribution equal to the lesser of 3% of pay or the highest percentage allocated (including salary deferrals) to any key employee.

To determine the top-heavy ratio, total account balances are adjusted by adding back certain distributions and subtracting balances of former participants who terminated employment before the start of the year. For a more detailed description of the top-heavy determination, visit the Knowledge Center.

Are there any plan design or operational changes we should consider if our plan is top -heavy?

If your financial situation allows for it, you may want to consider adding a safe harbor feature to your Plan. In exchange for making a fully vested, fixed company contribution of either a flat 3% of pay to all eligible participants or a 4% match to those who defer, the Plan is generally exempt from top heavy requirements as long as no other company contributions are made.

To avoid the top-heavy contribution requirements altogether, another alternative is to ensure that no key employees make salary deferrals or receive any company contributions. However, this approach does limit the ability of key employees to save for retirement through the Plan.