

Introduction to QRPs and 403(b) Plans

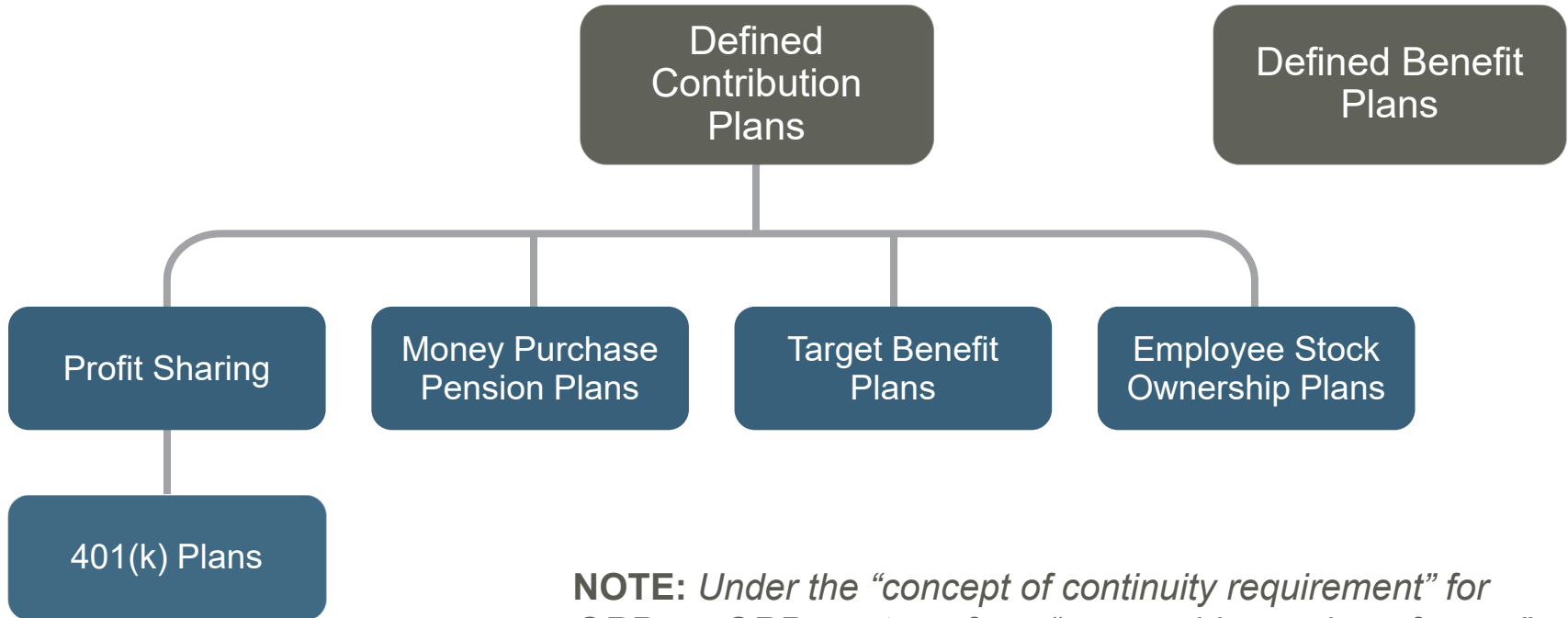
Learning Objectives

- ✔ Learn the benefits associated with 401(k) and 403(b) plans
- ✔ Review plan features, including eligibility and contribution requirements and distribution options
- ✔ Discuss plan design issues, such as safe harbor plans and automatic enrollment
- ✔ Differentiate between pretax and Roth deferrals
- ✔ Understand the difference between an ERISA and a non-ERISA 403(b) plan

Learning Objectives

- ✔ Examine the nondiscrimination testing requirements, including ADP and ACP testing
- ✔ Discuss the concept and requirements of 403(b) information-sharing agreements

Qualified Retirement Plan Types



NOTE: Under the “concept of continuity requirement” for QRPs, a QRP must run for a “reasonable number of years”.

Qualified Retirement Plan Types



Defined Contribution Plans

- Contributions are defined usually as a percentage of pay
- No promises or guarantees
- Participants bear the investment risk



Defined Benefit Plans

- Annual retirement benefit is defined
- Employer bears the investment risk

What Is a 401(k) Plan?



Cash or deferred
arrangement
(CODA)



Salary deferral
contributions to
plan



Part of a profit
sharing plan

401(k) Plan Establishment Deadline



Must establish by the end of the employer's tax year for which the deduction is desired



Salary deferral limitation is a calendar-year limitation

401(k) Salary Deferral Election Deadline

Partners and Self-Employed Individuals

W-2 Participants

Deferral election may apply only to compensation not yet paid or received.

Partners deferral election deadline is last day of partnership year.

Self-employed election deadline is last day of the taxable year (generally December 31).



Eligible 401(k) Employers



All types of
entities



Eligible as of
January 1, 1997



State and local
governmental
(plans adopted before
May 6, 1986 are
grandfathered)

401(k) Plan Eligibility and Exclusions

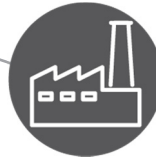
Statutory Exclusions



Age 21 maximum



Service
(1 or 2 years maximum)



Union employees



Nonresident aliens with no
U.S. earned income

401(k) Employee Elective Deferrals



Pretax Deferrals

- Reduces current taxable income
- Limit is \$19,000* for 2019 (applies to pretax and Roth deferrals in aggregate)

*Subject to cost-of-living adjustments.



Roth Deferrals

- Does not reduce current taxable income
- Deferrals (and earnings) are distributed tax-free if the participant has met the 5-year clock and has attained age 59½, is deceased, or is disabled
- Limit is \$19,000* for 2019 (applies to pretax and Roth deferrals in aggregate)

401(k) Catch-Up Deferrals



\$6,000

NOTE: *All plans of the employer are aggregated except for 457(b) plans.*

Coordination of IRC Sec. 402(g) Limit With Other Salary Deferral Plans

Deferral limit (\$19,000) applies in aggregate to multiple 403(b) and 401(k) plans

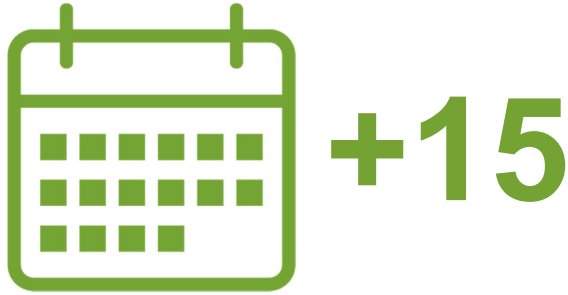
Lou has a single \$19,000 deferral limit for the 2019 calendar year if he participates in a 401(k) plan and a 403(b) plan.

Deferral limit (\$19,000) applies separately for 403(b) or 401(k) and governmental 457(b) plans

If Lou participates in a 401(k) or a 403(b) plan and a governmental 457(b) plan, he will have a separate \$19,000 deferral limit under the governmental 457(b) plan for 2019.



401(k) Plan Salary Deferral Deposit Deadline



DOL deadline: as soon as administratively feasible



DOL safe harbor for plans with fewer than 100 participants

401(k) Nonelective and Matching Employer Contributions



Nonelective Employer Contributions (NECs):

- Fixed or discretionary
- Not required



Matching Employer Contributions (MACs):

- Fixed or discretionary
- Not required
- May match on an ongoing basis or after year end

401(k) Annual Additions Limit (IRC Sec. 415)

Annual Allocation Limit



All contribution
types and
forfeitures

100

Up to \$56,000
(indexed)



Applies for each
unrelated employer

401(k) and 403(b) Vesting Options



Immediate vesting



Graded vesting



Cliff vesting

Graded Vesting Example

6-Year Graded Vesting	
Years	6 Year
1	0%
2	At least 20%
3	At least 40%
4	At least 60%
5	At least 80%
6	100%

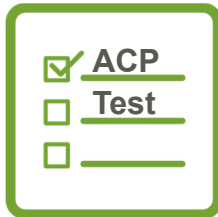
Cliff Vesting Example

3-Year Cliff Vesting	
Years	3 Year
1	0% or greater
2	0% or greater
3	100%
4	100%
5	100%

401(k) Plan Testing



- Tests salary deferral contributions to make sure deferrals are not discriminatory in favor of HCEs
- Includes pretax and Roth salary deferrals
- Compares HCE group's ADP to non-HCE group's ADP



- Tests matching and voluntary nondeductible employee after-tax contributions to make sure they are not discriminatory in favor of HCEs
- Compares HCE group's ACP to non-HCE group's ACP

HCE Definition

Highly Compensated Employee

5%

Owner in current
or preceding year

>\$125,000

In preceding year
(indexed)

20%

Top-paid group,
might reduce
number of HCEs

ADP Test Concept



1.25

OR



2x2%



**Plan may use
the test that
provides best
result**

ADP Test Methods



HCE group's ADP may not exceed 125% of the non-HCE group's ADP



HCE group's ADP may not exceed the lesser of

- 2 times the non-HCE group's ADP
- OR
- Non-HCE group's ADP plus 2 percentage points

Conducting the ADP Test Example

- Georgette, Ted, and Sue Ann are the only non-HCEs who work for All About Cars, Inc.
- All eligible to defer
- Georgette defers 8%
- Ted defers 4%
- Sue Ann elects not to defer

$$\text{ADP} = \frac{8\% + 4\% + 0\%}{3} = 4\%$$



Conducting the ADP Test Example

1.25 Test*

$4\% \times 1.25 = 5\%$ (maximum HCE ADP)

2 Times/2% Test*

$4\% + 2 = 6\%$

$4\% \times 2 = 8\%$

*May use the test that gives the plan the best result

> Lesser of = 6%
(Maximum HCE ADP)



ACP Test

Tests employer matching contributions and voluntary nondeductible employee contributions, if allowed, for discrimination



1.25

OR



2x2%



**Plan may use
the test that
provides best
result**

Conducting the ACP Test Example

- Georgette, Ted, and Sue Ann are the only non-HCEs who work for All About Cars, Inc.
- All eligible to defer and receive matching contributions
- Georgette receives a 1% match
- Ted receives a 6% match
- Sue Ann receives a 2% match

$$\text{ADP} = \frac{1\% + 6\% + 2\%}{3} = 3\%$$



ADP Excess Contributions



Returning excess
elective deferrals to
HCEs



Making additional
contributions for
non-HCEs

ACP Excess Aggregate Contributions



Distributing excess aggregate contributions to HCEs



HCEs forfeit excess matching contributions if not 100% vested



Make additional contributions for non-HCEs

401(k) Allowable Distribution Triggers for Employer Nonelective and Matching Contributions



Severance from employment



Attainment of a specified age or NRA



Death



Disability



Plan termination



In-service distributions



QDROs

401(k) Allowable Distribution Triggers for Elective Deferrals (Includes QNECs and QMACs)



Age 59½



Severance from
employment



Death



Disability



Qualified
reservist
distributions



Plan termination



Financial
hardship



QDROs

401(k) In-Service Distributions of Employer Contributions (NECs and MACs)

- May withdraw amounts attributable to employer contributions after they have been deferred in the plan for at least 24 months
- May withdraw amounts attributable to employer contributions after participant has had at least 60 months of plan participation

401(k) Plan Safe-Harbor Distributions of Elective Deferrals



Medical care



Funeral expenses



Tuition and related
educational fees

May include beneficiary hardship



Purchase of
principal residence



Preventing eviction
or foreclosure



Home repair after
casualty loss



Federal disaster
area distributions

Safe Harbor Hardship Distributions of Elective Deferrals

Hardship Distribution Money Is Expensive Money



Pretax amounts
are taxable



Pretax amounts
are subject to a
10% penalty tax if
under age 59½.



Hardship amounts
may *not* be
rolled over.

Plan Hardship Distributions of Elective Deferrals



Bipartisan Budget Act of 2018 (BBA) modifies safe harbor provisions



Plan loans are no longer required to be taken first, but plan **may** include this as a requirement



6-month freeze on deferrals **must** be eliminated for distributions taken as of January 1, 2020

- Suspensions **may** be eliminated for distributions taken as of January 1, 2019
- Suspensions in progress **may** be stopped or “turned off” as of January 1, 2019

Plan Hardship Distributions of Elective Deferrals

BBA allows the following categories of assets (in addition to elective deferral amounts) to also be withdrawn for hardship

- QNEC
- QMAC
- Safe-Harbor
- QACA contributions

Plan Hardship Distributions of Elective Deferrals

BBA created differences between 403(b) plan and 401(k) hardship provisions



Earnings on 401(k) plan elective deferrals **may** be withdrawn for hardship distributions



Earnings on 403(b) plan elective deferrals **may not** be withdrawn for hardship distributions

10% Early Distribution Penalty Tax Exceptions



Age
59½



Death



Disability



Substantially
equal
periodic
payments



Separation
after age 55



Dividends
from
ESOPs



QDRO
distributions



Deductible
medical
care



IRS
levies



Qualified
reservist
distributions

RMDs



RBD later of April 1 following 70½ year, or April 1 following year of retirement (plan permitting)



RMDs due by December 31 each year thereafter

50%

Excess accumulation penalty tax applies if missed RMD

RMDs



May aggregate all 403(b) accounts or contracts of the employee



May not aggregate with IRAs



If separately accounted for, pre-1987 403(b) plan balances do not need to be distributed until the later of

- the end of calendar year in which the participant attains age 75
- April 1 of the calendar year following the year of retirement

401(k) Safe Harbor Plans: ADP Safe Harbor



**ADP safe harbor
match (#1)**



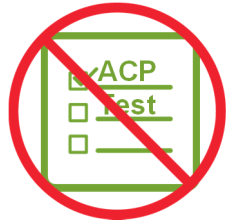
**ADP safe harbor
nonelective
contribution (#2)**

No ADP Testing Required

100% match on first 3% of compensation
and 50% match on next 2%, or equivalent
alternative

3% of compensation to each eligible
employee (even if employee did not
defer)

401(k) Safe Harbor Plans: ACP Safe Harbor



IF



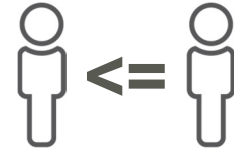
AND

>6%

Contributions or elective deferrals in excess of 6% are not matched.



Matching contributions do not increase as elective deferrals or contributions increase.



Match for any HCE does not exceed the match for a non-HCE.

NOTE: ACP safe harbor rules also may apply to 403(b) plans.

401(k) Safe Harbor Plans: Miscellaneous Considerations



100%

Contributions used to satisfy the ADP safe harbor must be immediately 100% vested.



If only ADP and ACP safe harbor employer contributions are made, the plan is exempt from the top-heavy rules.

401(k) Safe Harbor Plans: Notice Requirements



**Employer must
provide Safe
Harbor Notice**



**Employer may
provide “Maybe
Notice”**

- Due 30–90 days before each plan year
- Must tell participants about employer’s contribution amount for the coming year
- In some cases, may decide each year whether to operate as a safe harbor plan

- Intent to operate as a safe harbor plan
- First notice due 30–90 days before plan year
- Second notice and plan amendment due at least 30 days before plan year end if safe harbor option is elected
- Must satisfy ADP safe harbor with 3% NECs

401(k) Qualified Automatic Contribution Arrangements (QACAs)



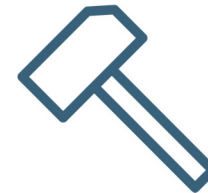
A second type of safe harbor 401(k) plan



Notice due 30–90 days before start of plan year



Effective for plan years starting on or after January 1, 2008



Exempt from the top-heavy rules

401(k) QACAs

PPA sets minimum and maximum QACA deferral percentages.

	Minimum	Maximum
Year 1	3%	10%
Year 2	4%	10%
Year 3	5%	10%
Year 4+	6%	10%

QACAs

PPA requires a matching or nonelective contribution.



100% on first 1% plus
50% on next 5%

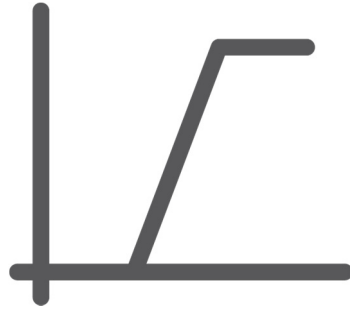
OR



At least 3% of
compensation

QACAs

PPA also requires accelerated vesting on all QACA contributions.



2-year cliff vesting

401(k) Safe Harbor Plan vs. QACA Safe Harbor Plans

<p>3% nonelective contribution</p> <p>OR</p> <p>Match up to 4%</p>	<p>3% nonelective contribution</p> <p>OR</p> <p>Match up to 3.5%</p> <p><i>(NOTE: Lower maximum match, but plan may have more deferrals because of auto enrollment.)</i></p>
<p>Requires immediate 100% vesting on ADP safe harbor contributions</p>	<p>2-year cliff vesting</p>
<p>ADP/ACP safe harbor available</p>	<p>ACP/ADP safe harbor available</p>
<p>Top-heavy exemption available</p>	<p>Top-heavy exemption available</p>