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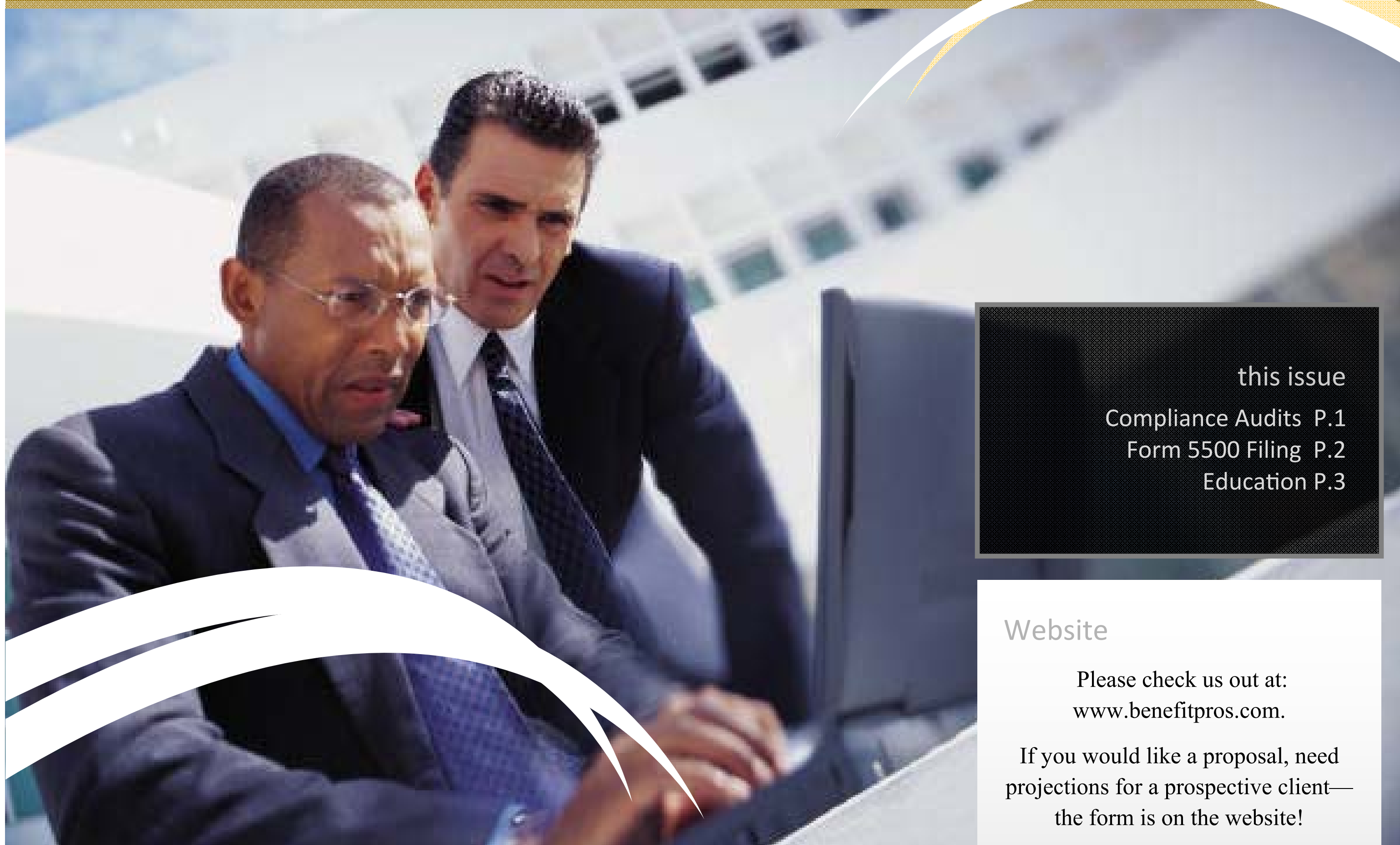

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Pass Those Tests

Unless your 401(k) plan has adopted a “safe harbor” design, is a SIMPLE 401(k), or contains a qualified automatic contribution arrangement (QACA), you must perform the actual deferral percentage (ADP) nondiscrimination test each year.

The ADP test compares the average rate at which highly compensated employees defer salary with the average deferral rate for non-highly compensated employees. The difference between the highly paid and the lower paid employees must be within certain defined limits. If it isn’t, you must correct the excess contributions made by the highly compensated employees.

Correcting Excess Contributions

You have three basic correction options. The first is to refund the excess contributions. While refunds can be made anytime within 12 months of the close of the plan year, a 10% excise tax applies to excess contributions not returned within 2½ months (six months for eligible automatic contribution arrangements). Another method is to recharacterize the excess contributions as after-tax contributions, if plan provisions allow. Recharacterizations must occur no later than 2½ months after plan year-end. With either option, the amounts will be taxable to the employees.
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Website

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Can We Help?

Our firm offers a broad range of employee benefit plan services. If we can be of service to you, please call.

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If allowed by the plan, an excess contribution made by an employee who is age 50 or older may be treated as a catch-up contribution, to the extent the employee hasn't already made the maximum allowable catch-up contribution for the year. This treatment avoids the need to recharacterize or refund the excess amount.

The third option is to make additional qualified non-elective contributions (QNECs) or qualified matching contributions (QMACs) to non-highly compensated employees. Such contributions will be treated as elective contributions for ADP testing purposes until the plan satisfies the nondiscrimination test.

Ways To Avoid Failure

If your plan has failed the ADP in the past or is likely to this year, you might want to look at adding automatic enrollment and automatic contribution escalation features to your plan (see "Automate Your Plan" on page two). Both of these features are proven to increase plan participation by lower paid employees.

Alternatively, or in addition to adding these plan features, you may want to ramp up your employee education efforts to reach lower paid and nonparticipating employees. Some approaches to consider: a targeted, personalized campaign of e-mails and/or paycheck stuffers stressing the benefits of participating in your plan, mandatory enrollment/education seminars on company time, posters in areas/departments with high concentrations of lower paid employees, and small prize incentives for attending retirement education/enrollment seminars or enrolling.

Studies show that offering matching contributions usually increases plan participation. If you don't currently offer a match or you discontinued your match consider offering one or bringing your company match back. Lower paid employees are often the ones most influenced by matching dollars. Those who participate frequently contribute up to the employer matching percentage. Consequently, changing your match structure from 50% on the first 4% of pay to 25% on the first 8% of pay could increase participant contributions without increasing your monetary outlay.

If you think your plan is in danger of failing the nondiscrimination tests, talk with us. We'll help you analyze your options, including adopting a safe harbor plan design.

". . . you may want to ramp up your employee education efforts . . . ."

Automate Your Plan

The stats are pretty clear. Too many employees don't take advantage of the opportunity offered by their employers' retirement savings plans -- to the detriment of their future retirement security. What can you do to boost participation in your plan and help employees increase their account balances? Consider automating your plan in one or more of these ways.

Automatic Enrollment

With automatic enrollment, when an employee becomes eligible to participate in the plan, a set percentage of the employee's compensation is withheld (often 3%) and deposited in a 401(k) plan account for the employee. Some employers apply automatic enrollment only to new employees, but you could choose to automatically enroll all of your eligible employees. All employees must be given the option to decline participation.

Automatic Contribution Escalation

Along with automatic enrollment, consider automatic contribution escalation. You can increase the automatic deferral percentage over time as long as the increases are made in accordance with a specified schedule. You must notify employees of the amount of the deferral increases and when increases will occur. Employees must be given the option to opt out of increases.

Automatic Rebalancing

Rebalancing may help cushion the impact of market downturns such as the one we saw in 2008. You may have several options for offering participants automatic rebalancing: Make automatic rebalancing an optional feature of your plan and encourage participants to use it; offer managed accounts; or choose a default investment option for your plan, such as a life-cycle or target-date fund, that automatically rebalances. *(continued on Page 3)*

Retirement Saving Stats *(continued from page 2)*

o 19% of employees choose not to participate in the retirement savings plan offered by their employer.

o 58% of employees who don't participate have saved less than $10,000 for retirement versus 13% of those who do.

Source: 2010 Retirement Confidence Survey, Employee Benefit Research Institute, www.ebri.org

Comparing Retirement Plan Choices

Sponsoring a retirement plan offers an employer tax advantages. Maximizing these advantages, while minimizing costs, is largely a matter of having the right retirement plan for your business.

Businesses can offer a variety of plans, including 401(k), profit sharing, savings incentive match plan for employees (SIMPLE), simplified employee pension (SEP), "traditional" defined benefit pension, and DB(k) plans -- a new type of plan available starting in 2010.

401(k) Plans

A 401(k) plan gives employees the opportunity to save more for retirement on a pretax basis than some other types of retirement savings plans. In 2010, employees can defer up to $16,500 in salary to the plan, plus another $5,500 catch-up contribution if they're age 50 or older (plan permitting). Employer contributions are optional. But, if your company chooses to make contributions, those contributions are tax deductible (within limits). With a 401(k) plan, retirement benefits are based on the vested balances in participants' individual plan accounts.

There are some disadvantages to 401(k) plans. Because 401(k) plans offer a flexible choice of features, they generally are more costly to administer than certain other plan choices. 401(k) plans require annual reporting and, generally, annual testing to ensure that the plan does not discriminate in favor of the highly compensated.

SEP and SIMPLE Plans

The easiest plans to administer are SEP and SIMPLE plans. With a SEP plan, your business contributes to individual retirement accounts established for you and your eligible employees. You can choose each year whether and how much to contribute (within the tax law's limits). SEP plans are easy to set up and maintain. Employer contributions are tax deductible (within limits). Employees cannot contribute to newly established SEP plans.

SIMPLE plans are generally available to businesses with no more than 100 employees that don't have another retirement plan. (Other requirements apply.) They can be structured as a SIMPLE 401(k) plan or as a SIMPLE IRA plan. Unlike a SEP plan, a SIMPLE plan allows employees to contribute -- up to $11,500 in 2010, plus $2,500 catch-up (if eligible). Your company must make a minimum matching contribution or contribute a minimum percentage of compensation on behalf of each eligible employee, whether or not the employee contributes. Contributions are tax deductible, and benefits are based on each participating employee's account balance. Plan set-up and administration are simplified. Recordkeeping and reporting requirements are also minimal.

Profit Sharing Plans

These plans offer employers a great deal of flexibility. Contributions may be made according to a formula written into your plan, or they may be made at your company's discretion. If you wish, the plan may be structured to allow contributions in years with low or no profits. Employees are not permitted to contribute. If employee contributions are desired, a 401(k) option may be added to the plan. *(Continued on Page 4)*

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Retirement benefits are based on each participant's vested account balance, which reflects the employee's years of service, your company's contributions, and your plan's investment performance. Since company contributions generally are dependent on profitability, a profit sharing plan can be a strong incentive for employees to perform well.

Defined Benefit Plans

Defined benefit plans generally pay fixed retirement benefits. Benefit amounts are based on a formula written into the plan. The formula may direct that employees be paid a percentage of their final average compensation multiplied by years of credited service. Or you may develop another formula that better meets your needs. A defined benefit plan is funded entirely by your company. Annual funding amounts for traditional defined benefit plans are based on actuarial calculations and are tax deductible.

DB(k) Plans

These plans essentially add a pension-plan-like guaranteed-income element to a 401(k) plan. Employers with no more than 500 employees can sponsor a DB(k) plan.

"Businesses can offer a variety of plans . . . ."

Final Say on the Timing and Order of QDROs

The U.S. Department of Labor has finalized its regulations on the timing and order of qualified domestic relations orders (QDROs). Like the interim guidance issued in 2007, the final regulations contain examples you may find helpful in determining whether an order is qualified.

A QDRO is a judgment, decree, or order issued under a state domestic relations law relating to child support, alimony payments, or marital property rights to a participant's spouse, former spouse, child, or other dependent. A QDRO creates or recognizes the right of an "alternate payee" to all or part of an employee's retirement plan benefits.

Examples used in the final regulations show that timing or order of issuance alone won't disqualify a domestic relations order. Some of the points illustrated:

- An order won't fail to be a QDRO simply because it is issued after, or revises, a QDRO that was previously issued to the same individual(s), even if it reduces the benefits payable under the first QDRO.
- A QDRO can be issued to an employee's spouse from a second or subsequent marriage after the spouse from a previous marriage has already been issued a QDRO. But the new order can't assign any benefits already payable under the original QDRO.
- An order issued after an employee's death or divorce can be a QDRO.
- An order issued after an annuity starting date can be a QDRO. For example, a participant is receiving benefits as a single-life annuity. The spouse has waived surviving spousal rights. They divorce. An order directing that the former spouse receive half of the participant's future benefit payments can be a QDRO. However, as the final regulations clarify, an order after the original annuity starting date requiring reannuitization with a new annuity starting date would disqualify the order, unless the plan specifically provides for the option.

Your plan should have reasonable written procedures in place to determine the qualified status of domestic relations orders and administer distributions made under them. In light of the final regulations, you may want to review these procedures and modify them if necessary.

Benefit Notes

A 2010 Snapshot of 403(b) Plans

The Profit Sharing/401(k) Council of America recently released the results of a survey that provides a broad overview of 403(b) plans. Some of the survey's highlights include:

o Average participation rate is 75.8%.

o Average account balance for active plan participants is $71,879.

o 83.2% of sponsoring organizations make contributions to the plan.

o Common contribution formulas include a guaranteed percentage of the participant's pay only (17%), stated employer match only (13.9%), and a fixed match only (8.9%).

o Participant contributions are allowed by 97.3% of the plans.

o Roth after-tax contributions are permitted by 13.9% of plans.

o Loans are available in 72.7% of plans.

o Participants can receive investment advice in 43.5% of plans.

No Obligation To Make Discretionary Employer Contribution

Construction Company's 401(k)/profit sharing plan had a provision for a year-end 3% of compensation discretionary profit sharing employer contribution. When the company didn't make any contribution to his plan account for the year, Nathan sued. He charged that Construction Company had failed to make required employer matching contributions to his account. "Not so," said a U.S. District Court (Lindell v. Landis Construction Co., DC-D.C., No. 08-1462). The court ruled that the employer was under no legal obligation to match Nathan's contributions for the year in question because the employer showed that the plan had a discretionary employer contribution, not an ongoing required match.

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