RETIREMENT & INVESTMENT SOLUTIONS

401(k) Compliance Toolkit

Navigating the Challenges & Complexities of Sponsoring a 401(k)

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INTRODUCTION

A 401(k) retirement plan involves complexities that require careful management. While you may feel confident that your plan is under control, it's important to consider whether it would pass scrutiny if reviewed by the Internal Revenue Service (IRS) or the Department of Labor (DOL).

This toolkit will explore the key requirements of administering a 401(k) plan, providing you with information to help ensure compliance with relevant regulations and identify potential deficiencies in your plan.

Contents

Determining Eligibility

As a 401(k) plan sponsor, there are various groups of employees that may be excluded from participation in the plan:

- Union employees
- Nonresident aliens with no U.S. source income
- Highly compensated employees
- Part-time/temporary/seasonal employees. However, due to the SECURE and SECURE 2.0 Acts, these employees will generally need to be eligible for the plan beginning the first day of the 2024 plan year if they worked at least 500 hours per year for three consecutive years and have attained age 21; this is reduced to two consecutive years beginning the first day of the 2025 plan year.

It's important to realize that these exceptions are not automatic; any of these categories you wish to exclude must be explicitly defined as such in your plan document. Other generic classifications may be used but may not discriminate in favor of highly compensated employees.

You may also have additional or different exclusions for employer contributions.

Once the determination is made as to which employees are eligible for the plan, eligibility conditions need to be reviewed to determine who enters the plan and when.

Any plan-defined age and/or service requirements should be reviewed to determine when the employee is able to contribute to the plan.

Be aware

- Any employee not in an excluded category in your plan document must be given the opportunity to defer once the plan's eligibility and entry requirements are met. Employees who move from a full-time to a part-time position must also be given the opportunity to defer.
- If employees who were previously eligible are rehired, in most cases, they must be given the opportunity to begin to defer immediately. A review of your plan's rehire provisions should be conducted to confirm.
- The maximum eligibility requirements for employer contributions are the attainment of age 21, with one year of service and semi-annual entry dates.

In Real Life

Jim was hired in 2020 as a part-time employee, and was excluded from his company's 401(k) plan by the '*part-time/less than 20 hours per week*' exception. From 2020 through 2022, Jim worked at least 500 hours each year, but in 2023, he only worked 400 hours.

Even though Jim worked at least 500 hours for three consecutive years, he is not considered a long-term part-time employee (LTPTE) because according to the SECURE Act, years before 2021 are ignored for LTPTE eligibility purposes. If he had worked 500 hours in 2023, he would have been eligible to participate in the company's 401(k) plan starting January 1, 2024.

However, according to the SECURE 2.0 Act, Jim's two consecutive years with 500 hours of service in 2021 and 2022 make him eligible to participate in the plan starting January 1, 2025, even though he did not work over 500 hours in 2023.

Defining Compensation

There are three basic definitions of compensation that are accepted by the IRS:

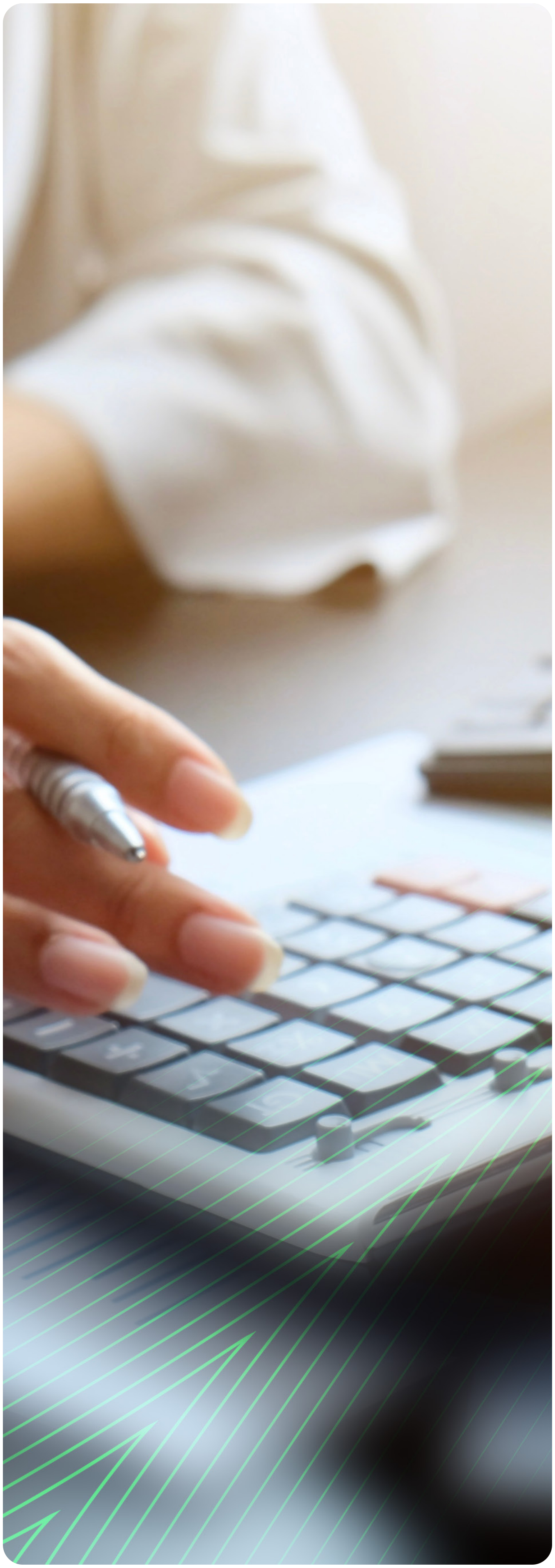
1. **W-2** (usually box one)
2. **Internal Revenue Code Section 3401(A)** (compensation that runs through payroll)
3. **Internal Revenue Code Section 415 Safe Harbor** (generally the same as W-2 for not-for-profit entities)

You will need to spell out the basic definition you have chosen in your plan document. When determining which definition to use, take into consideration payroll system capabilities and reporting for review. You will also need to indicate whether the employee's pre-tax deferrals should be added back in the basic compensation definition.

Your plan's definition of compensation for testing purposes does not necessarily have to be the same as that used for contribution determination. It could be different and possibly more flexible.

Compensation that may be excluded for contribution or testing purposes includes, but is not limited to:

- **Bonuses**
- **Overtime Commissions**
- **Severance**



Understanding Contribution Requirements

Generally, 401(k) plans have two basic types of contributions:

1. Employee Deferrals

Employee deferrals may be either pre-tax or Roth after tax (if the plan permits). Employee deferral limits are set by the IRS.

If the plan permits, an age 50 catch-up provision allows employees aged 50 or older to contribute at any time during a plan year and may change annually.

2. Employer Contributions

Employer contributions may be either match or non-elective contributions, and some plans may include both. The plan document must dictate exactly how the contribution will be calculated.

Self-Testing Your Plan

A 401(k) plan is legally required to test deferrals using the Actual Deferral Percentage (ADP) test, unless the plan is safe harbored.

In addition, most plans that offer employer matching contributions will require Actual Contribution Percentage (ACP) testing, unless any safe harbor provision applies to the match as well.

The ADP test looks at pre-tax and Roth deferral contributions to the 401(k) plan. It compares the percentage of deferral contributions made by all eligible participants, regardless of whether they deferred. The ACP test takes into consideration all matching contributions as well as non-Roth voluntary after-tax contributions, should the plan permit them.

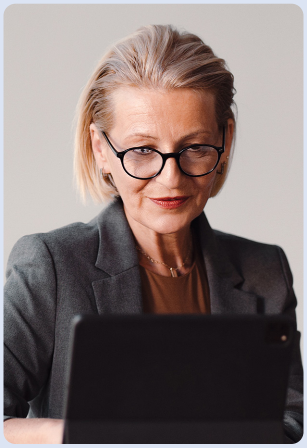
An individual's total deferral amount is divided by the testing compensation for that employee. Once this ratio is calculated for every employee on the plan, you'll divide your data into two groups – highly compensated and non-highly compensated. The individual percentages within a group are averaged and then compared.

For purposes of this test, a highly compensated employee is defined as someone who:

- Owned more than 5% of the interest in the business at any time during the year or the preceding year; or
- For the preceding year, received compensation from the business in excess of the highly compensated employee compensation limit of that plan year.

Generally, if there is more than a 2% difference between the highly compensated and non-highly compensated group average, the test has failed and must be corrected. To avoid a penalty tax, you will need to correct the test (usually by removing the excess from highly compensated individuals) within two and a half months after the end of the plan year.

The ACP test is calculated in the same manner as the ADP test, except it uses matching and voluntary after-tax contribution in place of the deferral contributions.



In Real Life

In 2020, Mary starts working at her husband's company doing office work and is paid for the services she performs, earning less than the compensation amount required to be considered highly compensated. The company has a retirement plan that has a one-year of service requirement for eligibility.

Mary works the year and becomes eligible for the plan. Because Mary is the spouse of the owner, she is considered to be an owner of the company for retirement plan purposes and, therefore, considered a highly compensated employee. While the plan may have passed discrimination testing in the past, Mary's eligibility into the plan may affect future testing. To reduce the possibility of testing challenges, a review of testing considerations should be conducted before family of company owners become eligible for the plan to determine, prospectively, if any changes to the plan should be considered.

Evaluating Your Retirement Program

A few simple steps can help ensure a compliant 401(k) retirement plan:

1. Keep your plan up to date, always

Establish a process to regularly review and update your plan document to ensure that it remains in compliance with IRS regulations.

2. Keep your staff informed

Be sure anyone who touches the plan knows, understands and follows the plan provisions, especially those related to their specific job functions.

3. Conduct an operational review

Review the areas we've discussed in this guide, as well as loan or in-service withdrawal procedures if your plan has these provisions. If any operational errors are found, correct them as soon as possible. The IRS has various correction programs available for you, including self-corrections for some errors.

4. Ask for help

Enlist the help of plan providers and/or consultants as needed. If they are not able to assist directly, they should be able to determine who can help with your situation.

Solutions for your needs

At CBIZ, we strive to help people achieve their financial goals while helping employers navigate the fiduciary responsibilities that come with sponsoring a retirement plan. We tailor our approach to meet the needs of each client.

Our team of professionals provide a broad range of services, including:

Defined Contribution

401(k), 403(b), 401(a), 457

Investment Advisory | Fiduciary Governance | Compliance Consulting | Third-Party Administration | Fees & Expenses | Mergers, Acquisitions & Conversions

Defined Benefit

Pension, Cash Balance, OPEB

Investment Advisory | Single-employer Actuarial Services | Multiemployer Actuarial Services | Mergers, Acquisitions & Conversions | Benefits Administration Outsourcing | Pension De-Risking | Plan Termination

Private Client

Participants, Individuals and Trusts

Participant Education | Point-in-Time Participant Advice | Financial Wellbeing
Personalized Retirement Account Management | Wealth Management

Other Offerings

Corporate Accounts | Endowments and Foundations | Nonqualified Plans
Investment Advisory | Nonqualified Plan Consulting

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