BENEFIT BYLINES

Timely Articles Intended To Be Of Interest To Sponsors Of Qualified Retirement Plans And Their Professional Advisors

Summer 2014
Published by Associated Benefit Planners, Ltd.

As discussed in our most recent newsletter, plan document restatements are now required for profit sharing, money purchase and 401(k) plans. ABP will be providing this restatement service and will be reaching out to each affected client within the week. This communication will include ABP's restatement cost as well as ideas for reviewing and potentially enhancing plan features. Although the restatement deadline is April 2016, we urge you to respond timely to start the process (which may require consulting and consideration of potential changes) and take advantage of special pricing from ABP. Please don't hesitate to contact your ABP administrator should you have any questions regarding the process. ▪

Safe Harbor Election Escape Clause

Safe Harbor Basics/Background

Historically, required ADP and ACP discrimination testing has been problematic for small employers who sponsor 401(k) plans. Failed tests (or fears that tests will be failed) have often resulted in restricting the amount of 401(k) elective deferral contributions that can be made by business owners and highly compensated employees (HCEs).

Fortunately, many employers have been able to rectify this problem by making a Safe Harbor Election. In doing so, the employer agrees to either (1) make a non-elective employer contribution (usually 3% of pay) for all eligible employees or (2) match the employee deferrals of those who contribute for themselves (usually dollar-for-dollar up to 3% of pay plus $0.50 per dollar for the next 2% of pay). This commitment by the employer results in a deemed "pass" on otherwise required ADP and ACP testing. An added advantage is that the 3% non-elective contribution will also satisfy the employer's minimum top-heavy plan contribution requirement, if applicable. *(Continued on Page 2)*

Failed 401(k) Plan Discrimination Testing (not always something to avoid)

For more than three decades, 401(k) plans have provided the opportunity for workers, executives and business owners to reduce current taxes while accumulating long-term savings. However, since the inception of 401(k) arrangements, some owners and highly compensated employees have seen their savings opportunities restricted. Required 401(k) plan nondiscrimination testing, specifically the Actual Deferral Percentage (ADP) test and the Actual Contribution Percentage (ACP) test, puts a cap on the disparity between amounts that can be contributed by or on behalf of Highly Compensated Employees (HCE's) when compared to Non-highly Compensated Employees (NHCEs). *(Continued on Page 3)*

Table of Contents

(Safe Harbor Election Escape Clause - Continued from Page 1)

Further, if the only employer contribution is the "safe harbor" match (referred to above), then the plan is deemed to be not top-heavy. As a result, owners and HCEs are able to maximize their deferrals and age 50+ catch-up contributions (up to each year's statutory dollar limits), irrespective of how much or how little other employees contribute to the plan. For 2014, those limits are $17,500 and $5,500, respectively

Plan documents must be amended to elect into or out of safe harbor status. Further, to qualify, the employer must issue a notice to employees between 30 and 90 days prior to the first day of the plan year (by not later than December 1st for calendar year plans) informing them that safe harbor status has been elected and that all employer contributions made pursuant to that election will be 100% fully and immediately vested.

Some Plan Sponsors Are Reluctant To Commit

Despite the potential advantages associated with making a safe harbor election, some employers whose HCEs are negatively impacted by ADP/ACP discrimination testing have been reluctant to commit in advance to the level of employer contributions needed to achieve safe harbor status. Employers who were stung by the recession tend to be particularly cautious about making financial commitments, even those like a safe harbor election that apply only to the next plan year. Previous guidance allowed employers to prospectively revoke their safe harbor matching contribution election for any reason, but required those employers with the (3%) non-elective safe harbor to demonstrate substantial business hardship. However, the criteria used to demonstrate substantial financial hardship resulted in very few employers actually being able to revoke their elections mid-year.

IRS Provides Relief

Good news recently came for employers who choose the non-elective version of safe harbor status in the future. In response to comments by the American Society of Pension Professionals and Actuaries (ASPPA) and other organizations, the final safe harbor regulations issued by the IRS provide consistent treatment for employers who choose either the Safe Harbor Match or the Safe Harbor Non-elective alternative. As a result, **employers who make either type of safe harbor election will be able to revoke that election mid-year without the need to demonstrate financial hardship.**

As with earlier guidance, an employer who wishes to suspend its safe harbor election mid-year must do the following:

(1) adopt a plan amendment revoking safe harbor status,
(2) issue a supplemental notice to employees 30 days in advance of the effective date of revocation, and
(3) fund accrued employer contributions through the effective date of revocation.

Significantly, the suspension or revocation of a safe harbor election results in the plan reverting to mandatory ADP/ACP testing for the full plan year. As a result, it is likely that owners and HCEs will need to reduce their elective deferral contributions or be required to take taxable refunds from the plan when discrimination tests are run following the end of the plan year. Further, if the plan is top heavy, the employer's required minimum contribution must be made. (Top heavy contributions, when applicable, are typically calculated at 3% of full year pay. So, suspension/revocation usually does not help an employer whose plan is top heavy.)

Safe Harbor "Maybe" Election Is Still An Option

The opportunity to make what is sometimes called a safe harbor "maybe" election continues to be available under IRS final regulations. An employer who issues a maybe notice makes only a conditional commitment to making a non-elective contribution for the following year. A supplemental notice is then provided to employees at least 30 days prior to the end of the year confirming whether or not the safe harbor contribution will actually be made.

Advantages of the safe harbor maybe election (when compared to a regular safe harbor election) include:

1. Enables the employer to qualify for safe harbor status with only a conditional financial commitment,

2. Provides the same benefits as a regular safe harbor election, if the employer later commits to the safe harbor contribution in a timely supplemental notice,

3. Allows the employer to totally avoid making safe harbor contributions if the safe harbor election is not reaffirmed as described above. (In contrast, The new guidance which allows an employer to revoke a definite election mid-year, also requires it to fund accrued employer contributions through the effective date as of which contributions are suspended.*)* *(Continued on Page 6)*

(Failed 401(k) Discrimination Testing not always something to avoid - Continued from Page 1)

Testing Methodology/Corrective Actions

The ADP test compares the average amount of elective deferrals (payroll deductions) contributed by NHCEs to the average amount of deferrals contributed by HCEs. In both instances, deferrals are expressed as a percentage of plan compensation. The ACP test follows the same methodology when testing employer matching contributions, if provided under the terms of the plan.
These are both operational tests. Essentially, if the average deferral (or match) for the HCE group is too high when compared to the NHCE group, some or all individuals in the HCE group will have a portion of their deferrals either returned (through a taxable distribution) or re-classified as catch-up contributions. This would cause affected employees to lose a portion of their intended tax deferred savings opportunity. Additionally, during the year, in an attempt to avoid failing the test(s), the employer can impose restrictions on the amount that can be contributed by HCEs. In an attempt to assure that ADP/ACP testing is passed at year end, some employers either restrict the amounts that can be contributed by HCEs before the start of the plan year or do so after conducting interim testing after the 2nd or 3rd quarter of the year. There are disadvantages to each of these work arounds, as discussed later in this article.

What If a Safe Harbor Election Isn't an Option?

By far, the most popular and fool-proof way of addressing the testing problem is for the employer to make a "Safe Harbor Election". A Safe Harbor Election is a very popular design tool for employers who want to provide tax-deferred savings opportunities for key employees but struggle to pass ADP and/or ACP testing because of low levels of payroll deduction contributions by rank and file employees. See our companion article *'Safe Harbor Election Escape Clause'* for more background on this election. However, despite its advantages, some employers just are not in a financial position to commit in advance to making a Safe Harbor contribution.

There are several strategies to address the risk of failed testing:

1. Limit the deferrals permitted by HCEs at the beginning of the year. This is a basic estimate based upon NHCE deferral rates for the previous year. This does not account for any changes in deferrals that employees may submit for throughout the year or any participants that may enter or leave the plan.

2. Conduct interim testing throughout the year. This involves a detailed analysis of the deferrals contributed throughout the year and assumptions for the remainder of the year. We can then curtail subsequent payroll deductions by HCEs for the remainder of the year to produce a passing test result.

The problem with both of these strategies is potential "opportunity cost." Neither strategy is an exact science. Events such as year-end bonuses and changes in employee elections can impact test results in either direction. All too frequently, the fear of failing the ADP/ACP testing leads to ultra-conservatism in restricting the deferrals of HCEs. As a result, discrimination testing may be passed for the year, but some or all of the HCEs are precluded from receiving the maximum tax and savings benefits they would have otherwise been entitled to if they had been allowed to contribute more.

3. Run discrimination tests using prior year results. Utilizing a plan amendment, we can design the plan to use the ADP/ACP of the NCHEs for the prior plan year as our testing benchmark. Under this design, we can predict within very close proximity what deferral rates will be permitted by HCEs.

Catch-up eligibility and large groups of HCEs complicate these predictions, but the ultimate results are much more accurate than the above strategies. A disadvantage to this strategy is that any increase in plan participation by the NHCEs is not realized in the testing until the following plan year.

An Alternate Strategy

Rather than interpreting failed ADP/ACP tests and related refunds as a total negative, there is another way to view the situation. If the tests are failed, it means that all of the HCEs obtained the maximum tax savings opportunity to which they were entitled under the circumstances. Therefore, an HCE who is required to take a refund after the end of the year can take comfort in knowing that the amount remaining in the plan was the maximum benefit to which he or she was entitled to under the rules. Further, the net remaining contribution is likely to be higher than what would have been contributed if overall HCE deferrals were limited in

(Continued on Page 4)

(Failed 401(k) Discrimination Testing not always something to avoid - Continued from Page 3)

advance of or throughout the year. Smaller and more stable groups tend to manage this process with the help of their TPA and close monitoring. The overseeing and analysis becomes more problematic with larger groups that experience turnover and changes in employee elections throughout the year.

Other than limiting deferrals using very basic assumptions, there are costs associated with all of these strategies. So it is worthwhile to consider that jumping through hoops to avoid failed 401(k) discrimination testing and the resulting refunds is not always the most beneficial strategy for the plan participant.

In conclusion, if 401(k) discrimination testing restricts the tax-favored savings opportunities for owners and other HCEs in your retirement plan, the first alternative to explore is making a Safe Harbor Election each year. Safe Harbor plans avoid ADP nondiscrimination testing problems and benefit all employees, including HCEs. If a Safe Harbor Election is not practical, discuss the pros and cons associated with the strategies discussed in this article. In addition, be sure that all employer decision makers and those in the HCE group are well informed about the opportunity of contributing aggressively despite the fact that refunds may be required following the end of the year.

Feel free to contact your ABP administrator if you have questions about how these rules impact your plan. ▪

Welfare Plans Require Form 5500 Filings Too

Background

If you have administrative or oversight responsibilities for a company 401(k) or other retirement program, you are aware of the need to file Annual Report Form 5500 with the DOL's Employee Benefit Security Administration each year. With few exceptions, the requirement to file Form 5500 returns applies to all types of tax-qualified retirement programs, irrespective of number of participants or asset size. (Notable exceptions include SEPS, IRA Simples and non-ERISA 403(b) plans.)

Historically, there has been a high degree of compliance by retirement plan sponsors in meeting this ERISA mandate. This is likely due to the monumental fines that are imposed on non-filers and the support routinely provided by TPAs, financial institutions and others who deliver retirement plan services.

Welfare Benefit Plans Another Story

The level of compliance with the Form 5500 mandate is much lower with respect to employee health and welfare plans. In fact, many employers continue to be surprised to learn that the Form 5500 filing requirements apply to these plans. A variety of arrangements providing employee health and welfare benefits are classified as Employee Benefit Plans under ERISA. However, the most common ones are group insurance contracts providing life, medical and disability protection.

The good news for many employers who provide group insurance and other health and welfare benefits for their employees is that an administrative exemption from the Form 5500 filing mandate applies to most of these arrangements covering fewer than 100 participants. The bad news is that if your firm provides health and welfare benefits to 100 or more participants and you have not been filing Form 5500 returns each year, you have a serious problem. Fines of potentially tens of thousands of dollars can be imposed by the IRS and DOL if/when they discover this compliance failure.

Significantly, the requirement to file Form 5500 returns resides with the employer who sponsors the plan.
Some employers erroneously believe that the insurance company from whom benefits are purchased or the plan's agent or broker are responsible for these filings. If fines are imposed, they are levied on the employer/plan sponsor. Recourse is rarely available against the plan's service providers.

Delinquent Filer Program Provides Welcome Relief

For many years, the DOL has recognized the lack of client awareness and compliance with ERISA's Form 5500 filing requirements, particularly in the health and welfare area. In an attempt to increase compliance, they developed the Delinquent Filer Voluntary Compliance (DFVC) Program and announced it in 1995. *(Continued on Page 5)*

(Welfare Plans Require Form 5500 Filings Too - Continued from Page 4)

Plan sponsors who take advantage of this voluntary program have the opportunity to submit past due Form 5500 returns together with a relatively small monetary penalty.

Once having done so, submitters are no longer subject to the monumental fines that apply to non-filers. To qualify for this program and its reduced penalties, the employer must actually submit all past due returns **before** receiving an inquiry or notice from the DOL. The program is **not** available to sponsors after they are contacted by the DOL.

ABP Can Help

Over the years, ABP has helped many employers take advantage of the DFVC program. Our service includes preparation of the missing Form 5500 returns and guidance with respect to the special procedures that apply for the submission to the DOL. To date, the success rate is 100%. If you are a broker or plan sponsor representative, feel free to contact ABP's ERISA Compliance Specialist, Jackie Cleary, for additional information about the delinquent filer program and ABP's services.

Final Note

The DOL's Delinquent Filer Voluntary Compliance Program has been highly effective in providing an opportunity for plan sponsors who were unaware of the need to file Form 5500 returns to bring their plans into compliance in a cost-effective way. Despite this success and the fact that the Annual Report filing requirements have been in effect since 1974, ABP continues to be contacted each year by or on behalf of plan sponsors who are in need of delinquent filer assistance. Most of these requests come from welfare plan sponsors rather than retirement plan sponsors and many are from businesses employing thousands of employees. In providing this program with reduced monetary sanctions, the DOL is clearly offering a carrot to incentivize sponsors to comply with this long-standing ERISA requirement. At the same time, DOL representatives have indicated a willingness to wield the stick in terms of substantial sanctions for employers who have not filed Form 5500 returns and fail to take advantage of the opportunity to correct the situation. ▪

Affordable Care Act - Mixed Reviews

Declining Uninsured Rate

One of the primary goals of the Affordable Care Act (ACA) is to reduce the number of individuals who have no medical insurance. A recent Gallup Poll illustrates that this is happening. The poll found that the percentage of Americans who report being uninsured dropped from 17.3% in 2013 to 13.4% in the second quarter of 2014. The Gallup Poll reflected substantial differences in the change of rates of uninsureds among the various states. Not surprisingly, the uninsured rate has generally dropped more in states that elected to expand Medicaid and run their own health exchanges than those who did not.

ACA More Unpopular Than Ever

Despite the above, ACA appears to be more unpopular than ever. A July, 2014 Kaiser Foundation poll showed that 53% of those surveyed view ACA unfavorably. The percentage of Americans who view ACA unfavorably has exceeded the number who view it positively in all but 3 months since March 2010. However, the July poll was the first one that reflected an overall disapproval rating in excess of 50%.

Fix or Repeal?

Although the support for ACA has been consistently weak among the American public, there also isn't strong support for repealing it. The July Kaiser poll found that 60% of those surveyed want congress to improve ACA, not repeal it. Not surprisingly, Republicans generally expressed a preference for repeal whereas Democrats favored a "Fix It" approach.

Observation

It should come as no shock that politicians selectively site and creatively interpret opinion polls and surveys to support their positions. The Affordable Care Act will certainly be a major topic of discussion as we approach the November 2014 congressional elections. If you are not yet tired of hearing about ACA, you probably will be by November 4th. ▪

(Safe Harbor Election Escape Clause - Continued from Page 2)

The **disadvantages** of a safe harbor maybe election (when compared to a regular safe harbor election) include

1. The maybe election notice can be viewed as a weak commitment on the employer's part which may be interpreted in different ways by employees.

2. HCEs may decide to hold off in making elective deferrals throughout the year based on concerns that the maybe election will not be confirmed. Some HCEs may end up with insufficient income to make up for contributions that would have been made equally throughout the year if a regular safe harbor election had been made.

3. Employers who are committed to making a regular safe harbor election each year tend to build that expense into their routine budgeting process. The maybe election process tends to compromise that financial discipline.

4. There is an administrative cost associated with this election due to required plan amendments. If previously a Safe Harbor plan, the employer needs to adopt an amendment removing Safe Harbor provisions prior to the beginning of the plan year. If the employer then decides to commit to the Safe Harbor contribution, a second amendment must be prepared adding the provisions. This process occurs separately for each plan year for which a maybe election is in effect.

Looking Forward

Beginning with plan years commencing on and after January 1, 2015, all regular Safe Harbor Election Notices that ABP prepare will include the escape clause permitted by IRS final regulations. There is no downside associated with including this language so the extra degree of flexibility and financial relief may end up being helpful. Despite this new guidance, clients who tend to struggle with non-discrimination testing but are also concerned about the risks associated with funding accrued partial or full year's safe harbor contribution should still take advantage of a safe harbor "maybe" election.

There may be other issues unique to each employer that will determine which type of safe harbor election is most appropriate or if other workarounds for failed testing might be more advantageous. Please contact your plan's dedicated administrator or any member of ABP's professional staff if you would like to discuss the issues addressed here or other plan matters. ▪

Associated Benefit Planners, Ltd.

Associated Benefit Planners, Ltd. (ABP) is an independent consultant and third party administrator (TPA). We specialize in the design and administration of employer-sponsored retirement/savings plans, including 401(k) arrangements. ABP also provides plan document and compliance support for Section 125 Plans and Employee Welfare Plans, operating on a fee-for-service basis.

Associated Benefit Planners, Ltd. ***abpmail@abp-ltd.com***

215 West Church Road, Suite 200, King of Prussia, PA 19406 ***Phone (610) 687-5504 · Fax (610) 687-3993***