The Basics of Operating a 401(k) Plan

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YOUR RETIREMENT PLAN TEAM:

WHO DOES WHAT?

Once you establish a 401(k) plan, you assume certain responsibilities to operate it.

Typically, you hire a team to help you and each plays an important role in the plan's success.

Your Retirement Plan Team

Recordkeeper

- Holds Investments
- Receives Contributions
- Processes Plan Benefits

Plan Sponsor / Employer

- Census
- Contribution Submission
- Fiduciary

Investment Advisor

- Investment Strategy
- Investment Advice
- Employee Education

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Third Party Administrator

- Plan Design and Plan Document
- Compliance
- Accounting

Your Retirement Plan Team: Who Does What?

Who do I call for questions?

How do I deposit contributions?
Recordkeeper

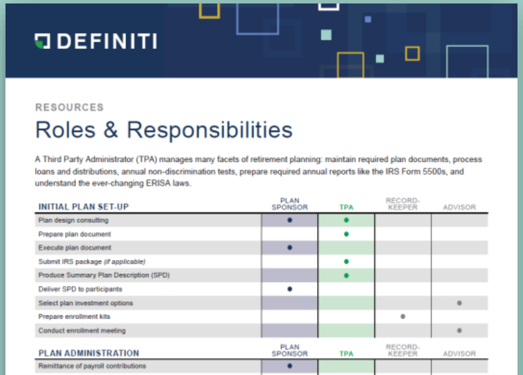
What should I invest in?
Investment Advisor

What about Plan Operations?
Retirement Plan Consultant (RPC)

Your Retirement Plan Team: Who Does What?

INITIAL PLAN SET-UP	PLAN SPONSOR	TPA	RECORD KEEPER	ADVISOR
Plan design consulting	●	●		
Prepare plan document		●		
Execute plan document	●			
Submit IRS package (if applicable)		●		
Produce Summary Plan Description (SPD)		●		
Deliver SPD to participants	●			
Select plan investment options				●
Prepare enrollment kits			●	
Conduct enrollment meeting				●

AVAILABLE MATERIALS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RESOURCES

Roles & Responsibilities

A Third Party Administrator (TPA) manages many facets of retirement planning: maintain required plan documents, process loans and distributions, annual non-discrimination tests, prepare required annual reports like the IRS Form 5500s, and understand the ever-changing ERISA laws.

INITIAL PLAN SET-UP	PLAN SPONSOR	TPA	RECORD-KEEPER	ADVISOR
Plan design consulting	●	●		
Prepare plan document		●		
Execute plan document	●			
Submit IRS package *(if applicable)*		●		
Produce Summary Plan Description (SPD)		●		
Deliver SPD to participants	●			
Select plan investment options				●
Prepare enrollment kits			●	
Conduct enrollment meeting				●

PLAN ADMINISTRATION	PLAN SPONSOR	TPA	RECORD-KEEPER	ADVISOR
Remittance of payroll contributions	●			

PLAN ADMINISTRATION	PLAN SPONSOR	TPA	RECORD KEEPER	ADVISOR
Remittance of payroll contributions	●			
Provide year-end employee census data and employee questionnaire	●			
Eligibility determination	●			
Allocate contributions to participant accounts			●	
Track and monitor plan and participant allocations		●	●	
Perform all required non-discrimination testing		●		
Top heavy determination		●		
Calculate top heavy minimum contributions *(as required)*		●		
Provide day-today support for plan sponsors and advisors		●		
Provide day-today support for participants			●	
Ongoing enrollment and education support			●	
Determine and monitor participant account vesting		●	●	
Calculate annual employer contributions		●		
Forfeiture allocations		●		
Ensure compliance with plan document and ERISA		●		
Reconcile individual participant accounts *(as needed)*		●	●	
Determine Highly Compensated Employees (HCE) and Key Employees		●		
Determine plan audit status		●		
Prepare audit package and provide assistance to auditor		●	●	

Retirement Plan Documents

- Your plan document must be written to comply with all requirements in the Internal Revenue Code.
- You must administer your plan consistent with the provisions in the plan document.
- You should review your plan annually to make sure it's operating according to its terms and the law.
- Make sure to sign and date all documents timely. The IRS assumes that if you don't have a copy of your current and/or previous retirement plan documents, restatements, and amendments (or if they are unsigned) – they were never done!
- Plan document restatements have started, now is a great time for a review!

PLAN OPERATIONS

YOUR PLAN DOCUMENT GOVERNS HOW YOUR PLAN OPERATES:

- When your employees become eligible to participate in the plan
- Types and amounts of allocable plan contributions
- How employer contributions are divided among Participants
- When participants are vested
- How benefits are paid

Plan Operations and Administration: Eligibility & Enrollment

- You must notify employees who are eligible to participate in the plan. In order to do that, you will need to know how to determine who is eligible and what documents to provide to them.

- *If you fail to notify or allow eligible participants to enroll in the plan timely, you could be responsible for additional funding towards that employee's retirement account*.

- Eligibility and Entry Dates are important to get right. Make sure to reach out to your Consultant to ensure you understand. We are here to help!

Standard 401(k) eligibility requirements (the most stringent eligibility requirements that your plan can impose):

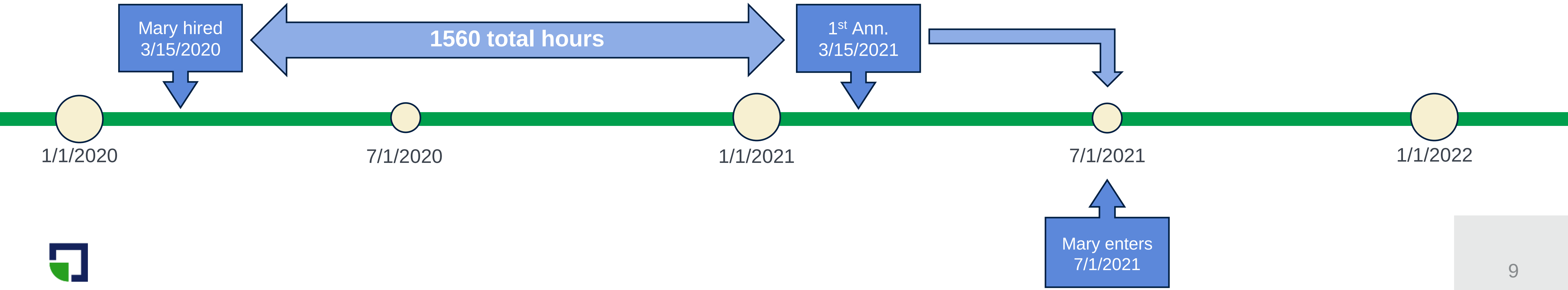
- Minimum Age: 21
- Service Requirement: 1 year
- Hours Requirement: 1000 hours
- Entry Dates: Semi-Annual (ex: Jan 1 & Jul 1)

These requirement can be more generous or flexible.

Plan Operations and Administration: Eligibility & Enrollment

Entry Date Example 1:
Mary satisfies all eligibility requirements

- Age 35
- DOH: 3/15/2020
- Computation Period: 1st Anniversary Year
- 1st Anniversary Date: 3/15/2021
- Hours in 1st Anniversary Year: 1560
- Mary enters the plan on ***July 1, 2021***

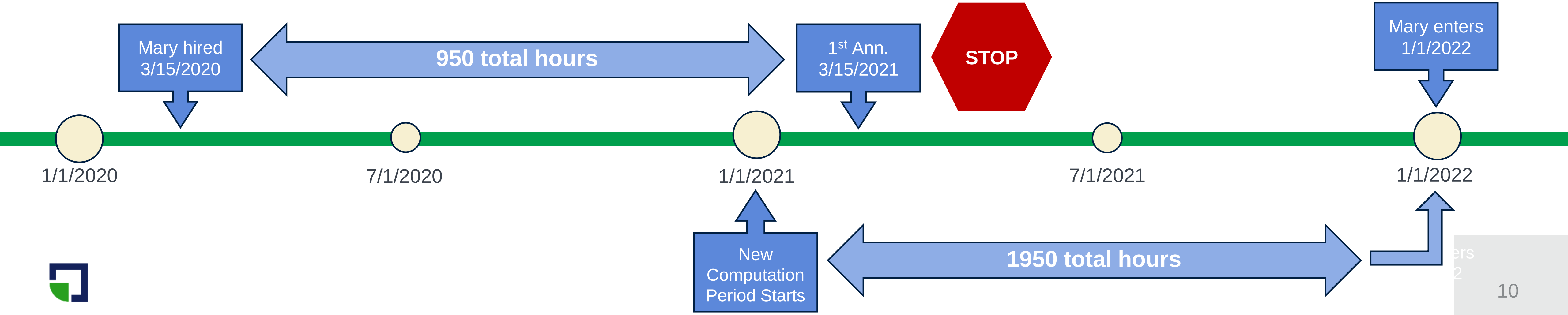


Plan Operations and Administration: Eligibility & Enrollment

Entry Date Example 2:

Mary does not satisfy hours requirements

- ***Fact Change!*** Hours in 1st Anniversary Year: ***950***
- Mary does not enter the plan on July 1, 2021
- New Computation Period: Plan Year *(it may overlap)*
- Hours from 1/1/2021 – 12/31/2021: 1950
- Mary enters the plan on ***January 1, 2022***



Plan Operations and Administration: Eligibility & Enrollment

Rehired Employees

- Must keep complete records for all employees with details of all their employment dates.
- If the employee met eligibility during their past employment with your company, they are eligible upon rehire.
- If the employee met eligibility during their past employment but terminated prior to their entry date and was later rehired after their original entry date has passed, they are eligible upon rehire.
- If the employee did not meet eligibility, terminated then later rehired after their first anniversary year, the computation period shifts to the plan year in which we would then determine if they meet the service and hours requirement.

Plan Operations and Administration: Eligibility & Enrollment

Rehire Example 1:

Mary satisfies all eligibility requirements but terminates before her entry date

- Age 35
- DOH: 3/15/2020
- Computation Period: 1st Anniversary Year
- 1st Anniversary Date: 3/15/2021
- Hours in 1st Anniversary Year: 1560

Mary is eligible on July 1, 2021 but…

- Terminates on June 15, 2021
- Rehired on September 15, 2021
- Entry date is September 15, 2021 *since original entry date has passed*

Rehire Example 2:

Mary does not satisfy hours requirements <u>and</u> terminates before her entry date

- ***Fact Change!*** Hours in 1st Anniversary Year: ***950***
- Computation Period shifts to Plan Year
- Hours from 1/1/2021 – 12/31/2021: 1,000
- Entry date is January 1, 2022

OR, if…

- Hours from 1/1/2021 – 12/31/2021: 950
- New Computation Period: 2022 plan year

Notices to Provide Employees Upon Eligibility for the Plan

- Summary Plan Description
- Annual Notices (if not done so already)
- Beneficiary Designation Form
- Deferral Election Form
- Investment Selection Form
- Other Account Establishment Forms

Plan Contributions

Employee Contributions

- **Pre-Tax Elective Deferrals** – Amounts contributed are excluded from taxable income. Taxes paid upon distribution.

- **Roth Elective Deferrals** – Taxes paid now on amounts contributed. Tax-free growth in your retirement account; no taxes* are payable on distribution of benefits.

** Qualified Roth Distribution – Age 59 ½ and 5 years since the first Roth contribution*

Plan Contributions

Employer Contributions

- **Discretionary Profit Sharing** – must be allocated by a non-discriminatory method defined in your plan document.
- **Discretionary Match** – example: $.50 per $1.00 up to 6% of wages
- **Safe Harbor Nonelective** – 3% of eligible compensation. Employee deferral participation is not required.
- **Safe Harbor Match** – two versions:
  - **Enhanced Match** (one-tier) – 100% of employee deferrals on the first 4% of compensation
  - **Basic Match** (two-tier) – 100% of employee deferrals up to the first 3% of compensation PLUS 50% on the next 2% of employee deferrals

Note: All Safe Harbor contributions must be 100% vested. No last day or hours requirement.

Plan Contributions

Forfeitures

Plan forfeitures can be used in one or more of four ways, depending upon the design of your plan:

1. Allocate as an additional contribution to eligible participants
2. Reduce employer contributions (matching or profit sharing)
3. Fund safe harbor contributions – NEW!
4. Pay certain plan administration expenses

Note: forfeitures used to reduce or fund employer contributions are not tax deductible

Plan Contributions: Deferral and Contribution Limits

Employee Deferrals

+

Employer Contributions

(Matching and Profit Sharing)

+

Forfeiture Allocations

=

Annual Additions Limit

Limits for 2020 and 2021

2020

Age 49 or younger:	*$19,500 EE + $37,500 ER =* ***$57,000***
Age 50 or older:	*$26,000 EE + $37,500 ER =* ***$63,500***

2021

Age 49 or younger:	*$19,500 EE + $38,500 ER =* ***$58,000***
Age 50 or older:	*$26,000 EE + $38,500 ER =* ***$64,500***

Plan Contributions: Compensation Limits

The <u>Compensation Limit</u> is the maximum compensation a plan can use for contribution calculations

2020: $285,000

2021: $290,000

What Compensation is used for owners?	
C-Corp	W-2 Wages
S-Corp	W-2 Wages (not K-1)
Sole Proprietor	Schedule C Net Profit
LLC/PLLC	K-1 Self Employment Earnings

Highly Compensated and Key Employees

Highly Compensated Employees (HCEs) and **Key Employees** (Keys) are terms used to describe certain employees for testing purposes in the annual compliance testing of a retirement plan.

The regulations applicable to retirement plans require that HCEs and Keys do not benefit from the plan disproportionately to the remainder of the plan participants.

Highly Compensated Employees

You are a **Highly Compensated Employee** (HCE) if:

1. You are a MORE THAN 5% owner at any time during the current or preceding Plan Year.

   Note: Lineal attribution applies: spouse, parents, grandparents, children (2 generations up, 1 down)

OR

2. You have compensation over a certain indexed amount in the previous year.
   - *If you earned more than $125,000 in 2019, you'll be an HCE for 2020*
   - *If you earn more than $130,000 in 2020, you will be an HCE for 2021*

Key Employees

Who are **Key Employees?**

Generally, key employees are the owners and officers of the plan sponsor *(or related employer)*.

More specifically, a key employee is anyone, who at any time during the plan year, fits into at least one of the following categories:

- An individual who owns more than 5% of the plan sponsor or a related employer
- An individual who owns more than 1% of the plan sponsor or a related employer AND has annual compensation exceeding $150,000
- An officer of the plan sponsor or a related employer with annual compensation exceeding $185,000 for 2020 (indexed for future years)
    - For purposes of officer status, no more than 10% of the total employees can be considered officers.

For purposes of ownership, family attribution rules apply. That means that an individual is generally deemed to own company stock owned by his or her spouse and lineal ascendants/descendants.

Highly Compensated and Key Employees

Why is it important to determine who the Highly Compensated and Key Employees are?

Each year it is necessary to conduct nondiscrimination and coverage testing on a plan to show the plan does not favor the HCEs or Keys over the non-Highly Compensated Employees (NHCEs) or non-Key employees.

Nondiscrimination Testing

Coverage Testing

The plan must demonstrate that the coverage rate for the non-HCEs is at least equal to 70% of the coverage rate for the HCEs.

Top Heavy Test

The Key employee definition comes into play in the “top heavy” test. Each year, it must be determined if the plan is top heavy. A top heavy plan is one in which the Key employees own more than 60% of the plan’s assets. If the plan is determined to be top heavy, the *general* rule is the employer must make a minimum 3% contribution to all Non-Key eligible employees employed on the last day of the plan year.

Nondiscrimination Testing

Actual Deferral Percentage (ADP) Test

The **ADP test** compares the HCE group employee deferral percentage average to the NHCE group deferral percentage average.

Actual Contribution Percentage (ACP) Test

The **ACP test** compares the HCE group employer matching percentage average to the NHCE group matching percentage average.

	Eligible Comp	Salary Deferral	% of Comp	Discretionary Matching	% of Comp
HCE 1	$ 285,000	$ 19,500	6.84%	$ 11,400	4.00%
HCE 2	$ 180,000	$ 7,200	4.00%	$ 7,200	4.00%
		HCE ADP	**5.42%**	**HCE ACP**	**4.00%**
NHCE 1	$ 80,000	$ 10,000	12.50%	$ 3,200	4.00%
NHCE 2	$ 50,000	$ 5,000	10.00%	$ 2,000	4.00%
NHCE 3	$ 45,000	$ 2,000	4.44%	$ 1,800	4.00%
NHCE 4	$ 35,000	$ 1,000	2.86%	$ 1,000	2.86%
NHCE 5	$ 28,000	$ -	0.00%	$ -	0.00%
		HCE ADP	**5.96%**	**HCE ACP**	**2.97%**

ADP/ACP Testing	HCE ADP	5.42%	HCE ACP	4.00%
	HCE Limit	7.96%	HCE Limit	4.97%
		PASSES!		**PASSES!**

Because of the annual testing, HCEs may find they cannot contribute as much to their 401(k) plan as they would like.

In general, the average deferral percentage of all HCEs cannot be more than 2% greater than the average deferral percentage of all NHCEs.

The "deferral percentage" is determined by dividing the employee deferrals by the employee compensation.

Nondiscrimination Testing

Safe harbor 401(k) plans allow sponsors to bypass ADP/ACP and other non-discrimination testing in exchange for providing eligible matching or nonelective contributions, that are 100% vested, on behalf of their employees.

This plan type allows owners to maximize salary deferrals regardless of the salary deferrals made by all other eligible employees.

Submitting Contributions: Deadlines

Employee 401(k) / Roth Deferrals

Plans with fewer than 100 participants:
7th business day following the paycheck date

Plans with 100 or more participants:
As soon as the deferrals can be reasonably segregated from the company's assets, but no later than the 15th day of the month following the paycheck date

Employer Contributions

- Due by the due date of the company's tax return, plus any extensions
- Pension contributions are due no later than September 15th (for calendar year plans)

Submitting Employer Contributions

Funding Options

OPTION #1 – After Year-End

1. Contributions still deductible for prior year
2. Contributions calculated just once (correctly)
3. No issues with taking back pre-funded contributions to partially vested participants

OPTION #2 – Fund As You Go

1. Employees may perceive this as a benefit
2. Match is calculated for each payroll (high chance of error)
3. Must be careful to not pay out terminated employee until vesting and other contributions issues are corrected

Types of Employer Contributions

- Safe Harbors (Match & Nonelective)
- Discretionary Matching
- Discretionary Profit Sharing

Year End Operations and Administration

Plan Year End Information to Provide to your TPA

Census Data

(for ALL employees regardless of their eligibility & status):

- SSN
- Legal Name
- Date of Birth
- Original Date of Hire
- Date of Termination
- Date of Rehire
- Compensation (as defined in the plan document)
- Pre-entry Compensation, if applicable
- Total Hours of Service
- Employee 401(k) and/or Roth Deferrals
- Employer Match deposited during the year
- Employee status: Union, Leased, NRA, etc.

Year End Operations and Administration

Plan Year End Information to Provide to your TPA

We need to receive accurate data.
Everything we do for compliance revolves around the data we receive from you.

If you are not sure what we need…

please call or email!

Payroll Detail Summary

- W-3 and W-2’s (if requested)
- Schedule K-1 and/or Schedule C for owners, when applicable
- Owner(s), including ownership percentage
- Officer(s) and titles
- Employees related to Owners/Officers
- Interrelated Companies
- Changes in key personnel

Vesting

- A participant's ownership in their account balance
- Vested account balance is the portion that is non-forfeitable
- Vesting does not apply to Safe Harbor, QNEC, Employee Deferrals or rollovers
- Vested is determined by the Plan Year hours.
- Most often, 1000 hours are required for a Year of Vesting Service

Years of Service	Cliff Vesting	Graded Vesting
1	0%	0%
2	0%	20%
3	100%	40%
4		60%
5		80%
6		100%

Vesting

Vesting schedules are ignored and 100% vesting occurs if:

- A participant reaches normal retirement age
- A plan is terminated, a partial termination occurs, or contributions are completely discontinued
- The plan allows, when a participant dies or becomes disabled

Partial Plan Termination

- 20% of plan participants terminated by company
- Affects ONLY terminated employees
- 100% vesting for those affected

Plan Distributions

Must have a "qualified" event to take a distribution from the plan

- Termination of Employment
- Death
- Disability

In-Service Distribution Options (must be allowed in the plan document):

- Hardships
- In-Service distributions after age 59 ½
- In-Service distributions prior to age 59 ½ (restricted sources)

Required Minimum Distributions (RMD)

- Retired, 5% owner or lineal ascendants of 5% owner
- Age 72 (NEW for 2020)
- Deadline 12/31 following age 72

Exception: first RMD, you can wait until 4/1 of the year following age 72 (must take two distributions that year)

Plan Loans

Must be permitted in the plan document (Loan Policy)

Limited to lesser of $50,000 or 50% of the participant's vested balance

Maximum repayment period is 5 years

(15 years for loans for principal residence)

Payments must be made at least quarterly *(typically through payroll deduction)* using level amortization and a reasonable interest rate.

i.e. Prime Rate + 1%

Notices Required to Be Distributed by Plan Sponsors

Notice	Due Date
Enrollment Package	Prior to eligibility/participation
Summary Plan Description (“SPD”)	Within 90 days after participation
Safe Harbor Annual Notice	30 days prior to beginning of the plan year
Summary Annual Report (“SAR”)	60 days after Form 5500 filing deadline
Annual Fee Disclosures	Annually
Auto Enrollment Notice (if applicable)	At least 30 days but no more than 90 days before autoenrollment
Summary of Material Modification for Plan Amendment	No later than 210 days after the close of the plan year of the amendment
Black Out Notice (if applicable)	At least 30 days, but not more than 60 days, in advance of any blackout

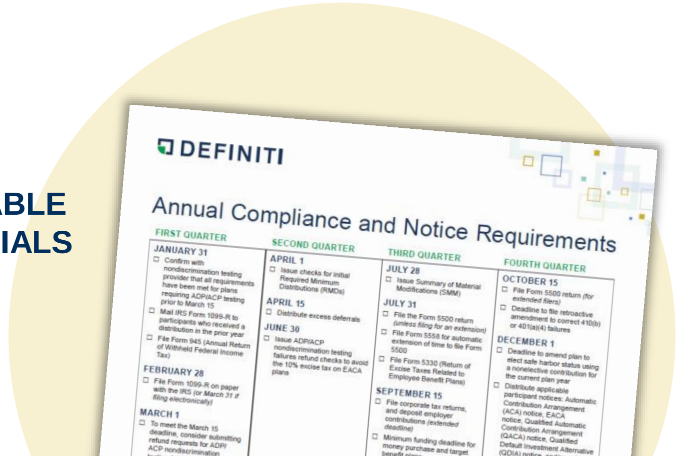
Annual Calendar for Plan Sponsors

Date	Task
January 31, 2021	Form 1099-R to participants with distributions in 2020 Form 945 due to IRS if all federal withholding not remitted timely
February 10, 2021	Form 945 due to IRS if all federal withholding was remitted timely
February 14, 2021	Deadline to distribute 4th quarter 2020 statements to participants
February 28, 2021	Form 1099-R due to IRS if filed on paper
March 15, 2021	Deadline for ADP/ACP corrective distributions to avoid 10% excise tax
March 31, 2021	Form 1099-R due to IRS if filing electronically Form 5330 due for excise tax for 2020 ADP corrective distributions
April 1, 2021	Minimum distributions for 2020 for terminated participants who reached age 70½ in 2020 and for participants over age 70½ who retired in 2020

Annual Calendar for Plan Sponsors - continued

Date	Task
April 15, 2021	Deadline for correction of 2020 salary deferrals exceeding $19,500 ($26,000 for those age 50 and older)
July 31, 2021	Form 5500 for 2020 due (unless extended) Form 8955-SSA due (reporting balances for terminated participants) Extension for Form 5500 and 8955-SSA due (if not already filed)
September 15, 2021	Contribution funding deadline for matching and other employer contributions if on extension
September 30, 2021	Deadline to distribute Summary Annual Report (unless Form 5500 extended)
October 15, 2021	Deadline to file Form 5500 and 8955-SSA if extension was submitted

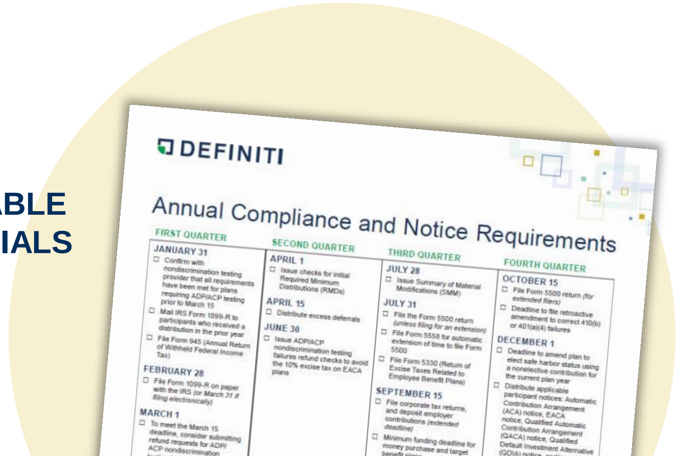
AVAILABLE MATERIALS



Annual Calendar for Plan Sponsors - continued

Date	Task
December 2, 2021	Deadline to distribute annual safe harbor notice, annual enrollment notice, and qualified default investment alternative (for 401(k) plans using those features)
December 15, 2021	Deadline to distribute Summary Annual Report (if Form 5500 deadline was extended)
December 31, 2021	Deadline for participants to take required minimum distributions for the 2021 calendar year

AVAILABLE MATERIALS



Document Retention Requirements

Keep Indefinitely

- All originals of the plan document from the inception of the plan, including amendments, summaries of material of modifications, summary plan descriptions, IRS approval letters
- Beneficiary Forms
- Payroll Records (electronic is fine)
- Participant demographic information (DOB, DOH, DOT, DOR, Comp, Hours, Name Changes, SSN, etc.)
- Loan and Distribution Records

Keep for Six Years Following the End of the Plan Year

- Annual reports & Form 5500 with associated backup
- Fidelity Bond
- Corporate Income Tax Returns

Final Notes

Even with the best intentions, mistakes in plan operation can still happen. The U.S. Department of Labor and IRS have correction programs to help 401(k) plan sponsors correct plan errors, protect participants, and keep the plan's tax benefits.

You can self-correct many insignificant operational errors without contacting the IRS or paying a fee. There are no application or reporting requirements.

An operational error occurs when you don't follow the written terms of the plan. Even where the operational error is significant, you may still be able to self-correct if action is taken in a timely manner.

Catching and fixing errors early is key.

Call us as soon as any issues arise so we can help you!

Thank You!

Questions?

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