

# ***Retirement Plan Choices and Design Options***

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# *Retirement Plan Choices and Design Options*

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## I. TYPES OF QUALIFIED PLANS.

### A. Profit-Sharing Plan.

1. Profit-Sharing plans are the most flexible of all qualified plans. The employer is not obligated to make contributions to the plan, but each year it can elect to contribute any amount between 0% and 25% of the annual compensation of the covered employees. Employer contributions may be determined each year by action of the board of directors or by a contribution formula written into the plan.
2. For all defined contribution plans, the maximum annual additions (which includes employer contributions, forfeitures and employee contributions) under IRC §415(c) for each year is the lesser of 100% of compensation or \$52,000 (adjusted). Thus, contributions and forfeitures allocated on behalf of each participant cannot exceed these limitations.
3. The IRS requires that contributions to a profit-sharing plan be recurring and substantial. Although an employer does not have to make contributions every year, the employer's contributions must be more than single or occasional. Treas. Reg. §1.401-1(b)(2). Rev. Rul. 80-146 provides that a plan may be considered to be terminated if no contributions have been made to the plan for five (5) consecutive plan years.
4. The Pension Protection Act of 2006 (PPA) requires that employer contributions made to defined contribution plans for plan years commencing after 2006 be vested no less rapidly than under a 3-year cliff or 6-year graded vesting schedule.

<u>Year</u>	<u>3-Year Cliff</u>	<u>6-Year Graded</u>
1	0%	0%
2	0%	20%
3	100%	40%
4		60%
5		80%
6		100%

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*Retirement Plan Choices and Design Options* • 2.1

B. 401(k) Plan.

1. A §401(k) cash or deferred compensation plan is a type of profit-sharing plan under which employees may elect to defer a portion of their compensation to the plan. An individual can defer a maximum of \$17,500 for 2014 under §402(g). Employees who have attained age 50 are permitted to defer additional "catch-up" contributions of \$5,500 for 2014.
2. In addition to satisfying the requirements applicable to a regular profit-sharing plan, a 401(k) plan must satisfy the Average Deferral Percentage ("ADP") Test under IRC §401(k)(3)(A) for each plan year. The ADP consists of two alternative tests which measure the deferral of income of highly-compensated employees in comparison to the deferral of all other employees.

Under the ADP limits, the ADP for the eligible highly compensated employees must be no greater than one of two limits.

- a. Under one limit, the ADP for Highly Compensated Employees ("HCEs") is limited to 125% of the ADP for the eligible non-highly compensated employees.
  - b. Under the second limit, the ADP for HCEs is limited to the lesser of 200% of the ADP for the eligible non-highly compensated employees; or the ADP for the eligible non-highly compensated employees plus two percentage points.
3. A "highly compensated employee" ("HCE") under IRC §414(q) is an employee who is either:
    - a. a 5% owner (during either the current year or the prior year) of the employer; or
    - b. who has compensation greater than \$100,000 (adjusted; \$115,000 in 2012-2014) (during the prior year) from the employer. HCE in 2015 if compensation greater than \$115,000 in 2014.

The stock ownership attribution rules of IRC Section 318 apply for purposes of determining a 5% owner for HCE purposes. Therefore, the spouse, children, and parents of a 5% owner are also deemed to be 5% owners.

3. Pension Protection Act of 2006 (PPA) Simplifies Administration of 401(k) Corrective Distributions.
  - a. All ADP/ACP testing refunds are taxable in the year distributed. Under prior law, refunds within the 2½ month window were taxable in the previous year.

b. "Gap period" earnings on refunds will not be required if paid under the 2½ month rule for all 401(k) plans and the new six month rule for auto enrolled plans.

c. The new rules are generally effective for the 2008 plan year.

4. Hardship Distributions for Non-Spouse Beneficiaries.

PPA allows hardship distributions from 401(k) and 403(b) plans with respect to any designated beneficiary, not just a spouse or dependent.

C. Roth 401(k) Contributions.

1. Plan Sponsors may amend 401(k) or 403(b) plans to permit plan participants to elect to treat some or all of their elective deferrals as contributed on a Roth basis. The amendment must be adopted by the last day of the plan year in the calendar year that Roth deferrals are permitted. However, the Participant must elect to treat a deferral on a Roth basis prior to the time that it is deferred.

IRS Notice 2006-44 provides a sample plan amendment for Roth contributions for a 401(k) plan.

2. If the Plan so permits, participants will be able to elect to have all or a portion of elective deferrals on or after January 1, 2006 as being deferred into the 401(k) plan on an after-tax basis. Future distributions from the Roth 401(k) account would be distributed on a tax-free basis (similar to a Roth IRA). Thus, a participant under Age 50 could defer up to \$17,500 into the 401(k) plan on a Roth basis in 2014. Participants Age 50 or older could also have catch-up contributions of \$5,500 treated on a Roth-type basis for total deferrals of \$23,000 (*i.e.*, the normal 401(k) deferral limits).

3. The Roth treatment only applies to the Participant's elective deferrals. Employer matching contributions or employer non-elective contributions will continue to be treated as tax-deferred contributions and will be taxable to the participant when distributed from the Plan.

4. Unlike Roth IRA assets, Roth 401(k) accounts will continue to be subject to the minimum distribution rules under IRC Section 401(a)(9).

5. Any excess deferrals attributable to a designated Roth contribution must be distributed no later than April 15 of the year following the year of the designated Roth contribution. If the excess deferrals are not distributed by April 15, the contribution will be taxed both in the year of contribution and the year of distribution (*i.e.*, subject to double taxation), however, earnings attributable to the excess Roth deferral are only taxed in the year of distribution.

6. Roth 401(k) Contribution Compliance.
  - a. Roth contributions are taxed at the time of the contribution and only earnings, if not qualified, are subject to future income taxes.
  - b. There is still one annual limit for deferrals which includes both Roth and traditional deferrals. The limit for 2013 and 2014 is \$17,500 (\$23,000 for participants age 50 or older).
  - c. Traditional 401(k) and Roth (401(k) deferrals are tested together in the ADP test.
  - d. Both contribution types will be treated the same when applying a match formula. All matching contributions are tested together in the ACP test. There is no special tax treatment for matching contributions attributed to Roth 401(k) contributions since these are still considered employer contributions.
  - e. Separate recordkeeping accounts for Roth 401(k) and Traditional 401(k) deferrals are required.
  - f. The amendment to the plan document will need to specify if the participant has the option between Roth 401(k) and Traditional 401(k) contributions or a mix of both, and whether the participant has a choice as to the source from which compliance refunds should be taken.
  
7. Roth 401(k) Distribution Rules.
  - a. Distributions are subject to the same restrictions as traditional 401(k) contributions — i.e., hardship distributions from contributions only and in-service distributions only allowed after attainment of age 59½.
  - b. The portion of the account attributable to Roth 401(k) contributions is always tax free upon distribution.
  - c. Earnings are tax free only if the participant is either age 59½, disabled or deceased AND the first Roth 401(k) contribution was deposited five or more tax years ago. (If the plan allows Roth 401(k) rollovers, this would include the date the first Roth 401(k) contribution was made to the prior plan.) Roth 401(k) earnings can be distributed tax free as early as 2011 under these rules (*e.g.*, for Roth deferrals first made in 2007).
  - d. The Plan Sponsor is responsible for tracking the five years and the basis on the contributions to determine the tax that may be due upon distribution, even on rollover Roth 401(k) contributions.

- e. The five-year period is based on tax years, not the elapsed time from the first contribution.
- f. Unlike the Roth IRA, withdrawals are taken out pro-rata between contributions and earnings. Participants cannot choose to take only contributions first for non-qualified distributions.
- g. Tacking Years for Roth 5-Year Holding Period.
  - i. Rollover FROM Roth 401(k) or Roth 403(b) INTO Roth 401(k) or Roth 403(b): Years from prior Roth plan are included to determine 5-year period.
  - ii. Rollover FROM Roth 401(k) or Roth 403(b) INTO Roth IRA: Years from Roth plan are NOT included for determining 5-year period in Roth IRA. Roth IRA and Roth plan have separate 5-year periods.
  - iii. Rollovers FROM Roth IRAs are not permitted (except to another Roth IRA).

8. In-Plan Roth Conversions.

- a. The Small Business Jobs Protection Act of 2010 (enacted September 27, 2010) permits in-plan Roth conversions after September 27, 2010. IRC §402A(c)(4). IRS Notice 2010-84.
- b. The Plan must otherwise permit Roth 401(k) deferrals. A plan cannot just be amended to permit Roth conversions without also permitting Roth deferrals.
- c. The plan needs to permit in-service distributions.
  - i. IRS permits amendments which limit in-service distributions to Roth in-plan conversions.
  - ii. In-plan Roth conversions may be permitted for funds not otherwise eligible for an in-service distribution.
- d. Advantages of Roth IRA over Qualified Roth 401(k).
  - i. Roth IRAs do not have lifetime required minimum distributions.
  - ii. Roth IRA rollovers have ability to recharacterize the rollover.
  - iii. Roth IRA assets are more accessible.

9. Roth IRA Rollovers. Elimination of \$100,000.00 AGI limit for Roth IRA Rollover (effective in 2010).
  - a. TIPRA eliminates the \$100,000.00 adjusted gross income (AGI) ceiling for converting traditional IRAs to Roth IRAs, for tax years after 2009. A conversion is treated as a taxable distribution, but is not subject to the 10% early withdrawal penalty. Taxpayers who convert in 2010 can elect to recognize the conversion income in 2010 or average it over the next two years (i.e., 50% of income is includable in 2011 and 50% in 2012).

D. Safe Harbor §401(k) Plan.

IRC §401(k)(12); IRS Notice 98-52; IRS Notice 2000-3.

1. The Safe Harbor means that:
  - a. The ADP test is deemed to be satisfied.
  - b. HCEs are permitted to defer up to the maximum amount.
2. Safe Harbor Non-Discrimination Rules. A 401(k) plan satisfies the non-discrimination rules (the ADP test) if it meets the following requirements:
  - a. a notice requirement; and
  - b. one of two contribution requirements (discussed below).
3. The notice requirement is met if each employee eligible to participate in the Plan is given written notice (prior to the plan year) of his rights and obligations under the plan. The notice must be given between 30 and 90 days before the beginning of the plan year.
  - a. For an employee who becomes eligible later than the 90th day before the beginning of the plan year, the notice may be given not later than the employee's date of eligibility.
  - b. With respect to a new plan, the notice can be given up to the first day of the first plan year.
  - c. Please note, the IRS has stated that if the safe harbor is blown (e.g., the notice is not provided), the plan is disqualified. It does not merely revert to a 401(k) plan subject to ADP testing.
4. Basic Formula. The contribution requirement is met under the safe harbor if the employer provides a matching contribution on behalf of each Non-Highly Compensated Employee of (i) 100% of the employee's elective contributions up to 3% of compensation and (ii) 50% of the employee's elective contributions to the extent that they exceed 3% (but not 5%) of the employee's compensation. Additionally, the rate of the matching



contributions with respect to any elective contribution for highly compensated employees is not greater than the rate of match with respect to non-highly compensated employees.

- a. Alternatively, the matching contribution safe harbor may be met if the rate of the employer's matching contribution does not increase as the employee's rate of elective contributions increases and the total amount of matching contributions is at least equal to the requirements set out above (*e.g.*, 100% of the contributions up to 3% of compensation and 50% of contributions between 3% and 5%).
  - b. Enhanced Formula. An enhanced formula provides a match that is at least equal to the amount of the match that would be made under the basic formula. A match of 100% of the first 4% deferred is an acceptable enhanced formula.
5. In lieu of a matching contribution, the employer may make a non-elective contribution of at least 3% of an employee's compensation to a defined contribution plan on behalf of each non-highly compensated employee who is eligible to participate in the plan regardless of whether the employee makes an elective contribution.
  6. 100% Vesting Required. The employer matching safe harbor contributions must be non-forfeitable and subject to the restrictions on withdrawals that apply to elective deferrals.
  7. Last Day of Plan Year And 1,000 Hour Requirements Not Permitted. The employer safe harbor matching or non-elective contribution for a plan year cannot be made subject to a requirement that the participant is employed in the last day of the plan year or that the participant completes 1,000 hours of service during the plan year.
  8. Definition of Compensation. A safe harbor matching contribution formula or a safe harbor nonelective contribution formula must use a definition of compensation that satisfies IRC §414(s). The plan is permitted to use partial-year compensation for newly eligible employees.
  9. Document Requirements. A plan must specify the formula requirement (the matching contribution or the nonelective contributions). As a general rule, a plan may not rely on the safe harbor unless the plan document reflects such requirements before the first day of the plan year. However, the remedial amendment period rules are applied by Notice 98-52 to the plan document requirements for the safe harbors.
  10. Plan Year Requirements. Plans may not rely on the safe harbors for a plan year unless the plan year is 12 months long. For a new plan, however, (other than a successor plan) the first plan year may be less than 12 months, but must be at least 3 months. A new plan for a newly established employer may be less than the 3-month minimum. A plan is a successor

plan if 50% or more of the eligible employees for the first plan year were eligible under another 401(k) plan of the employer in the prior year. IRS Notice 98-1.

Treasury regulations would allow a short plan year in additional circumstances:

- When the plan terminated, if the plan termination was in connection with a merger or acquisition involving the employer, or the employer incurred a substantial business hardship comparable to a substantial business hardship described in Section 412(d);
- When the plan terminated, provided the employer made safe harbor contributions for the short year, employees were provided notice of the change, and the plan passed the ADP test; and
- Where the short plan year was preceded and followed by 12-month plan years during which the plan was a safe harbor plan.

11. Participants required to receive safe harbor contributions.

- a. Generally, all nonhighly compensated employees who are eligible to make elective deferrals must receive the safe harbor contribution. The plan may provide that highly compensated employees also receive the safe harbor contribution.
- b. However, a safe harbor 401(k) plan may provide for immediate eligibility for the elective deferrals and one year of service/age 21 eligibility conditions for the safe harbor contributions. The plan may take advantage of the "otherwise excludable employee" rule (i.e., permissive disaggregation) to divide the plan into two plans for testing. The "upper group" plan includes all participants who would have entered the plan if the plan had a year of service/age 21 eligibility condition. The "lower group" plan includes all other plan participants (generally those with less than a year of service). The NHCEs (or all participants) in the upper group plan will receive the safe harbor contributions, thus satisfying the safe harbor requirement. The lower group plan is considered a separate plan, and since the participants would not be receiving safe harbor contributions, that plan must satisfy the ADP test.
- c. The otherwise excludable employee rule does not apply to the top-heavy rules. Therefore, all NHCE participants in the plan (including those in the "lower group") must receive the top-heavy minimum contribution.

12. "MAYBE" Safe Harbor Option. A non-safe harbor 401(k) plan that uses the current year testing method to be amended into a safe harbor plan as late as 30 days before the end of the plan year. The safe harbor

contribution must be in the form of a 3% nonelective contribution and two notices must be given. First, eligible employees must receive notice before the beginning of the plan year advising them that the plan sponsor may choose to amend the plan into a safe harbor plan. Second, a notice of the amendment must be given to participants at least 30 days before the end of the plan year.

Note: unless this "MAYBE" double notice procedure is followed, an existing 401(k) plan can only be amended to add safe harbor provisions as of the first day of the following plan year.

13. Amendment of Profit-Sharing Plan to Add Safe Harbor Provisions. Under Notice 2000-3, a profit-sharing plan can be amended to add safe harbor 401(k) features up to three months before the end of the plan year as long as the plan is not a successor plan (as defined in Notice 98-1), the cash or deferred elections begin not less than three months prior to the end of the plan year and the requirements of Notice 98-52 are otherwise satisfied for the period during which deferral elections are permitted.
14. Suspension of Safe Harbor Contributions.
  - a. A Safe Harbor Plan may suspend the safe harbor contribution if the Plan provides a 30 day notice of the suspension of safe harbor contributions and either:
    - i. Participants were provided a notice 30-90 days prior to the Plan Year stating that there is a possibility that the safe harbor contributions may be repealed or suspended. This notice may be combined with the safe harbor notice required for each plan year.
    - ii. If a notice was not provided prior to the beginning of the plan year, the Employer must be operating at an economic loss.
  - b. Effective dates. These rules are effective:
    - i. 2013 for Nonelective Contributions.
    - ii. January 1, 2015 for Matching Contributions.
  - c. Plan must apply current year ACP/ADP testing for the year that the safe harbor is revoked.
  - d. The Plan loses the top-heavy exemption.
15. Safe Harbor Contribution May Be Provided to a Separate Plan. If the contribution is made to a separate plan, the other plan must have the same plan year as the 401(k) plan.

16. Current Year Testing Method is Deemed to Apply to Safe Harbor Plans. This will impact the plan's ability to switch to the prior year testing method for any plan year beginning after the GUST remedial amendment period. Notice 98-1 generally requires that a plan use the current year method for at least 5 years before it can switch to the prior year method after the remedial amendment period ends.
17. Safe harbor contributions may not be used as QMACs or QNCs for other arrangements that need to apply the ADP test or ACP test.
18. Safe harbor 3% nonelective contribution can count in three ways:
  - a. Replaces and satisfies the ADP/ACP test.
  - b. Satisfies the 3% minimum top-heavy contribution.
  - c. As a profit-sharing contribution that can be taken into account for nondiscrimination testing under IRC §401(a)(4) (other than the permitted disparity/integration rules of §401(l)) including the minimum gateway test for cross-tested plans.
19. Safe Harbor Matching Contribution Satisfies Top-Heavy Rules. The safe harbor matching contribution is deemed to satisfy the top-heavy rules. This does not mean that an accompanying profit sharing plan automatically satisfies the top-heavy rules, but the matching contribution will count towards the top-heavy minimums. EGTRRA §613 modifying IRC §416 effective for plan years commencing after December 31, 2001. Rev. Proc. 2004-13.
20. Safe Harbor Plan cannot be amended during plan year except for:
  - a. addition of Roth provisions;
  - b. addition of Hardship Distribution provisions.
21. Safe Harbor Non-Discrimination Rules for §401(m). §401(m)(11).

There is also a safe harbor method of satisfying the special nondiscrimination test applicable to employer matching contributions (the ACP test).

  - a. The plan must meet the safe harbor contribution and notice requirements applicable to Section 401(k) arrangements.
  - b. The plan must meet the following limitations on matching contributions:
    - i. Employer matching contributions may not be made with respect to employee contributions or elective deferrals in excess of 6% of compensation;

- ii. The rate of an employer's matching contribution may not increase as the rate of an employee's contributions or elective deferrals increases; and
  - iii. The matching contribution with respect to any highly compensated employee at any rate of employee contribution or elective deferral is not greater than that with respect to an employee who is not highly compensated.
- c. Any after-tax employee contributions continue to be tested separately under the ACP Test.

**401(k) EXAMPLES**

**EXAMPLE I**

**Safe Harbor 401(k) Example (2015)**

			spouse	
Compensation:	\$ 50,000	\$ 100,000	\$ 265,000	\$ 30,000
	x .04	x .04	x .04	x .04
Match:	<u>2,000</u>	<u>\$ 4,000</u>	<u>\$ 10,600</u>	<u>\$ 1,200</u>
Deferral:	18,000	\$ 18,000	\$ 18,000	\$ 18,200
Subtotal:	<u>20,000</u>	<u>\$ 22,000</u>	<u>\$ 28,600</u>	<u>\$ 19,200</u>
Catch-Up (Age 50)	6,000	\$ 6,000	\$ 6,000	6,000
Total:	<u>\$ 26,000</u>	<u>\$ 28,000</u>	<u>\$ 34,600</u>	<u>\$ 25,200</u>

**EXAMPLE II**

Example Of Cost Of Benefits For NHCEs Under Various Retirement Plan Options To Provide Maximum \$53,000. Contribution For HCE.

a. Highly Compensated Employee (HCE) (2015)

Compensation: \$ 265,000  
 Contribution: \$ 53,000  
 Percentage: 20%

b. Non-Highly Compensated Employees (NHCEs)

<u>Retirement Plan Option</u>	<u>Employer Contribution</u>
1. Profit Sharing (Non-Integrated)	20%
2. Profit Sharing (Integrated)*	16.53%

<u>Retirement Plan Option</u>	<u>Employer Contribution</u>
3. Safe Harbor 401(k) (2015: \$18,000) with Integrated Profit Sharing	9.74%
4. Cross Tested Profit Sharing (with optimal demographics)	4.40%

\* Integrated at 5.4% of compensation > 80% of social security taxable wage base + \$1.00

### EXAMPLE III

#### Maximum Contribution for Corporation with One Plan Participant.

##### A. Profit-Sharing Without 401(k)

\$ 208,000	Compensation
x     .25	
52,000	Profit-Sharing
+ 208,000	Compensation
<u>\$ 260,000</u>	Total \$ Needed for Maximum Contribution

##### B. Profit-Sharing With 401(k)

\$ 138,000	Compensation (Including 401(k) Deferral)
x     .25	
34,500	Profit-Sharing
+ 17,500	401(k) Deferral
<u>\$ 52,000</u>	
+ 5,500	Catch-Up Deferral (50 Years of Age)
<u>\$ 57,500</u>	Total Contributions
\$ 138,000	Compensation (Including 401(k) Deferral)
+ 34,500	Profit-Sharing
<u>\$ 172,500</u>	Total \$ Needed for Maximum Contribution

##### C. Summary for 2014

1. Without 401(k): need \$260,000 to contribute \$52,000 to plan.
2. With 401(k): need \$172,500 to contribute \$52,000 to plan (\$57,500 if age 50 or older).

## EXAMPLE IV

### 60 Year-Old with Self-Employment Income.

\$ 35,000	Compensation
x .2	
<u>7,000</u>	Profit-Sharing
+ 17,500	401(k) Deferral
<u>24,500</u>	
+ 5,500	Catch-Up Deferral
<u>\$ 30,000</u>	Total Contribution to Plan

- E. 401(k) Automatic Contribution Arrangements: ACAs, EACAs, QACAs
1. Qualified Automatic Contribution Arrangement (QACA); IRC §401(k)(13).
    - a. Effective for plan years commencing on or after January 1, 2008, the 2006 Pension Protection Act (PPA) creates an optional nondiscrimination safe harbor for automatic enrollment plans. Plans satisfying the safe harbors would not have to perform the nondiscrimination tests for employee elective deferrals (ADP) or for matching contributions (ACP) and are exempt from the top-heavy rules.
    - b. The safe harbor requires that the automatic enrollment contribution rate be at least:

first year of participation:	3%
second year of participation:	4%
third year of participation:	5%
fourth (or greater) year of participation:	6%

The plan may specify a higher percentage up to 10%.
    - c. The QACA must provide a minimum employer matching contribution of 100% of elective deferrals up to 1% of compensation plus 50% of elective deferrals between 1% and 6% of compensation.
    - d. As an alternative to the matching contribution, the employer can make a nonelective contribution of 3% of compensation on behalf of each employee eligible to participate in the automatic enrollment feature.
    - e. The employer matching contributions or employer elective contributions satisfying the safe harbor must be vested no less rapidly than under 2-year cliff vesting (100% vested after 2 years of service).

- f. The QACA is optional. An employer is still permitted to have an automatic contribution arrangement (ACA) 401(k) plan and test for nondiscrimination under the ADP and ACP tests.
- g. Comparison of 401(k)(12) Safe Harbor to 401(k)(13) QACA.

	<b>401(k)(12) Safe Harbor</b>	<b>401(k)(13) QACA</b>
Employer Match	4%	3.5%
Employer Non-Elective	3%	3.0%
Vesting	Immediate 100%	2 Years/100%

- 2. Eligible Automatic Contribution Arrangement (EACA); IRC §414(w).
  - a. An EACA must meet participant notification requirements providing:
    - i. annual notice to affected employees before the beginning of the year (the requirement that the notice be issued before the beginning of the plan year will make it difficult to begin automatic enrollment mid year);
    - ii. notice of the participant's right to elect out of plan coverage or to change deferral percentages and the time periods for making such elections.
  - b. IRS proposed regulations provide a uniformity requirement for an EACA. Thus, the automatic deferral requirement must be applied uniformly with respect to all eligible plan participants in a specific class of employees (*e.g.*, employees hired after a certain date). Treas. Reg. §1.414(w)-1(b)(2).
  - c. Plans that notify participants how contributions will be invested and meet certain default investment guidelines will be treated as satisfying ERISA section 404(c) even if a participant does not make an affirmative investment election. If the participant in a EACA does not make an investment election, the automatic deferrals should be invested in a Qualified Default Investment Alternative (QDIA) under ERISA §404(c)(5). However, a QDIA is not mandatory for an EACA.
  - d. One of the advantages of satisfying the EACA requirements is that the plan may permit a participant to withdraw automatic contributions at any time during a 90-day window period without penalty. A plan meeting the EACA requirements can also make corrective distributions to pass nondiscrimination tests within 6 months of year end, rather than 2½ months. Amounts withdrawn or distributed are taxable in the year of receipt. IRC §414(w).



3. State payroll and withholding laws that limit automatic contributions are preempted by ERISA for all ACAs, EACAs and QACAs.
4. 2009 IRS Rulings for ACAs.
  - a. IRS Rev. Ruling 2009-30 provides guidance on how an escalator feature (automatic contribution increases) can operate in an EACA or a QACA.
  - b. IRS Notice 2009-65 provides two sample amendments for adding an ACA or EACA feature to a 401(k) plan.
  - c. IRS Notice 2009-66 provides guidance on including an ACA in a SIMPLE-IRA plan.
  - d. IRS Notice 2009-67 provides a sample amendment for adding an ACA to a SIMPLE-IRA plan.
5. ACAs are a very good option to increase plan participation and to increase the ADP for non-highly compensated employees.

F. Money Purchase Pension Plan.

1. In this type of defined contribution plan, contributions to the plan are fixed, but not the benefits. Contributions are based on a fixed percentage of annual compensation for all plan participants. Thus, under a 10% of compensation money purchase plan, an employee earning \$170,000.00 would receive a contribution of \$17,000.00 while an employee earning \$10,000.00 would receive a \$1,000.00 contribution.
2. As with all defined contribution plans, the benefits ultimately paid to a participant will depend upon the size of the annual contributions, the number of years contributions are made before retirement and investment gains and losses. Forfeitures may be used to reduce employer contributions or to increase benefits under the plan. IRC §401(a)(8).
3. The employer can deduct contributions to a money purchase plan up to the total of all annual additions for all participants; that is, the lesser of 100% of compensation or \$52,000 (adjusted) for each participant. However, the maximum deduction is 25% of the total compensation of all eligible participants.

G. Employee Stock Ownership Plan (ESOP) and other Plans Investing in Employer Stock.

1. Overview.
  - a. Tax qualified retirement plan

- b. Invest primarily in employer stock
  - c. Leveraged purchase of employer stock
  - d. Principal and interest tax deduction to company.
  - e. Useful for shareholder investment diversification
  - f. Potential tax deferred sale by shareholders
2. Employee Stock Ownership Plan C Corporation.
- a. Section 1042 tax deferred sale at 30% ESOP ownership
  - b. Potential for permanent tax deferred sale
  - c. Tax deductible dividends on Employer stock
  - d. Deduction up to 25% of pay, plus interest
  - e. Annual appraisal and repurchase liability
3. Employee Stock Ownership Plan S Corporation.
- a. ESOP can be up to 100% S-corp shareholder
  - b. Income on S-corp stock held by ESOP tax deferred
  - c. Useful for shareholder investment diversification
  - d. Section 1042 tax deferred sale not available to seller
  - e. Dividends not tax deductible
  - f. Leveraged purchase of stock
  - g. Principal and interest deduction limited to 25% of pay
4. Diversification of Investments in Employer Stock.
- a. The Pension Protection Act of 2006 requires any defined contribution plan holding publicly traded employer securities to permit participants to diversify account balances invested in such employer securities. At least three materially different investment alternatives must be available.
  - b. The diversification requirements apply to employee elective deferrals and after-tax contributions.

- c. Participants with 3 or more years of service must be permitted to diversify the investment of other contributions (e.g., employer matching or non-elective contributions).
- d. These provisions do not apply to ESOPs that have no elective deferrals, after-tax contributions, or matching contributions and do not form part of another qualified plan. Collectively bargained plans and affected ESOPs have later effective dates.

H. Cross-Tested Profit-Sharing Plan (New Comparability Plans).

26 CFR §1.401(a)(4)-8(b); Rev. Rul. 2001-30.

1. A cross-tested profit-sharing plan is a plan under which the contribution percentage formula for one category of participants is greater than the contribution percentage formula for other categories of participants.
2. To satisfy the nondiscrimination requirements of the IRC Section 401(a)(4) general test, participants are put into different "rate groups" and the rate groups are tested separately for nondiscrimination.

Note: The Plan can state that each plan participant is his or her own category or "rate group".

3. To determine rate groups, a cross-tested profit-sharing plan expresses each participant's allocation of employer contributions and forfeitures as an equivalent benefit rate rather than as an allocation rate. When equivalent benefit rates are used, the method is referred to as "cross-testing" because it analyzes the benefit that would be generated from the allocation as if the plan were a defined benefit plan.

Thus, whereas most defined contribution plans are tested for nondiscrimination based on the allocation of contributions and defined benefit plans are tested based on projected future benefits, cross-tested plans are defined contribution plans that are tested for nondiscrimination based on projected benefits.

4. Minimum Gateway Contribution. Treasury Regulation Section 1.401(a)(4)-8(b) (published 6/29/01) effective first day of plan year commencing after December 31, 2001. Cross-tested/new comparability plans need (i) broadly available allocation rates that increase as an employee ages or accumulates additional service or (ii) satisfy a gateway with different allocation rates so that the percentage of pay allocation for HCEs is no more than three (3) times the percentage of pay allocation for NHCEs (safe harbor of 5% for NHCEs). The final regulations also contain a 7½% of compensation cap on any contribution that may be required under the rules applicable to defined benefit/defined contribution combination plans.

5. It is often a good plan design to combine a cross-tested profit-sharing allocation formula with a safe harbor 401(k) plan. In this case, the 3% employer non-elective contribution option should be used for the 401(k) safe harbor since the 3% safe harbor contribution can count toward the cross-tested minimum gateway contributions. The same 3% contribution can be used to satisfy (a) the safe harbor contribution, (b) the top-heavy contribution, and (c) the minimum gateway contribution. Employer matching contributions to a 401(k) plan do not count toward the gateway contributions.
6. A cross-tested plan may impose 1,000 hours of service and/or last day of the plan year employment allocation conditions for participants to receive the minimum gateway contributions. A top-heavy plan must provide the top-heavy minimum contribution to NHCEs who are employed on the last day of the plan year even if such participants do not complete 1,000 hours of service during the plan year.
7. The IRS National Office noted that it would issue a technical advice memorandum permitting a corrective amendment under Treasury Reg. §1.401(a)(4)-11(g) naming specific nonhighly compensated employees (NHCEs) and the amount of the additional contributions that they would receive. Treasury Reg. §1.410(b)-4 contains a prohibition on naming individuals where the average benefits test is used to pass coverage. However, in this case, coverage was passed under the ratio percentage test.  
  
Treas. Reg. §1.401(a)(4)-11(g) requires that a corrective contribution have substance. Thus, an allocation to a terminated employee who is zero percent vested will not be recognized towards correction. In this case, the IRS approved a provision in the amendment granting an otherwise nonvested NHCE 20% vesting.
8. Guidance issued by the IRS in October, 2004 (the "Carol Gold Memo") seeks to limit the use of aggressive planning techniques in the design and operation of tax-qualified retirement plans. Such techniques are often intended to increase benefits for Highly Compensated Employees (HCEs) and to limit benefits for Non-Highly Compensated Employees (NHCEs). Plans covering extremely short service employees for purposes of satisfying coverage or contribution testing and plans providing large benefits as a percentage of pay to very low paid employees may be subject to increased scrutiny from the IRS. Such aggressive techniques are often associated with cross-tested plans and cash balance pension plans.

9. Cross-Tested Profit-Sharing: (2015)

**EXAMPLE 1**

\$ 53,000	§415 Maximum
<u>- 18,000</u>	Elective Deferral
\$ 35,000	
<u>÷ 265,000</u>	§401(a)(17) Compensation Limit
13.21%	HCE Allocation as Percentage of Pay
<u>÷ 3</u>	
4.40%	NHCE Gateway Allocation (includes 3% 401(k) Safe Harbor)

10. Cross-Tested/Safe Harbor 401(k):

**EXAMPLE 2**

\$ 150,000	HCE Compensation
<u>x 0.09</u>	3 x 3% Safe Harbor
\$ 13,500	Employer Contribution
+ 17,500	Elective Deferral
<u>+ 5,500</u>	Catch-Up Contribution (Age 50+)
\$ 36,500	Total Contribution

3% safe harbor 401(k) non-elective contribution also counts as 3% minimum gateway contribution permitting 9% employer contribution (3 x 3%) for HCEs.

I. Defined Benefit Pension Plan.

1. Under a defined benefit plan, the level of benefits is fixed and contributions are determined by an actuary to provide adequate funding to furnish those benefits at retirement.
2. Contributions to a defined benefit plan are mandatory, although some flexibility can be built into the plan.
3. In the context of a closely held business, the primary issue is how much does the key employee want to shelter from taxes. The benefit formula is then, in effect, prepared in reverse to accomplish the goal of sheltering a specific amount of money.
4. The maximum benefit that can be funded is the lesser of \$210,000 (adjusted) or 100% of an employee's annual compensation for the three highest consecutive years of service. IRC §415(b). The \$210,000.00 (adjusted) amount is reduced for benefit payments commencing prior to Age 62 and increased for benefit payments commencing after Age 65. Benefits for participants with fewer than 10 years of participation under the plan must be proportionately reduced.

5. Rev. Rul. 2003-11 provides that a defined benefit plan may be amended to apply the \$260,000 (adjusted) compensation limit increase to determine benefits payable to former employees who retain benefits under the plan.
6. Rev. Rul. 2003-85 clarified that the transfer of surplus assets from a terminated defined benefit plan to a qualified replacement plan (as defined in IRC Section 4980(d)) is exempt from the Section 4980 excise tax even if the amount transferred exceeds 25% of the surplus assets.
7. Note: In a professional corporation, if the Defined Benefit Plan covers 26 or more employees, it may be subject to the PBGC rules and regulations.
8. Small employer defined benefit plans are becoming popular for three primary reasons:
  - a. The elimination of the prior benefit restrictions under IRC Section 415(e).
  - b. The increased benefit limits under EGTRRA.
  - c. The introduction of cash balance pension plans.
9. Formula Methods for Defined Benefit Plans. Although there can be an endless set of variations in selecting a formula for a defined benefit plan, the formula is based on such factors as: a fixed percentage of compensation over fixed number of years of service; a flat dollar amount payment; or a flat dollar amount or percentage of compensation for each year of service of a participant.
  - a. Flat Benefit Plan. The benefit under the Plan is a flat dollar amount after a specified number of years. For example, a participant who has at least 10 years of service will receive a benefit of \$100.00 per month at age 65; or
  - b. Fixed Benefit Plan. The benefit under the Plan is a fixed percentage of compensation — such as 10% of average monthly compensation starting at age 65; or
  - c. Unit Benefit Plan. The benefit under the Plan is based on either a specified unit dollar amount multiplied by years of service or a percentage of compensation multiplied by years of service. For example, \$10.00 per month x years of service or 1% of compensation x years of service.
10. 2006 Pension Protection Act (PPA) changes to Defined Benefit Plans.
  - a. Changes to Interest Rate Assumptions for Calculation of Lump-Sum Distributions.

A plan's lump sum payment prior to PPA to a participant or beneficiary must be no less than the present value of the annuity to which the participant or beneficiary would have been entitled. For this calculation, the plan must use specified interest and mortality assumptions. Prior to PPA interest rate was the rate on 30-year Treasury bonds.

The PPA changes the interest rate assumption under IRC Section 417(e) from the 30-year Treasury rate to a corporate based yield curve. Note: the higher the interest rate, the lower the lump sum.

<b>Phase-In of New Interest Rate Assumptions</b>		
<b>Calendar Year</b>	<b>Interest Rate Components</b>	<b>Method</b>
2006	100% of 30-Year Treasury	30-Year Treasury
2007	100% of 30-Year Treasury	30-Year Treasury
2008	20% Corp Bond Yield Curve + 80% of 30-Year Treasury	Mixed Rate
2009	40% Corp Bond Yield Curve + 60% of 30-Year Treasury	Mixed Rate
2010	60% Corp Bond Yield Curve + 40% of 30-Year Treasury	Mixed Rate
2011	80% Corp Bond Yield Curve + 20% of 30-Year Treasury	Mixed Rate
2012 and after	100% Corp Bond Yield Curve	Yield Curve Method

- b. Defined benefit plans must use segmented interest rates (based on expected payment dates) similar to the rates used for funding purposes to convert annuity benefits to lump sums. Interest rates will be based on corporate bond yields and the determination of current liabilities based on three segments of 0-5, 5-15, and over 15 years.
- c. Defined benefit plans may provide in-service distributions to participants age 62 or older, *i.e.*, phased retirement.
- d. Defined benefit and money purchase plans must offer a joint and 75% survivor annuity, as well as an option with a survivor benefit between 50% and 75% (e.g., generally plans must offer both 50% and 75% survivor annuity options).
- e. Single employer defined benefit pension plans must provide an annual funding notice to participants that includes, among other things, information regarding the plan's funded status, PBGC guarantees and limitations, plan asset allocations, and material plan amendments. This requirement is similar to the current rule for multiemployer pension plans.
- f. Effect on Executive Compensation. The employer may not set aside assets in a rabbi trust or other arrangement to provide nonqualified deferred compensation to its five top executives or other section 16 "insiders" if its qualified defined benefit plan is at-

risk, if the employer is in bankruptcy, or during the 12-month period beginning six months before the termination of an underfunded plan.

- g. Eligible Combined Plan – DB(k). PPA provides for an "eligible combined plan" for sponsors with fewer than 500 employees that offers a combination of defined benefit plan features and 401(k) deferrals. The plan would operate under the respective defined benefit and 401(k) rules, but would be treated as a single plan for trust and reporting purposes if certain safe harbor provisions are included. The arrangement would be deemed to comply with the ADP/ACP requirements and the top-heavy rules, as long as it is not aggregated with other plans.
  - i. The DB component must offer one of the following benefit formulas:
    - (a) 1% of final average pay up to 20 years of service; or
    - (b) a cash balance formula that increases the accrual rate with the participant's age (a cash balance formula must comply with the vesting and interest credit rules in the PPA).
  - ii. The 401(k) feature would be required to provide:
    - (a) automatic enrollment at a 4% rate;
    - (b) vested match equal to 50% on the first 4% of compensation deferred; and
    - (c) vesting on other company provided accruals and contributions over three years of service.
  - iii. Plan will file a single Form 5500.
- h. New Funding Rules. Pre-PPA DB funding rules have two parts. First, the rules impose a basic minimum funding amount. Second, certain underfunded plans are subject to an additional funding requirement (the "deficit reduction contribution") required for a plan year in which the plan's funded current liability percentage is less than 90%.

The Act includes an entirely new set of rules for determining minimum required contributions. ERISA §303; Code §430 (new). The Minimum Required Contribution is the sum of the Target Normal Cost (value of benefits expected to accrue during the year) plus an amortization of the Funding Shortfall (called the Shortfall Amortization Charge).



Plans in At-Risk Status will have a larger Funding Target due to the required use of more conservative At-Risk assumptions. This, in turn, will create a larger Minimum Required Contribution.

- i. **Determining The Required Contribution.** Under the Act, the minimum required contribution is determined based upon a comparison of the value of the plan's assets (reduced by any prefunding balance and funding standard carryover balance) to the plan's funding target. A plan's funding target is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost is the present value of benefits expected to accrue or be earned during the plan year. Thus, unlike the pre-PPA rules where the funding target was essentially 90%, the funding target under the PPA rules will be 100%. However, the 100% funding target funding is phased in for plans that were in existence but not subject to the deficit reduction contribution rules for 2007. Code §430(c)(5)(B).

If the value of the plan's assets (reduced by any funding standard carryover balance and prefunding balance) equals or exceeds the plan's funding target for a plan year, then the minimum required contribution is the target normal cost for the plan year reduced by the excess (but not below zero). Code §430(a)(2).

If the value of the plan's assets (reduced by any funding standard carryover balance and prefunding balance) is less than the plan's funding target for a plan year, then the minimum required contribution will be the sum of: (1) the target normal cost for the plan year, (2) the shortfall amortization charge (if any) for the plan year, and (3) waiver amortization charge (if any), for the plan year. Code §430(a)(1).

Shortfalls are amortized over seven years. A shortfall amortization charge for a plan year is the aggregate total (but not less than zero) of the shortfall amortization installments for the plan year with respect to the shortfall amortization bases for such plan year and each of the six preceding plan years. Code §430(c).

Except in the case of a plan in "at risk" status, a plan's target normal cost is the present value of benefits expected to accrue or be earned during the plan year. For this purpose, if a benefit attributable to services performed in a preceding year is increased due to any increase in compensation during the current plan year, the increase is to be treated as having accrued during the current plan year. Code §430(b).

The Act recognizes two kinds of credit balances: (1) a credit balance existing when the Pension Protection Act is enacted (i.e., a "funding standard carryover balance" — Code §430(f)(1)(B)) and (2) credit balances created after the Pension Protection Act (a

"prefunding balance"). Plan sponsors may elect whether to maintain a prefunding balance as well as elect to maintain a funding standard carryover balance until the balance is reduced to zero. Code §430(f)(1)(A), (B). In addition, plan sponsors may be eligible to elect to apply the prefunding and funding standard carryover balances against the minimum required contribution or against the value of plan assets or to reduce the balance at any time. Code §430(f)(2).

- j. **Funding Target Attainment Percentage.** The Funding Target Attainment Percentage (FTAP) is the ratio of plan assets, reduced by both pre- and post-Act credit balances, to the plan's funding target. Many provisions of the PPA depend on a calculation of a plan's funding target attainment percentage.
- k. **At-Risk Plans.** PPA imposes a number of requirements on plans with an asset/liability ratio of less than 80%, and additional burdens if the plan's asset/liability ratio is less than 60%. If the asset/liability ratio is less than 80%, the plan can't use a credit balance to reduce contributions. It can't amend the plan to increase benefits. Its ability to pay lump sums is restricted. If the asset/liability ratio is less than 60%, accruals must be frozen, no lump sums or shutdown benefits can be paid.

Additionally, plans in at-risk status for less than five years (not taking into account pre-2008 years) have at-risk liability valuation phased-in.

In making those asset liability comparisons, generally (and ignoring the special treatment of pre-PPA credit balances), the plan cannot take its credit balance into account. For example, if the plan has assets of \$84 million, liabilities of \$100 million and a credit balance of \$5 million, the plan has an asset/liability ratio of 79%  $((84 - 5)/100)$ .

The plan also has the option of reducing the credit balance and thereby "increasing" assets. In the example above, for instance, the plan could reduce the credit balance by \$1 million and increase assets to \$80 million. The plan would then be 80% funded and could be amended (so long as, after the amendment, the asset/liability ratio is not less than 80%), pay unrestricted lump sums, and use the remaining (\$4 million) credit balance to satisfy funding obligations. However, the plan never would receive the \$1 million credit balance it exchanged for assets.

- l. **Increased Deduction Limits.**

**DB Deduction Limits.** Generally, plans can deduct contributions up to 100% of the plan's current liability. Contributions in excess of the limit are subject to a 10% excise tax.

The maximum deductible contribution is the greater of: (1) the excess (if any) of the sum of the plan's funding target, the plan's target normal cost, and a cushion amount, over the value of plan assets (as determined under the minimum funding rules); and (2) the minimum required contribution for the year. If the plan is not "at-risk", then (1) will not be less than the excess (if any) of the sum of the plan's funding target and target normal cost, determined as if the plan was in "at-risk" status, over the value of the plan assets. The cushion amount is (a) 50% of the plan's funding target for the plan year plus (b) the amount by which the plan's funding target would increase if determined by taking into account increases in participants' compensation for future years, or if the plan does not base benefits attributable to past service on compensation, on the basis of the average annual benefit increases over the previous six years. If the plan is covered by the PBGC insurance program, future increases in the compensation limit under 401(a)(17) may be projected. Code §404(o).

**Combined DB/DC Deduction Limit.** Employers that sponsor both defined benefit plans and defined contribution plans face a combined limit on deductible contributions. PPA provides that for plan years beginning in or after 2008, contributions to a PBGC-covered defined benefit plan are deductible without affecting the combined limit. For other plans covering at least one common participant, such as defined contribution plans, only contributions in excess of 6% of compensation count towards the combined limit, and that 6% does not count 401(k) deferrals. Code §§404(a)(7)(C)(iii) and (iv), effective for contributions for taxable years beginning in 2006.

This allows \$23,000 in 401(k) contributions (for those 50 and over) plus an additional deductible \$15,600 of employer contributions to PSP per HCE (6% x \$260,000). Total per participant DC contributions in 2015 are \$38,600.

- m. **Payment of Lump Sum Benefits.**
  - i. Plan may not pay at all where adjusted FTAP is less than 60%; restricted where adjusted FTAP is between 60% and 80%.

**Interest Rate Assumption for Applying Benefit Limitations to Lump Sum Distributions.**

PPA provides that the conversion rate cannot be less than the greater of (a) 5.5% (and the applicable mortality table under Section 417(e)), (b) 105% of the minimum distribution lump sum interest rate and applicable mortality table of §417(e)(3), or (c) the rate specified in the plan, and

the plan's mortality table. Code §415(b)(2)(E). This retroactive effect could reduce lump sums already paid.

- ii. The "top 25" rule also restricts lump sum distributions otherwise payable to the top 25 HCEs unless the plan is 110% funded after such lump sum distribution is made.

#### K. Cash Balance Pension Plan.

A cash balance pension plan is a defined benefit plan that defines an employee's benefit as the amount credited to an account. The account receives allocations (usually expressed as a percentage of pay) as the employee works. The account is also credited with interest adjustments until it is paid to the employee.

1. How is a cash balance plan different from defined contribution plans? Like other defined benefit plans, a cash balance plan defines an employee's retirement benefit by a formula, and the employee's retirement benefit does not depend either on the employer's contributions to the plan or on the investment performance of the plan's assets, as it would in a defined contribution plan.
2. How is a cash balance plan different from other defined benefit plans? A cash balance plan defines an employee's benefit as the amount credited to an account, while other defined benefit plans typically define an employee's benefit as a series of monthly payments.
3. Accrued benefit. An accrued benefit is the portion of an employee's normal retirement benefit that he or she has earned at a given point in his or her career.
  - a. Under a cash balance or hybrid plan, accrued benefit is often expressed as the employee's hypothetical account balance. For example, an employee might receive an allocation equal to 4% of pay each year he or she works, and the employee's account might be credited with interest at 5%, compounded annually, until it is paid.

In Notice 96-8, the IRS proposed standards for lump-sum calculations under cash balance plans and stated that, as defined benefit plans, the accrued benefit must be expressed in terms of an annuity benefit at normal retirement age.

- b. Under a traditional defined benefit plan, the accrued benefit is the amount the employee would receive as a monthly annuity for life commencing at age 65. For example, if an employee enters a final average pay plan at age 35, works until age 40, and earns average monthly pay of \$1,000, that employee's accrued benefit might be \$50 (1% x \$1,000 x 5 years). If the same employee works until age 55 and his or her average monthly pay increases to \$4,000, the accrued benefit would increase to \$800 (1% x \$4,000 x 20 years).

4 2006 PPA changes to Cash Balance Plans.

- a. A participant's accrued benefit must be at least as great as that of any similarly situated younger individual who is or could be a participant in the plan.
- b. The "interest credits" provided under the plan must not be at a rate that exceeds a "market rate of return", though the plan may provide for a reasonable minimum guaranteed rate of return or for interest crediting at the greater of a fixed or variable rate.
- c. The Act prohibits the use of "wearaway" provisions previously used in many defined benefit plan conversions. As a result, if a traditional defined benefit plan is converted to a cash balance plan, a participant's accrued benefit must be the sum of (1) his or her accrued benefit determined prior to the conversion, plus (2) the benefit accrued for years of service after the conversion.
- d. The Act provides that a plan need not project a participant's benefit forward to normal retirement age using the plan's interest rate assumptions and then discount it back using the Code-required interest rate, thus avoiding the "whipsaw" result mandated by IRS Notice 96-8 and several court decisions. For purposes of calculating lump sums and certain other optional forms, a plan can now treat the present value of a participant's accrued benefit as being equal to his or her hypothetical account balance.
- e. Cash balance and other hybrid plans must provide vesting no less rapid than 3-year cliff vesting (100% vesting after 3 years of service).

7. Advantages of Cash Balance Plan Over Traditional Defined Benefit Plan.

- a. In a traditional defined benefit plan partners will have different levels of accrued benefits and the levels of accrued benefits will not precisely match the contributions made on each partner's behalf.
- b. A cash balance plan focuses on account balances. This permits partners to accrue equal levels of benefits under the plan and allows the levels of accrued benefits to equal the contributions made on each partner's behalf plus the rate of investment return under each plan.
- c. A cash balance plan can be designed to provide different levels of benefits for different classes or tiers of employees. For example, partners could receive an allocation of \$25,000 per year while other employees receive an allocation of 5% of pay.

- d. The benefit formula in a cash balance plan can also be designed to provide precisely different levels of benefits to different key employees. These levels of benefits could fluctuate from year-to-year if desired by the partners.
- L. Defined Benefit and Cash Balance Plans can provide greater benefits and larger contributions for employees than Defined Contribution Plans.
1. Generally, defined benefit and cash balance plans should only be considered (in the small plan context) if contributions greater than \$52,000 (for 2014) (\$57,500 for employees age 50 or older) per year are desired for individual employees.
  2. Since the repeal of IRC §415(e), current or prior participation in a defined contribution plan no longer limits the level of benefits that a participant can accrue in a defined benefit plan.
  3. Deductible contributions by an employer to any combination of defined benefit and defined contribution plans are limited to the greater of:
    - a. the amount needed to satisfy the minimum funding requirements of the defined benefit plan; or
    - b. 25% of the aggregate compensation of the covered employees. IRC §404(a)(7).
  4. 2006 PPA Changes to Deduction Limits. The combined plan limit disregards contributions to a defined contribution plan up to 6% of compensation for plans not covered by the PBGC. Employers can ignore contributions to any single-employer defined benefit plan covered by the PBGC for purposes of the combined plan limit. IRC Sections 404(a)(7) and 4972.
    - a. Example after 2006 PPA (2014):
 

Cash balance benefit plan contribution (Age 62):	\$ 245,000
Profit sharing 6% of compensation (\$255,000 x .06)	15,600
401(k) elective deferral:	17,500
401(k) catch-up (Age 50+)	<u>5,500</u>
Total:	\$ 283,600
  5. Investment results in a defined benefit plan can be used to reduce the employer costs of the plan in the long term if the investment results exceed the assumed rate of return under the plan.

However, if the assumed rate of return is greater than the actual investment performance of plan assets, the employer cost of the plan will increase.

M. Section 412(e)(3) Plan (Formerly 412(i))

1. An insurance contract plan (or fully insured plan) under IRC §412(e)(3) (a "412(e)(3) plan") is a defined benefit pension plan that is funded exclusively by individual insurance and/or annuity contracts and meets the following requirements:
  - a. The insurance contracts provide for level annual premiums from the time the employee commences plan participation until retirement age.
  - b. Benefits under the plan are equal to the benefits provided under the contracts.
  - c. Benefits are guaranteed by an insurance company licensed to do business in the state in which the plan is located.
  - d. Premiums are paid timely or the contracts have been reinstated.
  - e. No rights under the contracts were subject to a security interest during the plan year.
  - f. No policy loans were outstanding during the plan year.
  - g. An employee's accrued benefit under the plan is not less than the cash surrender value of his insurance contracts.

A plan funded exclusively by a group insurance or group annuity contract is considered an insurance contract plan if the contract has the requisite characteristics of individual contracts. IRC §412(e)(3).

2. One of the advantages of a 412(e)(3) plan is that the maximum deductible (and required) contribution in the first few years of the plan is substantially greater than the maximum deductible contribution to a regular defined benefit plan. This is because the annuity settlement rate is based on the guaranteed interest rate, which can be as low as 3%, and the anticipated (and probably the actual) investment return is quite low.
3. A few of the disadvantages of a 412(e)(3) plan are:
  - a. The employee cost is higher for the same reasons that the owners cost is higher (as noted in section 2 above).
  - b. The investment returns are low (but they are guaranteed).
  - c. If a plan is terminated within the first few years, the cash value may be small. In later years, the large deposits may cause the plan to exceed the IRC §415 limits and the plan may need to be frozen for a few years before retirement.

- d. The employer/plan sponsor is wedded to a specific insurance company for the plan.
- e. A 412(e)(3) plan uses the guaranteed rates of the contract to justify higher contributions and lump sum benefits under the plan. That is what the problem is. Many vendors create the 412(e)(3) plan so that the maximum 415 benefit is provided. However, the guaranteed lump sum under the contract needed to convert the contract to an annuity is far in excess of the permissible 415 lump sum that may be rolled over into an IRA. Therefore, assuming the participant wants a lump sum, the plan is over funded.

N. Section 403(b) Plan

- 1. Overview. A Section 403(b) plan, also known as a tax-sheltered annuity (TSA) plan, is a retirement plan for employees of public schools, employees of tax-exempt organizations, and certain ministers. The plan is referred to as a 403(b) plan because it is established pursuant to Section 403(b) of the Internal Revenue Code. Any "eligible employee" can participate in a 403(b) plan. An "eligible employee" includes employees of tax-exempt organizations established under Section 501(c)(3) of the Internal Revenue Code, employees of public school systems who are involved in the day to day operations of a school, employees of cooperative hospital service organizations, and certain ministers. IRC §403(b)(1)(A). See also IRS Publication 571. Therefore, a 403(b) plan may be available as a retirement plan for physicians and other employees of tax-exempt employers such as hospitals and universities.

See IRS Publication 571 for a good overview of Section 403(b) plans.

- 2. Contributions.

- a. Contributions may be made to 403(b) accounts through elective deferrals made under a salary reduction agreement, non-elective contributions made by the employer, and after-tax contributions. With the enactment of the Economic Growth Tax Reform and Reconciliation Act of 2001 ("EGTRRA"), 403(b) plans are subject to the same §415(c) contribution limits as defined contribution plans. The §402(g) limit on elective deferrals through a salary reduction agreement is \$17,500 for 2014. The limit on total contributions is \$52,000 for 2014. Catch-up contributions (\$5,500 for 2014) also apply for employees who have attained age 50.
- b. For §402(g) purposes, elective deferrals do not include:
  - i. contributions pursuant to a one-time irrevocable election made at or before initial eligibility; or
  - ii. contributions made as a condition of employment. Prop. Reg. 1.402(g)(3)-1(b).



These contributions are still subject to FICA taxes.

3. Nondiscrimination. The basic nondiscrimination requirements that apply to qualified retirement plans also apply to 403(b) plans with respect to non-elective contributions and matching contributions of the employer. IRC §403(b)(12)(A)(i). For elective deferrals under a salary reduction agreement, a separate "universal availability" non-discrimination rule applies. If any employee of the employer sponsoring the 403(b) plan can make elective deferral referrals, the plan is discriminatory unless the opportunity to make elective deferrals of more than \$200 is available to all employees on a basis that does not discriminate in favor of highly compensated employees. IRC §403(b)(12)(A)(ii). Basically, any employee with compensation from the employer of at least \$200 per year must be permitted to make elective deferrals to a 403(b) plan adopted by the employer.
4. Investments. Participants in a 403(b) plan cannot invest in individual stocks. Instead, their choices are: (1) an annuity contract, which is a contract provided through an insurance company; (2) a custodial account, which is an account invested in mutual funds; or (3) a retirement income account set up for church employees. IRC §§403(b)(1), 403(b)(7), 403(b)(9). Since the assets of a 403(b) plan are generally held in a custodial account (unlike other retirement plans where assets are held in a trust), at least one federal court of appeals has questioned whether 403(b) accounts are entitled to the protection from creditor claims afforded to other tax-qualified retirement plans.
5. Distributions. Generally, a distribution cannot be made from a 403(b) account until the employee: (1) reaches age 59½; (2) has a severance from employment; (3) dies; (4) becomes disabled; or (5) in the case of a salary reduction contribution, encounters financial hardship. IRC §403(b)(11). The proposed §403(b) regulations permit 403(b) plans to be terminated and distributions can be made pursuant to the termination of the plan. Required minimum distributions from a 403(b) plan must be received by April 1 of the calendar year following the later of the calendar year in which a plan participant becomes 70½ or the calendar year in which the plan participant retires. Treas. Reg. §1.403(b)-3, Q & A-1. Generally, a plan participant can roll-over tax free all or any part of a distribution from a 403(b) plan to a traditional IRA or an eligible retirement plan. IRC §§403(b)(8), 402(c).
6. Catch-Up Contributions.
  - a. Under §402(g)(7), for employees with 15 or more years of service with a qualified organization, the §402(g) limit is increased by the least of:
    - i. \$3,000;

- ii. \$15,500, reduced by prior deferrals under this catch-up provision; or
  - iii. \$5,000 multiplied by years of service with the organization, reduced by prior year elective deferrals at the organization.
- b. The proposed regulations confirm that the age 50 catch-up contributions and the §402(g)(7) catch-up contributions can be made for the same year.
- i. Amounts above the general §402(g)(7) are treated first as 402(g)(7) catch-up contributions and then as age 50 catch-up contributions. §1.403(b)-4(c)(3)(iv).
  - ii. Employees may be using up their \$15,000 cumulative catch-up limits without knowing it.
- c. Maximum 403(b) deferral (2013):
- |                |                      |
|----------------|----------------------|
| \$ 17,500      | – deferral           |
| 5,500          | – Age 50 catch-up    |
| <u>+ 3,000</u> | – 402(g)(7) catch-up |
| \$ 26,000      |                      |

7. Plan Terminations. Prop. Reg. §1.403(b)-10(a).

- a. A 403(b) plan may be terminated and its accounts may be distributed if the employer (and any other member of the controlled group) does not make contributions to an alternative 403(b) contract or account outside of the plan from the date of termination until 12 months after distribution of all assets from the terminated plan.
- b. An exception applies if fewer than 2% of the employees who were eligible under the terminated plan are eligible under the alternative 403(b) contract or account.
- c. All accumulations under the terminated plan must be distributed as soon as administratively practicable after the termination.

8. Form 5500s

- a. Starting with the 2009 Plan Year, all 403(b) plans are required to file Form 5500s, including plans consisting solely of employee elective deferrals.
- b. Also starting with the 2009 Plan Year, the Form 5500 Audit/Accountant's Report rules also apply to 403(b) plans.

9. Prototype and Volume Submitter Plans were authorized by the IRS for 403(b) plans starting in 2013.

## II. OTHER RETIREMENT PLANS.

### A. Section 457 Plan.

1. IRC Section 457 governs the tax treatment of certain deferred compensation plans maintained by state or local governments or tax-qualified organizations. Any amount of compensation deferred by an employee or independent contractor under an "eligible deferred compensation plan" of a state or local government or a tax-exempt organization is includible in income for federal tax purposes only for the taxable year in which such compensation is paid or otherwise made available to such individual. IRC §457(a).
2. An "eligible deferred compensation plan" under Section 457(b) is a plan that meets the following requirements:
  - a. the plan provides that only individuals who perform service for the employer may be participants;
  - b. the plan is established and maintained by a state, political subdivision of a state, or agency, or instrumentality of a state or political subdivision of a state, or any other organization (other than a governmental unit) exempt from federal tax;
  - c. the maximum amount which may be deferred under the plan for a taxable year shall not exceed the applicable dollar amount \$17,500 for 2014. Catch-up contributions (\$5,500 for 2014) also apply to Section 457(b) Plans.
  - d. compensation may be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month;
  - e. amounts may not be made available to participants or beneficiaries earlier than the calendar year in which the participant attains age 59½, the participant separates from service with the employer, or the participant is faced with an unforeseeable emergency;
  - f. meets the minimum distribution requirements of IRC §401(a)(9) (*e.g.*, distributions must commence not later than age 70½); and
  - g. all amounts of compensation deferred under the plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall remain solely the property and rights of the employer, subject to the claims of the employer's general creditors. IRC §457(b).

3. One important issue to note is that an individual is not required to coordinate the maximum annual deferral amount for a 457(b) plan (*e.g.*, an "eligible plan") with contributions made to a 401(k) or 403(b) plan. Therefore, employees can defer the maximum applicable dollar amount to each plan. For example, in 2013, an employee can defer \$17,500 in a 403(b) or 401(k) plan and also defer an additional \$17,500 in a 457(b) plan (with an additional \$5,500 catch-up contribution to each plan if the employee is age 50 or older).
4. If a plan does not meet the statutory definition of an "eligible deferred compensation plan", the amounts held are not deferred for tax purposes and instead are taxable to the individual in the year the amounts are no longer subject to a "substantial risk of forfeiture" IRC §457(f). An "ineligible plan" under IRC §457(f) is a type of non-qualified deferred compensation plan. The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services. Therefore, once an individual has performed all services necessary to receive payment at any point in the future, the deferred amount is taxed as compensation to the individual.

## B. Simplified Employee Pensions (SEP)

1. SEP Requirements. I.R.C. §408(k).
  - a. A SEP is an individual retirement account which is employer-funded and can accept an expanded rate of contributions. An employer's annual contribution to a SEP on behalf of each employee is limited to the lesser of (a) 25% of the employee's compensation (not reduced for employee contributions to the SEP), or (b) \$52,000 for 2014 (adjusted). I.R.C. §§408(j) and 415(c)(1)(A). The SEP/IRA is owned by the employee, who may be self-employed.
  - b. The employer must contribute to the SEP on behalf of each employee who:
    - i. Has attained age twenty-one;
    - ii. Has performed service for the employer for at least three of the immediately preceding five years;
    - iii. Has performed service for the employer during the year for which the contribution is made (regardless of whether the employee is still employed by the employer at the end of such year) and has received at least \$550 (adjusted) in compensation for such year; and
    - iv. Non-resident aliens with no income from U.S. sources and employees covered by a collective bargaining agreement

with whom retirement benefits have been the subject of good faith bargaining may be excluded from participation. I.R.C. §408(k)(2). Prop. Regs. §1.408-7(d) and §1.219-3(b)(2).

- c. To establish a SEP, an employer must execute a written instrument which must include:
  - i. The name of the employer;
  - ii. The requirements for participation;
  - iii. The signature of an appropriate official;
  - iv. A definite formula for the allocation of employer contributions which specifies the manner in which the allocation is determined and what requirements an employee must satisfy to share in the allocation. Prop. Reg. §1.408-7(e); and
  - v. No minimum funding standards are imposed for a SEP.
- d. Withdrawals from a SEP must be permitted. Therefore, employer contributions cannot be conditioned on their retention in the plan and withdrawals cannot be prohibited. I.R.C. §408(k).
- e. SEPs are subject to the top-heavy rules. A top-heavy SEP is subject to the defined contribution plan minimum contribution rules. I.R.C. §§408(k)(1); 416(c)(2).
- f. SEPs may be integrated with social security in the same manner as a qualified defined contribution plan. I.R.C. §408(k)(3)(1). An employer cannot maintain an integrated SEP if the employer has an integrated qualified plan (*e.g.*, pension, profit-sharing or stock bonus) during the same year. I.R.C. §§408(k)(3)(D); 401(1)(4)(F).
- g. Employer contributions to a SEP may either be made on the basis of a calendar year or on the basis of the employer's non-calendar taxable year. Employer contributions on account of a given calendar year or taxable year must be contributed by the due date (plus extensions) for the employer's tax return for such year. I.R.C. §404(h)(1)(A).
- h. Contributions by an employer may not discriminate in favor of highly compensated employees and must bear a uniform relationship to compensation (excluding compensation in excess of \$260,000 (adjusted)). I.R.C. §408(k)(3)(C).
- i. Contributions must also be made to SEPs on behalf of employees who have attained age 70½ I.R.C. §219(b)(2).

2. Salary Reduction Simplified Employee Pensions (SARSEPS). I.R.C. §408(k)(6).

- a. A SARSEP may be maintained by an employer who did not have more than twenty-five employees who were eligible to participate at any time during the preceding taxable year. Employees may elect to receive cash or make elective deferrals to a SARSEP. The elective deferrals are subject to the same \$17,500 for 2014 limit applicable to §401(k) plans and are aggregated with §401(k) elective deferrals for the purposes of such limit.
- b. The election is available only if at least fifty percent of the eligible employees elect to make such deferrals. Additionally, the deferral percentage for each highly compensated employee cannot be more than 125% of the average deferral percentage for non-highly compensated employees. I.R.C. §408(k)(6)(C).
- c. State or local governments and tax-exempt organizations cannot adopt SARSEPS. I.R.C. §408(k)(6)(E).
- d. FICA and FUTA must be withheld from employee elective deferrals to SARSEPS.
- e. Note: SARSEPs repealed. Employers are not permitted to establish SARSEPs after 1996. SARSEPs established prior to 1997 may continue to receive contributions under the pre-1997 rules. Employees hired after 1996 may participate in SARSEPs established before 1997. I.R.C. §408(k)(6)(H).

3. SEP Establishment and Contribution Deadlines. IRS Publication 560.

- a. Deadline for setting up a SEP. You can set up a SEP for a year as late as the due date (including extensions) of your income tax return for that year.
- b. Time limit for making contributions. To deduct contributions for a year, you must make the contributions by the due date (including extensions) of your tax return for the year.

Please note: A SEP is a type of employer-sponsored IRA and is not a tax-qualified plan under IRC Section 401(a). SEPs do not enjoy the protection from creditor claims afforded to tax-qualified plans under ERISA §206(d) and IRC §401(a)(13), but are protected in bankruptcy under the 2005 Bankruptcy Act.

C. SIMPLE IRA.

I.R.C. §408(p)

1. Savings Incentive Match Plans for Employees (SIMPLE Plans).

*Employers with 100 or fewer employees* who received at least \$5000 in compensation in the preceding year may adopt a SIMPLE plan *if they do not maintain another qualified plan (i.e., a qualified plan, a SEP or a 403(b)).*

- a. Employer may not maintain a plan to which any employee receives an allocation of contributions or an increase in accrued benefits for plan years beginning or ending in that calendar year.
- b. However, an employer may adopt and maintain a SIMPLE IRA for noncollectively bargaining employees even if it maintains a qualified plan for collectively bargained employees. I.R.C. §408(p)(2)(D)(I).

2. Employees May Contribute by *Salary Reduction Up to \$12,000 for 2014* of Compensation Per Year (Up to 100% of Earned Income or Compensation).

- a. Catch-up contributions for individuals who have attained age 50:

2014: \$2,500

3. Employer Must Satisfy One of Two Contribution Formulas.

- a. Employer must match 100% of contributions up to three percent of compensation.
  - i. Employer can reduce the total match to less than three percent of compensation (but not less than one percent of compensation) in two out of five years.
  - ii. In order to apply the lower matching percentage, the employer must notify employees of the lower percentage within a reasonable time prior to the sixty-day election period during which employees are allowed to determine whether to participate in the SIMPLE plan.
- b. Employer may elect to make a nonelective contribution of two percent of compensation for each eligible employee who has earned at least \$5,000 of compensation from the employer during the year.

4. Compensation Limited to \$260,000 (adjusted) for Two Percent Non-Elective Contributions (But Not for Matching Contribution). §408(p)(2)(B)(ii).
  - a. Maximum contribution is \$12,000 (for 2014) elective deferral plus \$7,800 matching contribution.
  - b. Matching contributions on behalf of self-employed persons to SIMPLE IRAs are not treated as elective contributions and, therefore, are not subject to the \$12,000 limit on elective deferrals. I.R.C. §408(p)(8).

5. Eligibility Requirements.

Employees may participate in SIMPLE Plan if they:

- a. Received at least \$5,000 in compensation from the employer during any two preceding years; and
- b. Are reasonably expected to receive at least \$5,000 in compensation during the year.

Employees who are covered under a collective bargaining agreement and certain nonresident aliens may be excluded from participation.

6. Contributions Are 100% Vested.

7. Overall Elective Deferral Limitation Applies to SIMPLE.

Elective deferrals to SIMPLE IRAs are subject to the overall \$17,500 (adjusted) limit on elective deferrals to retirement plans under I.R.C. §402(g). The §402(g) limit is a cumulative limitation applying to all elective deferrals by an individual in a given year made under §401(k), §403(b), §408(k) (SARSEPs) and §408(p) (SIMPLES). I.R.C. §402(g)(3).

8. Two-Year Grace Period.

Employers who maintain a SIMPLE plan but who fail to be eligible in subsequent years (*i.e.*, employer has 100 or more employees in subsequent years) may continue to maintain the plan for a transition period following a merger or acquisition. The transition period begins on the date of the transaction and ends on the last day of the second calendar year following the calendar year in which the transaction occurs. I.R.C. §408(p)(10), as amended by the 1998 Act.

9. Sixty-Day Election Period.

Eligible employees may elect to make elective deferrals during the sixty-day period before the beginning of the year (or before the employee



becomes eligible to participate). A plan may also allow a participant to modify salary reduction contribution percentages during the year.

10. Twenty-Five Percent Additional Tax for Early Withdrawals.

Employees who withdraw contributions during the two-year period beginning on the date that they first commenced participation in the SIMPLE plan will be assessed a twenty-five percent additional tax. I.R.C. Section 72(t).

11. Timetable for Elective Deferrals.

Employer must contribute elective deferrals to employee's account not later than thirty days after the last day of the month for which the contributions are made. Employer contributions must be made by the due date for the employer tax return (plus extensions) for the year on behalf of which the contributions are made.

12. Reporting Requirements.

Employer must notify employees of their rights to make salary deferrals to the SIMPLE plan and the contribution alternative elected by the employer (*i.e.*, three percent match or two percent nonelective contribution) immediately prior to the employee's sixty-day election period.

- a. Trustee must annually provide the employer with a summary description and the employer must distribute the summary description to each eligible employee prior to the sixty-day election period.
- b. IRS Forms 5304-SIMPLE and 5305-SIMPLE provide a model sixty-day notification form. The summary description requirement can be satisfied by providing the employee with a completed copy of the first two pages of applicable Form.

13. Automatic Enrollment in a SIMPLE-IRA.

- a. IRS Notice 2009-66 provides guidance on including an automatic contribution arrangement (ACA) to a SIMPLE-IRA.
- b. IRS Notice 2009-67 provides a sample amendment for adding an ACA to a SIMPLE-IRA.

14. Please note: A SIMPLE-IRA is a type of Employer-sponsored IRA and is not a tax-qualified plan under IRC Section 401(a). A SIMPLE-IRA does not enjoy the protection from creditor claims afforded to tax-qualified plans under ERISA §206(d) and IRC §401(a)(13), but is protected in bankruptcy under the 2005 Bankruptcy Act.

15. Comparison of SIMPLE-IRA to Safe Harbor 401(k)
  - a. SIMPLE-IRA
    - i. defer up to \$12,000 (plus \$2,500 catch-up).
    - ii. 3% employer match or 2% employer non-elective contribution.
    - iii. no additional employer contributions are permitted.
  - b. Safe Harbor 401(k)
    - i. defer up to \$17,500 (plus \$5,500 catch-up).
    - ii. 4% employer match or 3% employer non-elective contribution.
    - iii. additional employer matching or profit-sharing contributions are permitted.

## COMPARISON OF TYPES OF TAX-QUALIFIED RETIREMENT PLANS

PLAN ELEMENTS:	PROFIT-SHARING	401(K)	CROSS-TESTED PROFIT-SHARING	MONEY PURCHASE PENSION	DEFINED BENEFIT	COMMENTS:
1. Contributions:						
(a) Employer-Mandatory	No	No	No	Yes	Yes	Generally, employer contributions for profit-sharing and 401(k) plans are discretionary.
(b) Employer-Discretionary	Yes	Yes	Yes	No	No	Contributions for profit-sharing and 401(k) plans can range from 0-25% of aggregate eligible compensation.
(c) Employee-Pre Tax	No	Yes	No	No	No	Generally, "elective deferrals" for 401(k) are limited to the lesser of 100% of compensation or \$17,500 for 2014. Non-discrimination testing limits elective deferrals for highly compensated employees to a multiple of the non-highly compensated employees elective deferrals.
(d) Employee-After Tax	Yes	Yes	Yes	Yes	Yes	Subject to nondiscrimination testing.
(e) Employer-Matching	Yes	Yes	No	No	No	Employer may proportionately match employee elective deferrals or after-tax contributions, subject to non-discrimination testing.
2. Overall Limitation on Contribution Based on Eligible Compensation:						
(a) On Employer Contribution (§404)	25%	25%	25%	25%	Limitations Based on Benefits, Not on Contributions	Limitation does not include employee elective deferral contributions.
(b) On Allocation to Each Employee (§415)	Lesser of 100% of Comp. or \$52,000 for 2014	Lesser of 100% of Comp. or \$52,000 for 2014	Lesser of 100% of Comp. or \$52,000 for 2014	Lesser of 100% of Comp. or \$52,000 for 2014	Annual Benefit Limit is Lesser of 100% of Comp. or \$210,000 for 2014	Limitation aggregates employer contributions, matching contributions, employee contributions and forfeitures.

\* Profit-Sharing, 401(k), Cross-Tested Profit-Sharing and Money Purchase Pension Plans are all classified as defined contribution plans and are subject to many of the same restrictions.

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PLAN ELEMENTS:	PROFIT-SHARING	401(K)	CROSS-TESTED PROFIT-SHARING	MONEY PURCHASE PENSION	DEFINED BENEFIT (DB)	COMMENTS:
3. Eligibility to Participate Maximum Restrictions: Age Service	21 2 Years	21 1 Year	21 2 Years	21 2 Years	21 2 Years	Additional exclusion available for employees covered by a collective bargaining agreement. Any additional exclusion of employees is subject to non-discriminatory coverage and participation testing.
**4. Maximum Vesting Schedules of Employer Contributions: (a) If 1 Year of Service	3 Year Cliff 6 Year Graded	3 Year Cliff 6 Year Graded	3 Year Cliff 6 Year Graded	3 Year Cliff 6 Year Graded	5 Year Cliff 7 Year Graded	Employee contributions and elective deferrals are always fully vested. Employer matching contribution can be subject to vesting schedule.
*** Top Heavy matching contribution (eff. 2002) all defined contribution plans (eff. 2007)	3 Year Cliff 6 Year Graded	3 Year Cliff 6 Year Graded	3 Year Cliff 6 Year Graded	3 Year Cliff 6 Year Graded	3 Year Cliff 6 Year Graded	
(b) If 2 Years of Service	2 Year Cliff	N/A	2 Year Cliff	2 Year Cliff	2 Year Cliff	
** See Summary of Vesting Schedules Below. *** The top heavy schedules (3 year cliff or 6 year graded) are the maximum vesting schedules for all DC plan contributions made on or after the first day of the 2007 plan year.						
5. Participant Loans	Yes	Yes	Yes	Yes	Yes	Optional plan provision. Generally, a loan cannot exceed lesser of \$50,000.00 or 50% of participant vested benefit. Loan is generally repaid by monthly or quarterly payments over 5 year term at market interest.

**Vesting Schedule	Immediate	2 Year Cliff	3 Year Cliff	5 Year Cliff (DB)	6 Year Graded	7 Year Graded (DB)
Year 1	100%	0	0	0	0	0
2		100%	0	0	20	0
3			100%	0	40	20
4				0	60	40
5				100%	80	60
6					100%	80
7						100%

<b>PLAN ELEMENTS:</b>	<b>PROFIT-SHARING</b>	<b>401(K)</b>	<b>CROSS-TESTED PROFIT-SHARING</b>	<b>MONEY PURCHASE PENSION</b>	<b>DEFINED BENEFIT</b>	<b>COMMENTS:</b>
6. Distribution of Vested Benefits Upon:	Death  Disability  Retirement  Employment Termination	Death  Disability  Retirement  Employment Termination	Death  Disability  Retirement  Employment Termination	Death  Disability  Retirement  Employment Termination	Death  Disability  Retirement  Employment Termination	
7. In-Service Distributions:	Yes	Hardship Age 59½	Yes	Only Upon Attainment of Plan's Normal Retirement Age or Age 62	Only Upon Attainment of Plan's Normal Retirement Age or Age 62	Profit-sharing plans may permit in-service distributions as an optional provision. IRS regulations define the events qualifying for hardship distributions from 401(k) plans. Hardship distributions are limited to participant elective deferrals. In service distributions from all plans must commence at age 70½.
8. Benefits Subject to PBGC Coverage:	No	No	No	No	Yes	
9. Participant Individual Accounts:	Yes	Yes	Yes	Yes	No	
10. Plan Benefit at Retirement or Other Termination of Employment:	Vested Account Balance (Employer and Employee Contributions, Forfeitures and Investment Gains and Losses)	Vested Account Balance	Vested Account Balance	Vested Account Balance	Vested Accrued Benefit Based on Plan Benefit Formula	Maximum annual benefit from defined benefit plan is lesser of 100% of Average Compensation or \$210,000 (Adjusted by COLA).
11. Plan Contributions/Benefits Weighted in Favor of Older and/or Long Service Employees:	No	No	Yes	No	Yes	Contributions under a defined contribution plan (other than a cross-tested profit-sharing or a target benefit plan) are generally allocated based on a participant's compensation, without regard to age or service (e.g. a 50 year old employee with 20 years of service and a 30 year old employee with 5 years of service will receive the same contribution if they have the same compensation). Cross-tested and target benefit plans take the participant's age into account and test contributions for non-discrimination purposes based on future projected benefits.

PLAN ELEMENTS:	PROFIT-SHARING	401(K)	CROSS-TESTED PROFIT-SHARING	MONEY PURCHASE PENSION	DEFINED BENEFIT	COMMENTS:
12. Level of benefits paid to participants is affected by Plan's investment performance:	Yes	Yes	Yes	Yes	No	In a defined contribution plan, income, expenses, gains and losses with respect to plan investments affect the value of the participants' individual accounts. In a defined benefit plan, investment income, etc. affect the funding standard account only — not the ultimate amount of benefits paid to an individual participant.