401(k) Plan Design

Presenter Information

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What we will cover

- Review of the Safe Harbor 401(k) Plan Rules
- ADP and ACP safe harbor requirements
- SECURE Act Changes
- Designing a Safe Harbor 401(k) Plan
- Triple Stacked Match Design
- Top Heavy Exemption
- Early Eligibility Design
- Combination Safe Harbor 401(k) and Cross-Tested Plans
- Qualified Contribution Arrangements (QACA)

Traditional 401(k) Plans

Eligibility

- The most cost effective eligibility condition is 1 YOS/age 21/semi-annual entry dates
- However, the employer may want to be more generous, or, need to be more generous to compete for workers
  - 6 months/500 HOS
  - 3 months/no HOS
  - Immediate Eligibility
- Plan may have different eligibility requirements for deferrals and employer contributions
  - Additional administrative burden
  - SECURE solved the top heavy issue

Which Eligibility Provisions avoid the application of the LTPT Rules?

- Immediate eligibility for deferrals
- 1 - 12 months of service with no HOS (mere passage of time)
- 500 or fewer HOS in 12 months (not 6)

Vesting

- Vesting: requires plan to count vesting YOS
  - Helps in retaining workforce
  - Forfeitures help offset future contributions or expenses
- Vesting Schedules
  - 6 year graded
  - 3 year cliff

Matching Contributions

- Formulas
  - Fixed (50%) or discretionary (or both)
  - Levels
  - Based on years of service
- Allocation
  - Payroll
  - Annual (if contributed on payroll basis, plan will need to true-up)
- Limits
  - Disregarding deferrals in excess of certain level of deferrals (e.g., 6%)

Review of the Safe Harbor 401(k) Plan rules

Why safe harbor 401(k)?

Advantages

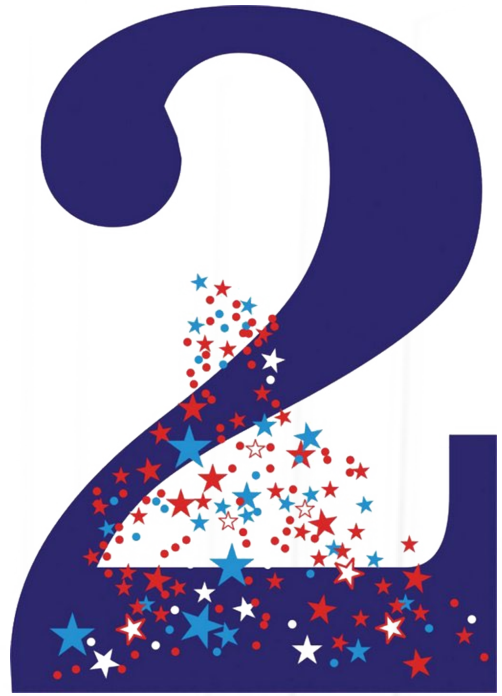
- No ADP tests
- Options:
  - No ACP tests
  - No top heavy $
- No corrective distributions
- HCE deferral certainty
- Possibly greater HCE contributions

Problems

- Fully vested ER contribution
- Annual notice for SH Match plan
- Less midyear flexibility

Two Safe Harbors

- *Must* sail into ADP test safe harbor
  - Otherwise, not a safe harbor plan
- *May* sail into ACP test safe harbor
- Most employers will do both



ADP safe harbor requirements

- Employer contribution
  - Fully vested
  - Subject to 401(k) distribution restrictions
  - To all NHCEs eligible to defer to the plan
    - So no allocation conditions
    - Can also give to HCEs
- Annual notice (SH Match)
- 12-month plan year (with exceptions)
- Document provisions in place at beginning of year (with exceptions)

Safe harbor contribution alternatives

Basic match

- 100% of deferrals up to 3% of comp
- 50% of deferrals from 3% to 5% of comp
- Max = 4%

Nonelective

At least 3% of comp

Whether or not EE defers

Enhanced match

1. Get at least as much as basic match no matter how much you defer
2. No HCE has higher match at any level of deferrals than any NHCE
3. Rate of match doesn't climb as deferrals increase

Safe harbor match vs nonelective

Match	Nonelective
No ER obligation if EE doesn't defer	EE who doesn't defer gets 3%
Possible lower ER costs	Counts in rate group testing (cross-tested plan)
Higher ER costs if EEs defer maximum	Counts for minimum gateway
Stacking match allows HCE to reach 415 limit at lower cost	Absolutely predictable costs
HCE contribution flexibility	Little or no increased costs if top-heavy
Safe harbor notice	No notice requirement

ACP Safe Harbor
Flexible and powerful

ACP Test Safe Harbor

- Safe harbor 401(k) plan <u>may</u> be ADP safe harbor only, or both ADP and ACP safe harbor
  - Most employer maintaining a safe harbor 401(k) plan will elect to be both ADP and ACP safe harbor plans
- Compliance with ACP safe harbor avoids ACP test on matching contributions

What are the advantages of the ACP safe harbor?

- Free pass on ACP test
- Provides certainty to HCEs
- May qualify for free pass on the top heavy
- Plan design
  - Flexibility
  - Disparity in favor of the HCEs

ACP safe harbor requirements

- Satisfy ADP safe harbor
  - Either classic or QACA
  - Can use match or nonelective for ADP safe harbor
- The document must require that all matching contributions under plan satisfy four conditions:
  1. No HCE has higher match at any level of deferrals than any NHCE
     - Prohibits allocation conditions for any matching formula in plan
  2. Rate of match doesn't climb as deferrals increase
  3. No matching formula can take into account deferrals/after-tax contributions > 6% of comp
  4. Total amount of discretionary match cannot exceed 4% of comp

Enhanced matching formula

- Enhanced does not automatically satisfy the ACP test safe harbor because it may match on deferrals in excess of 6%
- If enhanced matching formula limits deferrals taken into consideration to 6%, plan satisfies ACP test safe harbor
  - Ex: 100% match on the first 8% deferred.
    - Plan satisfies ADP test safe harbor but plan does not qualify as an ACP test safe harbor
  - Alt: 200% match on the first 4% deferred
    - Also satisfies ACP test safe harbor

“Other” matching contributions

- Match not used to pass ADP test safe harbor
- Match made in addition to safe harbor contribution (nonelective, basic match or enhanced match)
- If ADP safe harbor match also satisfies ACP safe harbor requirements but “other” match does not, plan must apply ACP test to <u>both</u> formulas
  - No partial ACP safe harbor

"Other" matching contributions

- Types of ACP safe harbor matches:
  - Used in ADP safe harbor
    - **Basic**
    - **Enhanced** (limit deferrals matched to 6% of comp)
    - Must be fully vested
  - **Other:** Not used for ADP safe harbor
    - May be subject to <u>vesting</u> schedule
    - Not subject to <u>distribution</u> restrictions
    - May <u>NOT</u> be subject to allocation conditions
- Permits ER to "stack" matching w/o ACP testing, allowing greater allocations and disparity

Matching contribution possibilities in ACP safe harbor

	Basic match	Enhanced match	Other match
Can be discretionary	No	At least basic must be fixed	Yes, but 4% amount limit
Must be fully vested	Yes	Yes	No
Subject to 401(k) distribution restrictions	Yes	Yes	No
Available for hardship	Yes	Yes	Yes
Can have allocation condition	No	No	No

- You can "stack" the matches:
  - Enhanced match: 100% of deferrals up to 4% of comp +
  - Fixed other match: 50% of deferrals up to 6% of comp +
  - Discretionary match: Up to 2/3 of deferrals up to 6% of comp

Stacking the matching formulas

ADVANTAGES

- HCE flexibility
- Increased disparity
- Sometimes able to reach 415 limit at lower cost
- Not age sensitive
- TH exempt
- No nondiscrim. testing

PROBLEMS

- Fixed matching costs
- ER costs dependent on deferrals of NHCEs
- No allocation conditions
- More complex design

Basic Match + Discretionary Match

Name	Net Comp	Normal Deferral	Basic Match	Discretionary Match	Total
Sam	$345,000	$30,500	$13,800	$13,800	$58,100
Sue	$345,000	$23,000	$13,800	$13,800	$50,600
Anne	$84,000	$6,000	$3,360	$3,360	$12,720
Maria	$58,000	$2,000	$1,870	$1,333	$5,203
Tina	$39,000	$1,000	$1,000	$667	$2,667
Frank	$24,000	$0	$0	$0	$0
Total	$895,000	$62,500	$33,830	$32,960	$129,290

- Discretionary match
  - Amount can't exceed 4% of comp ($10,000 for Sam and Sue)
  - Can't look at deferrals over 6% of comp ($20,700 for HCEs)
  - Formula if fully funded = 2/3 of deferrals up to 6% of comp
- These figures based on net comp, limited to $345,000

Deadlines for Establishing Matching Formulas

- For matching formulas (including “other” matching formulas) to qualify for the ACP test safe harbor, the formulas must be in place prior to the beginning of the plan year
- ER may not amend or add matching formulas during or after the plan year
  - Exception for “exiting”
- However, for the discretionary matching formula, ER may decide on the contribution amount after the close of the plan year

SECURE Changes Affecting Safe Harbor 401(k) Plans

Mandatory Automatic Enrollment

- New 401(k) (including a safe harbor 401(k) plan) and deferral 403(b) plans required to have automatic enrollment EACA
- Default deferral percentage
  - First year 3% to 10%
  - Auto increase of 1%/year thereafter
    - Capped at 10 – 15%
- QDIA unless participant makes different choice
- Must allow permissible withdrawals (up to 90 days after first auto deferral)

Act Section
101
Code Section
414A
Qualified
401(k)
403(b)
Yes
457(b)
No
Eff. Date
Plan Years after 2024

Exemptions

- SIMPLE 401(k)
- Plans established before 12/29/2022
- Governmental and church plans
- Plans sponsored by employer that normally employs fewer than 11 employees
  - Exemption expires 1 year after close of first tax year after employer goes over limit
- New business: exempt during first 3 years of existence of the business or a predecessor business

SECURE 2.0 Extends Roth Options

- SECURE 2.0 §604 created a new option for participants in 401(k) and 403(b) plans to elect to receive employer matching and nonelective contributions on a Roth basis
  - Effective 12/29/22
  - However, with no guidance, virtually no employers implemented the option
- This option is particularly attractive because:
  - Beginning in 2024, 401(k) and other plan Roth accounts will no longer be subject to lifetime RMDs

Roth Employer Contribution Elections?

- The election rules are based on the current regulations for Roth deferral elections
- The election must be made no later than the date the contribution is allocated to the participant's account and must be irrevocable
  - Participants must be given the effective opportunity to make or change Roth employer contribution elections at least once a year

Amending a 401(k) Plan Into a Safe Harbor 401(k) Plan

Plan Year Amendment

- Amending the 401(k) plan into a <u>Safe Harbor Nonelective</u> Plan during the plan year
- **Deadline:** 30 days prior to the close of the plan year
  - 2024 calendar plan year (12/01/24)
- **Safe harbor nonelective contribution:** 3%

Result

- **No ADP testing**
  - ACP testing still applies
- **No Corrective Distributions for failed ADP test**
  - No excise tax
  - No distribution paperwork
- **No QNECs for failed ADP test**
- **SH nonelective can substitute for all or part of discretionary profit sharing contribution**

Amending Plan Into a Safe Harbor 401(k) Plan

Post PY Amendment

- Amending the 401(k) plan into a <u>Safe Harbor Nonelective</u> Plan after the close of the plan year
- **Deadline:** last day of the plan year following the plan year
  - 2024 calendar plan year (12/31/25)
- **Safe harbor nonelective contribution:** 4% (rather than 3%)
  - Will <u>not</u> need to continue the 4% SH nonelective for future plan years

Result

- **No ADP testing**
  - ACP testing still applies
- **No corrective distributions for failed ADP test**
  - No excise tax
  - No distribution paperwork
- **No QNECs for failed ADP test**
- **SH nonelective can substitute for all or part of discretionary profit sharing contribution**

Designing a Safe Harbor 401(k) Plan

Design a safe harbor 401(k) plan

- Factors in designing a safe harbor 401(k) plan:
  - Who should benefit (all or only deferring Ps)
  - Should plan have disparity (more for HCEs)?
  - Desired contribution amount (*e.g.*, 415 maximum - $69,000 in 2024)
  - NHCEs likely deferrals (ER’s cost)
  - Importance of contribution flexibility

Cast of characters

Name	Position	Age	Net Comp	Normal Deferral
Sam	Shareholder	55	$345,000	$30,500
Sue	Shareholder	45	$345,000	$23,000
Anne	Associate	35	$84,000	$6,000
Maria	Office Manager	50	$58,000	$2,000
Tina	Secretary	32	$39,000	$1,000
Frank	Filing Clerk	24	$24,000	$0
Tonia	Secretary	26	$30,000	$0
Carl	Law Clerk	27	$13,500	$0

- Carl works less than 1,000 HOS/year
- Tonia is full time but hasn't satisfied 1 YOS Eligibility Requirement
- HCE ADP = 6.67%; NHCE ADP = 3.29%

Deferral-only plus top-heavy and QNEC

Name	Gross Comp	Deferral	QNEC	Profit Sharing	Total
Sam	$345,000	$30,500	$0	$5,589	$36,089
Sue	$345,000	$23,000	$0	$5,589	$28,589
Anne	$90,000	$6,000	$1,242	$1,458	$8,700
Maria	$60,000	$2,000	$828	$972	$3,800
Tina	$40,000	$1,000	$552	$648	$2,200
Frank	$24,000	$0	$331	$389	$720
Total	$904,000	$62,500	$2,953	$14,645	$80,098

- With QNEC (1.38% of gross comp), ADP test passes
- Profit sharing = 1.62% of gross comp
- QNEC + PS = Top-heavy minimum
- EE cost = $6,420 (9.03% of ER dollars)

Deferral-only plus 3% safe harbor (gross)

Name	Gross Comp	Deferral	3% Safe Harbor	Total
Sam	$345,000	$30,500	$10,350	$40,850
Sue	$345,000	$23,000	$10,350	$33,350
Anne	$90,000	$6,000	$2,700	$8,700
Maria	$60,000	$2,000	$1,800	$3,800
Tina	$40,000	$1,000	$1,200	$2,200
Frank	$24,000	$0	$720	$720
Total	$904,000	$62,500	$27,120	$89,620

- Plan uses 3% safe harbor based on gross comp
- EE cost: $6,420 (7.96% of ER dollars)
- Owners get more because they participate in SH contribution
- Downside: entire contribution is fully vested

Deferral-only plus 3% safe harbor (net)

Name	Net Comp	Deferral	3% Safe Harbor	Total
Sam	$345,000	$30,500	$10,350	$40,850
Sue	$345,000	$23,000	$10,350	$33,350
Anne	$84,000	$6,000	$2,520	$8,520
Maria	$58,000	$2,000	$1,740	$3,740
Tina	$39,000	$1,000	$1,170	$2,170
Frank	$24,000	$0	$720	$720
Total	$895,000	$62,500	$26,850	$89,050

- Want to save $330? Use net comp
- Since the plan is pure safe harbor, it is not top heavy
- Want to save even more? Exclude associates (Anne) from participating
  - Coverage passes with ratio percentage = 75%

Deferral-only plus basic match (net)

Name	Net Comp	Deferral	Basic Match	Total
Sam	$345,000	$30,500	$13,800	$44,300
Sue	$345,000	$23,000	$13,800	$36,800
Anne	$84,000	$6,000	$3,360	$9,360
Maria	$59,000	$2,000	$1,870	$3,870
Tina	$39,000	$1,000	$1,000	$2,000
Frank	$24,000	$0	$0	$0
Total	$895,000	$62,500	$33,830	$96,330

- Total ER Cost = $6,230 based on net comp (7.13%)
  - Close to 3% nonelective based on net comp
  - It would be more expensive if Maria, Tony or Frank deferred more
- Frank gets $0 thanks to top-heavy exemption
- Standard enhanced match (100% of deferrals up to 4% of comp) would give Maria an extra $130

Basic and discretionary match (net comp)

Name	Gross Comp	Deferral	Basic Match	Discretionary Match	Total
Sam	$345,000	$30,500	$13,800	$13,800	$58,100
Sue	$345,000	$23,000	$13,800	$13,800	$50,600
Anne	$84,000	$6,000	$3,360	$3,360	$12,720
Maria	$58,000	$2,000	$1,870	$1,333	$5,203
Tina	$39,000	$1,000	$1,000	$667	$2,667
Frank	$24,000	$0	$0	$0	$0
Total	$895,000	$62,500	$33,830	$32,960	$129,290

- Discretionary match = 2/3 of deferrals up to 6% of comp
  - That satisfies 4% limit on amount of match
  - Subject to 6-year vesting schedule; available for hardships
- Total ER Cost = $11,590 based on net comp (9.64%)
  - Are you sure you don't want to exclude Anne from participation?
  - With a match this good, Maria and Tony may want to defer more
- Plan is still top-heavy exempt

Plan design – 3% nonelective + PS

- ER Goals:
  - Maximize allocations for owners
  - Provide a contribution to all participants regardless of whether they defer
- EE Cost =$27,564 (17.58%); $6,420 fully vested

Name	Net Comp	Normal Deferral	3% Safe Harbor	Profit Sharing	Total
Sam	$345,000	$30,500	$10,350	$35,650	$67,500
Sue	$345,000	$23,000	$10,350	$35,650	$61,000
Anne	$84,000	$6,000	$2,700	$8,677	$17,335
Maria	$58,000	$2,000	$1,800	$5,991	$9,762
Tina	$39,000	$1,000	$1,200	$4,009	$6,209
Frank	$24,000	$0	$720	$2,467	$4,029
Total	$895,000	$62,500	$27,120	$92,444	$165,835

3% safe harbor + integrated PS + disc. match

Name	Net Comp	Deferral	3% Safe Harbor	Profit Sharing	Disc. Match	Total
Sam	$345,000	$30,500	$10,350	$29,720	$5,930	$76,500
Sue	$345,000	$23,000	$10,350	$29,720	$5,930	$69,000
Anne	$84,000	$6,000	$2,700	$4,788	$1,445	$14,854
Maria	$58,000	$2,000	$1,800	$3,306	$562	$7,648
Tina	$39,000	$1,000	$1,200	$2,223	$271	$4,694
Frank	$24,000	$0	$720	$1,368	$0	$2,088
Total	$895,000	$62,500	$27,120	$71,125	$14,138	$174,784

- PS = 5.7% of comp + 5.7% of excess comp
  - Uses integration to maximum extent
- Discretionary match = 28.65% of deferrals up to 6% of comp
  - Brings us to 415 limit
- Employee cost = $20,284 (12.24% of total ER cost)

Strategies on discretionary match

- In an ACP safe harbor plan, discretionary match not subject to testing
  - Limitation: Amount of match can't exceed 4%
- Giving ER choice between discretionary match and discretionary profit sharing can be a smart idea
  - Wait until year is over and see what works best
  - Example: In last design, we used integrated PS to maximum extent of permitted disparity, and then switched to discretionary match
- Disadvantage: More to explain

Compensation for deferral allocation (type)

- Safe harbor 401(k) plan may use any reasonable definition of compensation for elective deferrals
- Definition does not need to be nondiscriminatory (*i.e.*, does not need to pass compensation ratio test)

Compensation for deferral allocation (amount)

- Plan may limit the amount of compensation a participant may defer provided each NHCE:
  - May defer a sufficient amount to receive maximum match available, and
  - May defer any lesser amount
- Safe harbor plan does not need to impose percentage limits on deferrals because the plan is not subject to the ADP test
- Plan may require employees to defer in whole percentages or in whole dollar amounts

Case study: Deferral compensation

- Employer proposes a safe harbor 401(k) plan
  - Enhanced match of 100% of deferrals up to 4% of compensation
  - Employees must defer a minimum of 6% of compensation to participate

  a) Is this limitation legal?

  b) What is the highest minimum percentage of compensation limit the plan can impose?

- Suppose instead the employer wants to limit employees to deferring from their bonus
  - Many employees don't receive a bonus, or it is less than 4% of compensation

  c) Is this limitation legal?

  d) Would it be legal in a safe harbor nonelective plan?

Compensation for allocation of Safe Harbor Contributions

- Plan may use any *nondiscriminatory* definition of compensation for allocating safe harbor contribution (ADP or ACP; nonelective or match)
- Total (415) comp definitions are nondiscriminatory
  - W-2
  - Federal income tax withholding wages
  - 415 regulation (current income)
    - Regular
    - Simplified
- Safe harbor compensation adjustments:
  - Gross comp or comp net of elective deferrals
  - Comp while a participant or plan year comp
- Can use reasonable alternative definition that passes comp ratio test
  - Do you really want tested comp definition in a safe harbor plan?
- Can't impose nonstatutory dollar limit

Compensation strategy

- If the goal is to maximize the wealth of the HCEs/owners then:
  - Participating compensation is usually a smart choice
  - Net compensation makes sense if the owner's net compensation is at least equal to the 401(a)(17) compensation limit
    - Net compensation can do more harm than good otherwise

Limit	$345,000
Deferral + catch-up	$30,500
Gross comp target	$375,500

Forfeitures as funding source

- Employer may use forfeitures to fund ADP safe harbor employer nonelective contributions
- Employer may use forfeitures to fund ACP safe harbor match

Triple Stacked Match

Triple stacked match objectives

- Get the owners 415 limit (+ catch-up, if eligible)
- Pure safe harbor plan
  - No ADP testing
  - No ACP testing
  - No 401(a)(4) testing
  - Not top-heavy
- Players only design (defer $0 = get $0)
- 6-year vesting to extent possible
- Maximum use of discretion

Players only – Triple Stacked Match – Step 1

	Net Comp	Deferrals	Basic Match	Discretion Match	Fixed Match	Total
Sam	$345,000	$30,500	$13,800			$76,500
Sue	$345,000	$23,000	$13,800			$69,000
Anne	$84,000	$6,000	$3,360			
Maria	$58,000	$2,000	$1,870			
Tina	$39,000	$1,000	$1,000			
Frank	$24,000	$0	$0			
Total	$895,000	$62,500	$33,830			

- Deferrals plus basic safe harbor match
  - 4% enhanced match would cost $298 more
- Uses net compensation because we aren’t trying to encourage deferrals

Players only – Triple Stacked Match – Step 2

	Net Comp	Deferrals	Basic Match	Discretion Match	Fixed Match	Total
Sam	$345,000	$30,500	$13,800	$13,800		$76,500
Sue	$345,000	$23,000	$13,800	$13,800		$69,000
Anne	$84,000	$6,000	$3,360	$3,360		
Maria	$58,000	$2,000	$1,870	$1,333		
Tina	$39,000	$1,000	$1,000	$667		
Frank	$24,000	$0	$0	$0		
Total	$895,000	$62,500	$33,830	$32,960		

- Discretionary match limited to 4% of comp
  - Can't consider deferrals over 6% of comp
- Formula = 2/3 of deferrals up to 6% of comp

Players only – Triple Stacked Match – Step 3

	Net Comp	Deferrals	Basic Match	Discretion Match	Fixed Match	Total
Sam	$345,000	$30,500	$13,800	$13,800	$18,400	$76,500
Sue	$345,000	$23,000	$13,800	$13,800	$18,400	$69,000
Anne	$84,000	$6,000	$3,360	$3,360		
Maria	$58,000	$2,000	$1,870	$1,333		
Tina	$39,000	$1,000	$1,000	$667		
Frank	$24,000	$0	$0	$0		
Total	$895,000	$62,500	$33,830	$32,960		

- Owners need $18,400 to reach 415 limit
- Can only consider $20,700 of deferrals (6% of comp)
- Fixed match = 18,400/20,700 = 88.89% of deferrals up to 6% of comp

Players only – Triple Stacked Match – Step 4

	Net Comp	Deferrals	Basic Match	Discretion Match	Fixed Match	Total
Sam	$400,000	$30,500	$13,800	$13,800	$18,400	$76,500
Sue	$350,000	$23,000	$13,800	$13,800	$18,400	$69,000
Anne	$90,000	$6,000	$3,360	$3,360	$4,800	$17,520
Maria	$60,000	$2,000	$1,870	$1,333	$1,778	$6,981
Tina	$40,000	$1,000	$1,000	$667	$889	$3,556
Frank	$24,000	$0	$0	$0	$0	$0
Total	$904,000	$62,500	$33,830	$32,960	$44,257	$173,057

- Total employee cost = $19,057 (11.01%)
  - $1,863 cheaper than integrated SH + disc. match
- Compare with $10,700 for pure XT plan with same EEs
- Potential XT sticking point: Age
- Potential triple stacked match sticking point: Deferrals

Plan design: changing limits

- To accommodate changes in compensation, 415 and deferral limits, the practitioner should consider increasing the fixed match and then using the discretionary match to obtain the 415 limit
- We will increase fixed match from 86.90% to 90% of deferrals not exceeding 6% of comp
- We then will decrease our discretionary matching contribution to compensate
  - The discretionary match floats

Top Heavy Exemption
Top Heavy Changes

Secure Act 2.0 §310

Top-heavy exemption

If, for a given plan year, allocations consist solely of safe harbor money

Then the plan is not top-heavy for the year

- Safe harbor money:
  - Elective deferrals that don't have to be ADP-tested because plan is safe harbor plan
  - Employer contributions used to satisfy ADP safe harbor
  - Matching contributions (if any) which satisfy ACP safe harbor

Discretionary PS contribution

- If ER makes discretionary profit sharing contribution for a year, the plan is not top heavy exempt for that year
  - However, merely having a clause permitting PS contribution doesn't hurt exemption if only safe harbor money allocated for a given year
- Year-by-year determination
  - Example:
    - Plan established in 2021 as ADP tested plan
    - For 2022 ER makes discretionary PS contribution
    - In 2023 ER amends to SH plan with PS contribution option
      - Only contributes safe harbor money for 2023
    - Exemption applies to 2023

Watch out for forfeitures

- Allocation of forfeitures other than as safe harbor contributions <u>kills the</u> top-heavy exemption
- Alternatives that keep exemption alive:
  - No question these are OK
    - Reduce other ACP safe harbor fixed match contributions
    - Increase ACP safe harbor discretionary match
    - Pay plan expenses

Comparison of top-heavy and safe harbor rules

	Top-heavy	Safe harbor
Compensation definition options	415	Any 414(s) definition
Compensation while a participant option?	No	Yes
Net comp. option?	No	Yes
Last day condition?	Yes	No
Vesting Schedule	Yes	No (fully vested)
Required allocations	Non-keys	NHCEs
Otherwise Excludible EE	No	Yes

Example: Sample Law Firm, Inc.

Name	Position	Age	Gross Comp	Deferral	Fulltime	1 YOS?
Sam	Shareholder	55	$400,000	$30,500	Full	Yes
Sue	Shareholder	45	$350,000	$23,000	Full	Yes
Anne	Associate	35	$90,000	$6,000	Full	Yes
Maria	Office Manager	50	$60,000	$2,000	Full	Yes
Tina	Secretary	32	$40,000	$1,000	Full	Yes
Frank	Filing Clerk	24	$24,000	$0	Full	Yes
Tonia	Secretary	26	$30,000	$0	Full	No
Carl	Law Clerk	27	$13,500	$0	900 HOS	No

- Unless otherwise specified, example plans require 1 YOS (so Tonia and Carl don't participate)
- Deferral shows what EE would defer even without a match (could go up if match increased)
- ADP test would fail by almost 1.5%

Deferral-only plus top-heavy and QNEC

Name	Gross Comp	Deferral	QNEC	Profit Sharing	Total
Sam	$345,000	$30,500	$0	$5,175	$35,675
Sue	$345,000	$23,000	$0	$5,175	$28,175
Anne	$90,000	$6,000	$1,350	$1,350	$8,700
Maria	$60,000	$2,000	$900	$900	$3,800
Tin	$40,000	$1,000	$600	$600	$2,200
Frank	$24,000	$0	$360	$360	$720
Total	$904,000	$62,500	$3,210	$13,560	$79,270

- With QNEC (1.5% of gross comp), ADP test passes
- Profit sharing = 1.5% of gross comp
- QNEC + PS = Top-heavy minimum
- EE cost = $6,420 (9.14% of ER dollars)

Deferral-only plus 3% safe harbor (gross)

Name	Gross Comp	Deferral	3% Safe Harbor	Total
Sam	$345,000	$30,500	$10,350	$40,850
Sue	$345,000	$23,000	$10,350	$33,350
Anne	$90,000	$6,000	$2,700	$8,700
Maria	$60,000	$2,000	$1,800	$3,800
Tina	$40,000	$1,000	$1,200	$2,200
Frank	$24,000	$0	$720	$720
Total	$904,000	$62,500	$27,120	$89,620

- Plan uses 3% safe harbor based on gross comp
- Plan is top heavy exempt
- Because the plan uses gross compensation, SH contribution = TH minimum
- Downside: entire contribution is fully vested

Deferral-only plus 3% safe harbor (net)

Name	Net Comp	Deferral	3% Safe Harbor	Total
Sam	$345,000	$30,500	$10,350	$40,850
Sue	$345,000	$23,000	$10,350	$33,350
Anne	$84,000	$6,000	$2,520	$8,520
Maria	$58,000	$2,000	$1,740	$3,740
Tina	$39,000	$1,000	$1,170	$2,170
Frank	$24,000	$0	$720	$720
Total	$895,000	$62,500	$26,850	$89,350

- Even though the plan uses net compensation, the plan is top heavy exempt
- Since the plan is pure safe harbor, it is not top heavy

Deferral-only plus basic match (net)

Name	Gross Comp	Deferral	Basic Match	Total
Sam	$345,000	$30,500	$13,800	$44,300
Sue	$345,000	$23,000	$13,800	$36,800
Anne	$84,000	$6,000	$3,360	$9,360
Maria	$59,000	$2,000	$1,870	$3,870
Tina	$39,000	$1,000	$1,000	$2,000
Frank	$24,000	$0	$0	$0
Total	$895,000	$62,500	$33,830	$96,330

- Plan is top heavy exempt
- Frank gets $0 thanks to top-heavy exemption

Basic and discretionary match (net comp)

Name	Gross Comp	Deferral	Basic Match	Discretionary Match	Total
Sam	$345,000	$30,500	$13,800	$13,800	$58,100
Sue	$345,000	$23,000	$13,800	$13.800	$50,600
Anne	$84,000	$6,000	$3,360	$3,360	$12,720
Maria	$58,000	$2,000	$1,870	$1,333	$5,203
Tina	$39,000	$1,000	$1,000	$667	$2,667
Frank	$24,000	$0	$0	$0	$0
Total	**$895,000**	**$62,500**	**$33,830**	**$32,960**	**$129,290**

- Plan is still top heavy exempt because it is a pure safe harbor plan because other match qualifies under the ACP safe harbor
  - Discretionary match satisfies 4% limit on amount of match
  - Other match is subject to 6-year vesting schedule

Plan design – 3% nonelective + PS

Name	Net Comp	Normal Deferral	3% Safe Harbor	Profit Sharing	Total
Sam	$345,000	$30,500	$10,350	$35,650	$76,500
Sue	$345,000	$23,000	$10.350	$35,650	$69,000
Anne	$84,000	$6,000	$2,700	$8,635	$17,335
Maria	$58,000	$2,000	$1,800	$5,962	$9,762
Tina	$39,000	$1,000	$1,200	$4,009	$6,209
Frank	$24,000	$0	$720	$2,467	$3,187
Total	$895,000	$62,500	$27,120	$92,373	$181,993

- Because of the PS contributions, the plan is not top heavy exempt
- PS and SH contributions satisfy the TH minimum

Compensation example

- X sponsors a calendar year top-heavy safe harbor 401(k) plan with 3% nonelective
  - 1 YOS to participate
  - Quarterly entry dates
  - SH contribution based on net comp while participant
- Diane
  - Entered plan 10/1/2022
  - 2022 comp = $10,000/month ($120,000/year)
  - Deferrals 10/1/2022 – 12/31/2022 = $12,000
  - SH compensation = $18,000 ($30,000 – $12,000)
  - SH allocation = $540
  - TH minimum = $3,600
    - Top Diane up with $3,060 contribution
    - Extra contribution can be subject to vesting schedule

Top Heavy SECURE Act Changes

Top Heavy

- Employees who are eligible to participate in the plan solely because of the new LTPT EE provision are excluded from the vesting and benefit provisions of the top heavy rules
  - However, such employees are included in determining whether the plan is top heavy
- A Safe Harbor 401(k) plan that is designed to be top heavy exempt will NOT lose its top heavy exempt status because a LTPT employee doesn't receive Safe Harbor 401(k) nonelective or match

Top-Heavy and Otherwise Excludable Employees

- If plan covers otherwise excludable employees (less than 1 YOS), can treat them as a separate group for purposes of top-heavy minimum contribution in defined contribution plan
  - Typically, this means they don't need to receive the TH minimum

Act Section
310
Code Section
416
Qualified
DC
403(b)
No
457(b)
No
Eff. Date
Plan years after 2023

Example

- Law firm maintains a safe harbor 401k plan
  - One YOS/age 21 eligibility requirements
  - In addition to deferrals, the plan provides a basic SH match and PS contributions
  - For 2023, the law firm doesn't make a profit sharing contribution
  - The plan is top heavy exempt and the firm doesn't have to make an additional TH minimum contribution

Example: Law Firm, Inc. (2023)

Name	Position	Net Comp	Deferral	Basic SH Match	TH Minimum	Fulltime?	1 YOS?
Sam	Shareholder	$330,000	$30,000	$13,200	$0	Full	Yes
Sue	Shareholder	$330,000	$22,500	$13,200	$0	Full	Yes
Anne	Associate	$84,000	$6,000	$3,360	$0	Full	Yes
Maria	Office Manager	$58,000	$2,000	$1,870	$0	Full	Yes
Tina	Secretary	$39,000	$1,000	$1,000	$0	Full	Yes
Frank	Filing Clerk	$24,000	$0	$0	$0	Full	Yes
Tonia	Secretary	$30,000	$0	$0	$0	Full	No
Carl	Law Clerk	$13,500	$0	$0	$0	800 HOS	No

- Eligibility: 1 YOS/age 21 (so Tonia and Carl don't participate)
- Safe harbor 401(k) plan is top heavy exempt
- The firm doesn't need to make a TH minimum contribution for Tina and Frank

Example

- Assume the same facts as in the previous example, except the law firm amends the plan to provide immediate eligibility for deferrals (one YOS/age 21 continues to apply for the SH match) and excludes <u>part-time employees</u>
  - For 2023, X applies the OEE rule for coverage and nondiscrimination
  - Under the OEE rule, the upper group plan is SH and doesn't need to apply the ADP or ACP tests
  - Since the OEE doesn't apply for TH purposes, X will need to make a TH minimum contributions for all eligible EEs, including those EEs with less than a year of service (Tonia, Frank and Tina)

Example: Law Firm, Inc. (2023)

Name	Position	Net Comp	Deferral	Basic SH Match	TH Minimum	Fulltime?	1 YOS?
Sam	Shareholder	$330,000	$30,000	$13,200	$0	Full	Yes
Sue	Shareholder	$330,000	$22,500	$13,200	$0	Full	Yes
Anne	Associate	$84,000	$6,000	$3,360	$0	Full	Yes
Maria	Office Manager	$58,000	$2,000	$1,870	$0	Full	Yes
Tina	Secretary	$39,000	$1,000	$1,000	$200	Full	Yes
Frank	Filing Clerk	$24,000	$0	$0	$720	Full	Yes
Tonia	Secretary	$29,500	$500	$0	$900	Full	No
Carl	Law Clerk	$13,500	$0	$0	$0	800 HOS	No

- Safe harbor 401(k) plan is NOT top heavy exempt
- Tina, Frank and Tonia must receive the TH minimum

Example

- Assume the same facts as in the previous example, except the plan year is 2024
  - For 2024, X applies the OEE rule for coverage and nondiscrimination
  - Carl is eligible to defer under LTPT employee rule
  - Under the OEE rule, the upper group plan is SH and doesn't need to apply the ADP or ACP tests
  - Commencing in 2024, Section 310 provides that the firm will not need to make a TH minimum contribution to the OEEs (Tina)
  - Unfortunately, Section 310 doesn't address the top heavy exemption for the "upper" group
    - Accordingly, the firm will need to make a TH minimum contribution for the upper group employees

Example: Law Firm, Inc. (2024)

Name	Position	Net Comp	Deferral	Basic SH Match	TH Minimum	Fulltime?	1 YOS?
Sam	Shareholder	$345,000	$30,500	$13,800	$0	Full	Yes
Sue	Shareholder	$345,000	$23,000	$13,800	$0	Full	Yes
Anne	Associate	$84,000	$6,000	$3,360	$0	Full	Yes
Maria	Office Manager	$58,000	$2,000	$1,870	$0	Full	Yes
Tina	Secretary	$39,000	$1,000	$1,000	$200	Full	Yes
Frank	Filing Clerk	$24,000	$0	$0	$720	Full	Yes
Tonia	Secretary	$29,500	$500	$0	$0	Full	No
Carl	Law Clerk	$13,500	$0	$0	$0	800 HOS	No

- **Eligibility**: Immediate eligibility for deferrals (Tonia can defer) and Carl can defer under LTPT employee rule; 1 YOS/age 21 for SH match (so Tonia and Carl don't participate)
- SECURE §310 states that the plan doesn't need to give TH minimum to OEE (Tonia), however, it doesn't preserve safe harbor TH exemption (Tina and Frank)

Early Eligibility Design

Early entry

- What if you'd like Tonia the secretary to be able to defer?
  - She doesn't have a year of service yet
- What if you don't want her to qualify for safe harbor contributions until she has a year of service?
- And then there's Carl the Law Clerk who is a part-time employee
  - How do you let Tonia in and keep Carl out?

Keeping part-time employees out

Easiest way to exclude part-timers: Require 1,000 HOS

↓

Problem: That also keeps out new full-time employees

↓

Eligibility regs generally do not let us exclude part-time EEs as a classification

IRS recommends a solution!

- Plan can exclude part-time as long as part-time defined as EE scheduled to work less than 1,000 HOS
- Must also include fail-safe language for part-time EE who actually works 1,000 HOS
  - Once they have 1,000 HOS, they enter and cannot be forced out because they later drop below 1,000 HOS
- Allows immediate or early entry for full-time employees while requiring 1 YOS for part-time
  - While saving on top-heavy minimums and other contributions for part-timers

Frequently Asked Question

- **May a plan continue to utilize the part-time EE exclusion now that the LTPT EE rules apply?**
- A plan cannot exclude part-time or seasonal EEs from LTPT status (and the right to defer) if they are credited with the requisite 500 hours in three consecutive years (two years beginning in 2025)
  - However, a plan may continue to apply a part-time EE exclusion until an EE is eligible under the LTPT rules
- A plan may continue to apply the part-time EE exclusion with respect to employer contributions (profit sharing and match)

Back to new hire, Tonia the Secretary

- Suppose plan provides that nonexcluded employees can begin deferring on the first day of the calendar quarter following their date of hire
  - Now Tonia can defer without waiting for a YOS
  - But, Tonia then becomes eligible for the safe harbor contribution
    - All NHCEs eligible to defer must receive the safe harbor contribution (except LTPT EEs)
- Can you eat your cake and have it too?
  - Yes: Use the otherwise excludable employee rule (OEE)

How could OEE rule affect safe harbor plan?

- Just two employees in lower group
  - Tonia: NHCE Participant
  - Carl: Excluded NHCE
- Since there are no HCEs in lower group
  - Lower group automatic passes coverage and nondiscrimination, including ADP/ACP
  - No need for safe harbor
- Plan can specify that only upper group employees receive safe harbor contributions
  - Leaves Tonia in the cold
  - But that's OK, because she's in "another plan"
    - Not the safe harbor plan
  - Tina's portion of the plan is ADP-tested; it passes

Deferrals plus basic match without Tonia

Name	Gross Comp	Deferral	Basic Match	Total
Sam	$345,000	$30,500	$13,800	$44,300
Sue	$345,000	$23,000	$13.800	$36.800
Anne	$84,000	$6,000	$3,360	$9,360
Maria	$59,000	$2,000	$1,870	$3,870
Tina	$39,000	$1,000	$1,000	$2,000
Frank	$24,000	$0	$0	$0
Total	$895,000	$62,500	$33,830	$96,230

- Plan is top-heavy exempt
  - Frank gets nothing
  - Tina gets only 2½%

Deferrals plus basic match with Tonia

Name	Net Comp	Normal Deferral	Basic Match	Top Heavy	Total
Sam	$345,000	$30,500	$13,800	$0	$44,300
Sue	$345,000	$23,000	$13,800	$0	$36,800
Anne	$84,000	$6,000	$3,360	$0	$9,360
Maria	$58,000	$2,000	$1,870	$0	$3,870
Tina	$39,000	$1,000	$1,000	$200	$2,200
Frank	$24,000	$0	$0	$720	$720
Tonia	$30,000	$0	$0	$900	$900
Total	$925,000	$62,500	$33,830	$1,820	$98,150

- Whether she defers or not, Tonia's going to cost if she's in the plan
- Note: if you give Tonia the safe harbor match:
  - It costs nothing if she doesn't defer
  - Even if she does defer, she doesn't create top-heavy minimums for others

Alternative approaches to top-heavy issue

- No entry until 1 YOS
- Extend safe harbor to all participants
- Give top-heavy minimum contributions to all nonkey participants
  - Could reduce cost by excluding part-time employees
- Split the plan into two plans
  - One for upper group; one for nonkey employees in lower group
  - Preserves top-heavy exemption for upper group
  - Price:
    - 2 5500's
    - 2 plan documents
    - Administrative inconvenience

Early participation rule is N/A to safe harbor

- Early participation rule permits ER to disregard NHCEs with less than 1 YOS from the ADP and ACP tests
  - HCEs with less than 1 YOS still included
  - Only one test
- ER may <u>not</u> apply early participation test to safe harbor plan (limited to otherwise excludible EE rule)

Safe Harbor 401(k) Nonelective or Matching Contributions

- The new LTPT employee rule only requires the plan to make elective deferrals available to such employees
- The plan does not need to provide employer nonelective or matching contributions (including SH nonelective or matching contributions) for the LTPT employees
  - The employer will need to elect not to provide employer contributions to the LTPT EEs
    - Election for SH and TH contributions must be in the plan document
  - However, an employer may provide employer contributions to LTPT employees

Combination Safe Harbor 401(k) and Cross-Tested Plans

Maximizing disparity: Alternatives to safe harbor plan

- What other plan design options should LTD consider to maximize disparity for the HCEs?
  - Safe harbor with cross-testing plan
  - Cross-testing plan
  - Defined benefit plan
  - Combination defined benefit and defined contribution plan

Comparison: Safe Harbor Plan vs. Cross-tested plan

	Cross-tested plan	Safe harbor plan
Fund to 415 limit	Yes	Yes
Disparity	Disparity affected by age of EEs	Disparity affected by NHCE deferrals
Top-heavy	Yes	Can be exempt
Minimum gateway	Yes	No
Participant flexibility	No	Yes
ER Contribution flexibility	Yes	Limited

Why add a 401(k) Feature?

Advantages

- Flexibility
- Catch-up Contributions
- EEs carry some of the responsibility for the plan
- EEs expect a 401(k) plan
- Roth

Disadvantages

- Additional Testing
- Payroll burden
- Administrative issues

XT with ADP-tested 401(k) plan

	Gross Comp.	Deferral	Alloc.	Alloc. Rate	PV Factor	Rate Group EBR	AB%T EBR
A	$ 345,000	$ 30,500	$ 46,000	13.33%	2.338	5.70%	8.55%
B	$ 345,000	$ 23,000	$ 46,000	13.33%	1.555	8.57%	12.86%
C	$ 60,000	$ 2,000	$ 2,658	4.44%	1.034	4.28%	7.50%
D	$ 45,000	$ 1,500	$ 1,994	4.44%	0.538	8.23%	14.43%
E	$ 35,000	$ 1,000	$ 1,551	4.44%	0.389	11.39%	18.74%
F	$ 25,000	$ -	$ -	0.00%	0.304	0.00%	0.00%

- Allocation based on gross comp to encourage deferrals
- Assume F quit midyear with more than 500 hours

	HCE	NHCE	Ratio
5.68	100%	50%	50%
8.57	50%	25%	50%
AB%T	10.71	10.17	95%
ADP	6.80%	2.38%	Fail

Observations of XT with ADP tested plan

- Deferrals and match aren't part of 401(a)(4) plan
  - They don't satisfy minimum gateway
  - They don't count in figuring highest HCE allocation
  - They don't entitle EE to minimum gateway if the EE receives no PS
  - They don't enter into rate group testing
  - But, they are part of average benefit % test
    - Recompute EBR with deferral + match
    - Catch-ups aren't part of AB%T
- Two ways to pass ADP test
  - Refund $6,047 to each HCE
    - Still included in AB%T
  - Make QNEC to NHCEs

Handling the QNEC

- Plan fails ADP test by 2.42%
  - We must increase plan NHCE ADRs by 9.68% (aggregate)
  - Consistent with anti-targeting rules cheapest QNEC is:
    - 5.00% ($1,250) to F
    - 4.68% ($1,638) to E
- Must pass with and without F's QNEC
  - If you don't count the QNEC then they don't count for rate groups, AB%T, or gateway (so E needs full gateway + QNEC)
  - If you count the QNEC, then F is benefitting but has 5%
  - If you don't count the QNEC, then F isn't benefiting and doesn't need a gateway
- If you give each NHCE 2.42%, then F needs the full gateway + QNEC

Gateway with K

415 Limit	$69,000
Deferrals	$23,000
PS Contribution	$46,000
Net Comp	$345,000
PS Allocation Rate	13.33%
Gateway	4.44%

- Deferrals don't count in computing gateway
  - Gateway may be less with K
  - Deferrals won't satisfy gateway
- Ignore catch-ups completely
  - Not in AB%T

Cross-tested plan with 3% safe harbor

	Comp.	Defer	3% Safe Harbor	Other PS Alloc.	Alloc. Rate	PV Factor	EBR
A	$345,000	$30,500	$ 10,350	$ 35,650	13.28%	2.338	5.68%
B	$345,000	$23,000	$ 10,350	$ 35,650	13.28%	1.555	8.57%
C	$ 58,000	$ 2,000	$ 1,740	$ 829	4.44%	1.034	4.28%
D	$ 43,500	$ 1,500	$ 1,305	$ 622	4.44%	0.538	8.23%
E	$ 34,000	$ 1,000	$ 1,020	$ 486	4.44%	0.389	11.39%
F	$ 25,000	$ -	$ 750	$ 358	4.44%	0.304	14.57%
Total	$850,500	$58,000	$ 25,515	$ 73,595			

	NHCE	HCE	Plan
8.57	2/4	1/2	100%
5.68	3/4	2/2	75%
AB%T	Not needed		

Uses of safe harbor contribution

- 3% Safe harbor does it all
  - No ADP test
  - Top heavy
  - Gateway
  - Rate group
  - ABPT
- QNEC in ADP/ACP test
  - Can help ADP/ACP
  - Top heavy
  - Pass 401(a)(4) with and without

An Easy Sell: 3% SH + 6% PS = 9% XT plan

- Design
  - SH 401(k) with 3% nonelective
  - HCEs get additional 6% XT PS
  - 3% nonelective doubles as gateway minimum
  - Might as well base contributions on gross full year comp, because the nonkeys will get TH minimum
- Testing
  - Still have to make sure plan passes 401(a)(4)
  - But it will any time you would pass with just the minimum gateway
- How to explain it:
  - As long as you're doing this SH plan anyway, I can easily contribute another 6% to HCEs if you want it without $1 of extra employee cost

Cross-tested plan with 3% safe harbor + 6%

	Comp.	Defer	3% Safe Harbor	Other PS Alloc.	Alloc. Rate	PV Factor	EBR
A	$345,000	$30,500	$ 10,350	$ 20,700	9.00%	2.338	3.85%
B	$345,000	$23,000	$ 10,350	$ 20,700	9.00%	1.555	5.79%
C	$ 58,000	$ 2,000	$ 1,740	$ 60	3.00%	1.034	2.90%
D	$ 43,500	$ 1,500	$ 1,305	$ 45	3.00%	0.538	5.58%
E	$ 34,000	$ 1,000	$ 1,020	$ 30	4.40%	0.389	7.71%
F	$ 25,000	$ -	$ 750	$ 0	4.40%	0.304	9.87%
Total	$850,500	$58,000	$ 25,515	$ 41,535			

	NHCE	HCE	Plan
5.79	2/4	1/2	100%
3.85	3/4	2/2	75%
AB%T	Not needed		

Safe Harbor 401(k) cross-tested plan with matching

- ER maintains a safe harbor 401(k) plan with 3% safe harbor nonelective and a discretionary match
- The potential match rate is 66 2/3% on deferrals not exceeding 6% of compensation
- The match is capped at 4% of compensation
- No ADP or ACP test
- **Advantage**: You can decide after the year is over whether match or PS is cheaper
- **Disadvantages:**
  - More to communicate and explain
  - No allocation conditions on match

Gateway with K and match

415 Limit	$69,000
Deferrals	$23,000
Match	$12,200
PS Contribution	$33,800
Net Comp	$345,000
PS Allocation Rate	9.80%
Gateway	3.27%

- If NHCEs defer don't contribute the match
- If NHCEs don't defer, lower gateway thanks to match

SH XT Plan with 3% + Disc. Match

	Comp.	Defer	Disc. Match	3% Safe Harbor	PS Alloc.	Alloc. Rate	EBR
A	$345,000	$30,500	$13,800	$ 10,350	$ 21,850	9.20%	3.93%
B	$345,000	$23,000	$13,800	$ 10,350	$ 21,850	9.20%	5.92%
C	$ 58,000	$ 2,000	$ 1,333	$ 1,740	$ 39	3.07%	2.97%
D	$ 43,500	$ 1,500	$ 1,000	$ 1,305	$ 29	3.07%	5.70%
E	$ 34,000	$ 1,000	$ 667	$ 1,020	$ 23	3.07%	7.88%
F	$ 25,000	$ -	$ -	$ 750	$ 17	3.07%	10.09%
Total	850,500	$58,000		$ 25,515	$ 43,808		

	NHCE	HCE	Plan
5.92	2/4	1/2	100%
3.93	3/4	2/2	75%
ABPT	Not needed		

- In this case, adding the match adds $753 to the cost
  - But if D didn't defer, then this would be cheaper

Enhanced and discretionary match

415 Limit	$69,000
Deferrals	$23,000
Match	$27,600
PS Contribution	$18,400
Net Comp	$345,000
PS Allocation Rate	5.33%
Gateway	1.76%

- No SH QNEC
- Enhanced match 100% deferrals up to 4% of comp
- Discretionary match 2/3 deferrals up to 6% of comp
- Top heavy > gateway
  - Match counts for top heavy but not gateway

Qualified Automatic Contribution Arrangements (QACA)

2025: Safe Harbor 401(k) Plans

- 2025
  - For employers (unless the employer qualifies under an exception) who want to establish a new safe harbor 401(k) plan, they should consider a **QACA** because the plan will be subject to the mandatory automatic enrollment requirement
- Grandfathered 401(k) plans (pre 12/29/22) may be converted into a safe harbor 401(k) plan and not be subject to the mandatory automatic enrollment requirement

QACA requirements

- 401(k) (or 403(b))
- Uniform default deferral – minimum %
- Minimum employer contributions
  - Can be subject to 2 year vesting schedule
  - Use standard vesting YOS definitions/rules
- Otherwise very similar to classic safe harbor 401(k)

Automatic deferral

- Automatic deferral not > 15%
- Minimums at right
  - Easiest schedule: 6% from start
- If participant does nothing, gets auto deferral
- Participant can choose:
  - Auto deferral
  - Some other deferral percentage
  - No deferral at all

Min%	P's plan years in QACA
3%	Year of 1st auto deferral and 2nd year
4%	3rd year
5%	4th year
6%	After 4th year

QACA uniformity requirement

- QACA default deferrals must be uniform except:
  - Percentage can differ based on years of participation in QACA
  - Deferrals in effect prior to QACA not reduced
  - Deferrals limited under 401(a)(17), 402(g), 415
  - Defaults don't apply to participants who have made affirmative election:
    - To defer different amount
    - To defer 0
- Same as EACA rules

3 choices for QACA employer contributions

1. 3% nonelective contribution

- Same as classic SH
- Can be greater

2. Basic QACA match

% of comp	Match rate
Up to 1%	100%
1% to 6%	50%

3. Enhanced QACA match

- At least as good as basic QACA at all levels of deferrals
- Rate of match doesn't climb
- No HCE has rate of match > any NHCE

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QACA employer contribution requirements

- Must be subject to 401(k) withdrawal restrictions
- Must be fully vested after 2 YOS
  - Can employer switch from classic safe harbor to QACA and impose 2 year cliff vesting on existing participants?

ACP safe harbor available

- Matching contribution not subject to ACP test if:
  - Comply with QACA safe harbor
    - Nonelective or match
  - All matching contributions:
    - Not consider deferrals over 6% of compensation
    - Rate of match doesn't climb
    - No HCE has rate of match at any level of deferrals greater than any NHCE at that level
      - Therefore no allocation conditions on any match
    - Discretionary match $ limited to 4% of compensation

Top heavy exemption available

- Plan must consist solely of:
  - Deferrals that aren't ADP-tested because of QACA
  - ER nonelective or match that satisfies QACA safe harbor
  - Matching contributions which are under ACP safe harbor
- Forfeitures must be used as SH contributions or to pay expenses

Classic safe harbor rules carry over

- Can't convert from ADP-tested 401(k) to QACA midyear
- Can start new 401(k)/QACA with at least 3 months left on the year
- Can terminate plan or exit match midyear
- Don't have to true up periodic match if employer contributes match at by end of next plan year quarter
- Otherwise excludable employee rule available
  - No ER contributions for EE's with less than 1 YOS/ age 21
  - But lose top heavy exemption

QACA/EACA combination

- Can add EACA to QACA to provide 90-day withdrawal
  - 6 months for ADP correction doesn't matter
- Things to do:
  1. Start with valid QACA
  2. Default investments under QDIA rules
  3. Plan spells out withdrawal procedures
  4. Notice includes QDIA/EACA withdrawals

Differences: QACA vs SH Match

Assume participant comp $40,000						
Deferral		3% QNEC	QACA match		Basic SH match	
%	$	$	%	$	%	$
1.0%	$400	$1,200	1.0%	$400	1.0%	$400
2.0%	$800	$1,200	1.5%	$600	2.0%	$800
3.0%	$1,200	$1,200	2.0%	$800	3.0%	$1,200
4.0%	$1,600	$1,200	2.5%	$1,000	3.5%	$1,400
5.0%	$2,000	$1,200	3.0%	$1,200	4.0%	$1,600
6.0%	$2,400	$1,200	3.5%	$1,400	4.0%	$1,600

THANK YOU

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