401(k) Plan Provisions That Should Be Reviewed For "Tinkering"

By Ary Rosenbaum, Esq.

When I was in law school, I was a bit of a malcontent. I'm a big fan of truth and transparency, but that's me. One of the explanations in retort to my criticisms was that things done a certain way were done that way because they were always done that way. Well, what if what was always done was wrong? When you set up a 401(k) plan, the plan provisions weren't set in stone, so it's beneficial to look at your plan provisions to determine whether they still fit your needs and the needs of your employees.

Eligibility for salary deferrals

I understand that employers may not want part-time employees to be covered under their plan, so they want to require a Year of Service (1,000 hours within 12 months of service). For employer contributions, I also certainly understand why you would require an eligibility period of a Year of Service. The problem that I have with plan sponsors requiring a Year of Service for salary deferrals is twofold: 1) it may deter the recruitment of new employees who have retirement plan coverage with their employer and 2) the law was changed, so that long time, part-time employees are going to have been covered under the 401(k) plan. Effective for plan years beginning on or after January 1, 2021, long-term, part-time employees who complete three consecutive 12-month periods, each with at least 500 hours of service, must be given the opportunity to participate in the employee deferral component of your 401(k) plan. The initial computation period begins on January 1, 2021. That means part-time employees may first become eligible to defer under your 401(k) plan as a long-term, part-time employee after earning at least 500 hours of service in each of 2021, 2022, and 2023, starting January 1, 2024. Since you have no choice but to let certain part-time employees in the deferral component of the plan anyway in 2024, this might be the time to revisit the eligibility requirement for salary deferrals anyway and eliminate it completely. My wife just changed jobs and that six-month eligibility requirement might have been a deal breaker if she wasn't near maximizing her salary deferrals for the year. I understand many employers don't want small account balances from participants because of constant employee turnover, but if the turnover of employees is an issue, that isn't the fault of the 401(k) plan. A more liberal eligibility requirement for salary deferrals won't impact your testing as you may have the opportunity to test the salary deferral component if you had an age 21 and a Year of Service requirement. Again, eligibility is your choice, I'm just offering my two cents as a former employee.

Loans and hardship distributions

There are 401(k) plans out there that don't offer participant loans and/or hardship distributions. It may be a policy reason that employers don't want their employees to raid retirement savings. Another reason is the headaches with compliance issues that arise from loans and hardship distributions, such as loan defaults which result in taxable distributions to plan participants. The reason I recommend plan sponsors in allowing distributions for hardships and allowing loans is because ultimately, it's the plan participant's money. When employees defer money in their 401(k) plan, I believe that the intent was that it would be there for their retirement and not invaded for current needs. However, as my dear Grandmother would say, life doesn't go to plan. I'm not proud that I had to withdraw money from my 401(k) plan in 2012, but life and Hurricane Sandy destroying half my home got in the way. People often use the loan provision in the plan to help buy a house. As a plan sponsor, telling participants that they can't tap their 401(k) plan when they need it and qualify, is that a good thing? To avoid compliance headaches, hardship dis-

tributions and loans should require a $1,000 minimum. For loans, I think just allowing one loan outstanding (but allowing refinancing) will avoid some of the mistakes that would allow a plan loan inadvertently go into default, forcing a taxable distribution to participants.

59 ½ in-service distributions

Like with hardship distributions, there are 401(k) plans that don't allow distributions until actual retirement. Quite honestly, participants who have attained age 59 ½ or normal retirement age, should have access to their retirement savings, whether a distribution to themselves or to a rollover individual retirement account.

Safe harbor contributions

Retirement plans such as 401(k) plans must pass certain testing to make sure that contributions aren't discriminating in favor of highly compensated employees. If you fail one or more of these tests, it must be corrected. There could be salary deferral refunds (if they fail the Actual Deferral Percentage Test) or corrective contributions. To avoid that, you could add a safe harbor contribution to your plan to avoid the headaches of failed testing. There are three types of safe harbor plans that could give you a choice in finding the best fit for you and your budget. Each plan structures the mandated safe harbor contributions differently. The three 401(k) safe harbor match types include 1) Basic Safe Harbor Match: To qualify for the employer's match, employees must contribute to the 401(k) plan. The employer matches 100% of the first 3% of each employee's salary deferrals and 50% of the next 2%, the contribution is 100% vested; 2) Non-Elective Safe Harbor: Employees are not required to contribute to the plan. The employer contributes 3% of their salary, which comes directly from the business and is not deducted from employees' wages. If you add this feature after the Plan Year is over, the contribution would be 4% of compensation. The contribution is 100% vested;3) Qualified Automatic Contribution Arrangement (QACA) - Safe Harbor with Auto-Enroll: There are two options available under this plan design: QACA Match - eligible participants are required to contribute to the plan and will receive a 100% employer match on the first 1% contributed and a 50% match on the next 5% contributed. QACA Non-Elective Contribution – Employees are not required to contribute to the plan in order to receive a 3% employer contribution. In both the QCA Match and QACA Non-Elective Contribution options, employer contributions must be fully vested after 2 years. The option to choose a 100% immediate vesting schedule is also available. If your plan has failed or came close to failing your contribution discrimination testing and you can afford the contributions, the safe harbor contribution is a must to avoid headaches after the Plan Year is over.

Cross tested allocations

While most plans offer a profit-sharing contribution that gives every participant the same contributions in the percentage of compensation. Some plans offer an integrated allocation Cross-testing (or new comparability) is a plan design concept that would allow you to define classes of employees and contribute profit-sharing contributions on a percentage basis to each class, which could give owners and/or highly compensated employees more of a contribution. The contribution formula has to pass an average benefits test. In addition to the average benefits test, the plan must also satisfy a minimum allocation gateway where each non-highly compensated employee (NHCE) in the plan has an allocation rate that is at least one-third of the allocation rate of the highly compensated employee (HCE) with the highest allocation rate, or, each NHCE receives an allocation percentage of at least 5% of the NHCE's compensation. For plans that want cross-testing and the safe harbor contribution, a minimum gateway contribution of 3% to the rest of the employees would satisfy the safe harbor contribution and allow you and other highly compensated employees you choose to receive 9% of compensation as a contribution. If you can afford the contribution, it's something to consider.

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