



Give Your 401(k) Plan a Boost

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Give Your 401(k) Plan a Boost

- Interesting Facts
 - Estimated number of plans
 - 30,000 – in 1985
 - 200,000 – in 1995
 - 640,000 – in 2010
 - Amounts held in 401(k) plans
 - \$900 billion – in 1995
 - \$4.7 trillion – in 2014



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– Percentage of compensation matched
(for plans that provided matches)

- 3% or less - 22%
- 4% - 15%
- 5% - 12%
- 6% - 41%
- 7% or more - 6%



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- Matching percentage of each dollar deferred (simple match formulas)
 - 100% - 44%
 - 50% - 15%
 - 25% - 9%
- 11% of participants eligible to make Roth deferrals take advantage of it
- 21% of participants eligible to take loans take advantage of it

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- Our Own Quick Survey
 - How many of our employers do not offer a 401(k) or 403(b) plan?
 - How many offer a Roth option?
 - How many plan participants?
 - Under 10
 - 10 to 100
 - Over 100
 - How many fail the ADP test?
 - How many offer plan loans?

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- The Basics
 - Traditional 401(k) Plans
 - Pre-tax contributions
 - Distributions are taxable
 - Maximum deferral in 2016-\$18,000
 - Maximum catch-up deferral in 2016-\$6,000
 - Subject to non-discrimination testing (ADP test) to assure that HCEs do not defer disproportionately large amounts

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– Roth 401(k) Plans

- After-tax contributions
- Distributions are tax free (if eligible)
- Contribution/deferral limits the same as in a traditional 401(k)
- Subject to the same ADP test as in a traditional 401(k)

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- Why choose Roth 401(k) over a traditional 401(k)
 - Tax rates may be higher during retirement than current rates
 - Not subject to required minimum distributions if rolled into Roth IRAs
 - Maximizes retirement benefits
 - Facilitates estate planning by prepaying income taxes
 - Facilitates estate planning by providing “terrific” death benefits to beneficiaries

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- Curing ADP Test Problems
 - What is ADP? Must meet either of these two tests:
 - ADP for HCEs is not more than the ADP for NHCEs multiplied by 1.25; or
 - ADP for HCEs is not more than 2% higher than ADP for NHCEs and more than 2 times the ADP for NHCEs

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- Example

	Comp.	Deferral	ADP
HCE1	\$205,000	\$13,000	6.34%
HCE2	\$180,000	\$12,000	6.67%
NHCE1	\$60,000	\$ 6,000	10.00%
NHCE2	\$40,000	\$ 3,200	8.00%
NHCE3	\$40,000	\$ 2,000	5.00%
NHCE4	\$40,000	\$ 0	0.00%
NHCE5	\$20,000	\$ 600	3.00%
NHCE6	\$20,000	\$ 300	1.50%

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ADP Test 1 Failed

HCE ADP% = 6.51%

NHCE ADP% = 4.58%

6.51% / 4.58% = 1.42%

Therefore ADP Test 1 Failed

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ADP Test 2 Passed

$6.51\% - 4.58\% = 1.93\%$

$1.93\% < 2\%$ and

$6.51\% < 9.15$ (2 times the NHCE ADP%)

Therefore ADP Test 2 Passed

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- How to cure a failed ADP Test
 - Refund deferrals to HCEs
 - Employer makes a Qualified Non-Elective Contribution (QNEC) or a Qualified Matching Contribution (QMAC) for NHCEs

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- Other options to cure ADP problems
 - Adopt a Safe Harbor Plan
 - Automatically passes ADP
 - Requires a mandatory 3% non-elective contribution or a match of 100% of the first 3% of deferral and 50% of the next 2%
 - Add or increase matches
 - Extend matches
 - Use escalating match rates

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- Provide automatic enrollment for new participants
- Give participants access to their accounts with loans, hardship distributions and in service distributions after 59 ½
- Increase opportunities to change deferral or investment elections

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- Paying Expenses from Plan Assets
 - When?
 - Plan document must authorize payment
 - May not be “settlor function” expenses - an independent decision or business activity
 - Design expenses
 - Initial plan document
 - Voluntary amendments

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- The types of expenses that may be paid include:
 - Participant record keeping
 - Non-discrimination/top-heavy testing
 - Preparation of Form 5500
 - Accountant's audit reports for large plans
 - Various notices such as automatic enrollment, default investments and safe harbor 401(k) plans

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- Plan amendments and/or restatements required by law changes or new regulations
- IRS Determination Letter requests
- Purchase of trustees fiduciary bond
- Trustee fees
- Investment management fees

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- Which expenses can be borne directly by an affected participant?
 - Plan document must authorize payment
 - Participant must be informed of the fee in advance
 - The types of fees typically charged directly
 - Fees to prepare distribution packages and consent forms
 - Hardship withdrawal expenses
 - Fees to prepare participant loan documents
 - Qualified Domestic Relations Order determinations and processing fees
- Using forfeitures to pay expenses

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- Don't Overlook Roth 401(k) Opportunities
 - Add Roth 401(k) options to a traditional 401(k) Plan
 - More media coverage than ever before
 - More plans are adding Roth options every day
 - Provides a method of diversifying future risk that rates will increase
 - Employers get more “bang for the buck” because very little cost to add this feature

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- Allow for In-Plan Roth Conversions
 - What is a Roth Conversion?
 - Allows a participant to transfer a non-Roth portion of their account into a designated Roth account
 - Generally the amount converted is subject to Federal Income Tax in the year converted
 - The ten percent early distribution penalty does not apply

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- What accounts can be converted?
 - Pre-tax elective deferrals
 - Vested matching contributions
 - Vested non-elective employer contributions
 - Rollover contributions
 - Earnings on any of the above accounts

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- Paying the tax created by the Conversion
 - The big deterrent to a Conversion is the obligation to pay the tax immediately
 - Ideally, a participant will be in a low tax bracket and have cash available to pay the tax
 - The participant may have available other distribution opportunities
 - Plan loans
 - In-service distributions of other plan assets (which will subject the distribution to taxation and penalties, if appropriate)