401(k) Plan Design Checklist

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Summary

Are you thinking of offering a 401(k) plan to your employees? If you're just getting started, you may be overwhelmed by all of the plan design options and trying to understand the best fit for your firm. Simply typing "401(k) plan design" in a Google search can be very daunting. That's where this checklist comes in. After reading through our checklist, you should be able to do the following:

1. Understand the different sections of a legal 401(k) plan document;
2. What to consider for plan design in each section and what each of your options are;
3. Have a better understanding of your preferred plan design before engaging with a 401(k) provider.

There is no such thing as "one size fits all" 401(k) retirement plan. Good 401(k) plan design matches plan specifications to employer goals and employee demographics. Employer goals for a retirement plan can vary greatly. Some employers may want to maximize owner contributions at the lowest overall cost while others want to incentivize employee participation in their plan.

Regardless of your goals, it's important to understand that all 401(k) plans are required to operate according to the terms of a written plan document. During the plan design process, you will select the terms for your plan document. This checklist highlights the major terms you will choose for your plan document during the plan design process.

BEFORE YOU START

Before you start this checklist, we recommend that you first confirm whether or not your company is part of a Controlled Group (CG) or Affiliated Service Group (ASG). Under the law, a CG or ASG is considered a single employer for 401(k) "coverage testing" purposes. To pass coverage testing, a 401(k) plan is often required to cover all employees of a CG or ASG. A 401(k) plan may be disqualified for failing coverage testing in any year.

Do not fail coverage testing because you do not know your company's CG or ASG status. If you have trouble making a CG or ASG determination, consult your 401(k) provider or legal counsel.

A. General Information

Plan type and plan features are elected in this section. A 401(k)/profit sharing plan can be sponsored by private or tax-exempt organizations. A 403(b) plan can be sponsored by tax-exempt or public education organizations. A 457(b) plan can be sponsored by tax-exempt or certain government organizations.

If a plan feature is selected here, the applicable section of the Plan Specifications Form must also be completed. For example, if safe harbor is elected, the safe harbor section of the Plan Specifications Form must also be completed.

Plan Effective Date: _____________ **Plan Year-End:** _____________

Plan Effective Date will affect plan compensation for the 1st plan year. For example: if a calendar year plan selects a January 1, 2015 effective date, contributions will be calculated based on full 2015 compensation. If a mid-year date is elected, contributions will be based on pro-rated compensation.

B. Eligibility

Employers may allow new employees to enter the plan immediate or hire and wait to set minimum age requirements. Employers may also limit plan entry dates to monthly, quarterly, or semiannual windows. Generally, employers with transient work force favor more restrictive eligibility requirements.

The law permits you to exclude union and nonresident alien employees from your plan without issue. You can exclude other classes of employees, but only if these classes do not exceed 30% of your workforce.

B. Eligibility *(continued)*

SERVICE REQUIREMENT:	401(k)/Safe Harbor	Match	Profit Sharing
One Year of Service	☐	☐	☐
None	☐	☐	☐
Other: ________________	☐	☐	☐
AGE REQUIREMENT:			
Age 21	☐	☐	☐
None	☐	☐	☐
Other: _________________	☐	☐	☐
ENTRY DATES:			
Semi-annual	☐	☐	☐
Quarterly	☐	☐	☐
Monthly	☐	☐	☐
Immediate	☐	☐	☐
Other: ________________	☐	☐	☐

Will plan waive above-selected eligibility provisions for ALL employees employed on a particular date?

☐ No ☐ Yes

If Yes, enter special effective date: ______________________

Will an employee have to work 1,000 hours in order to be credited with one year of eligibility service?

☐ No ☐ Yes

Excluded Employees:

☐ None ☐ Union Employees ☐ Nonresident Aliens

☐ Leased Employees ☐ Other: ____________________

C. Compensation

The law permits you to exclude certain types of compensation for plan purposes without issue, including compensation earned prior to plan entry and fringe benefits. You can exclude other types of compensation *(bonuses, overtime, etc., but these exclusions will subject the compensation definition to special annual testing. Additional fees apply)*.

Plan compensation shall mean wages and other payments for which the employer must file a Form W-2, except:

☐ Fringe Benefits ☐ Post-Severance [(1)] ☐ Other [(2)]

[(1)] "Post-severance" compensation is unused sick, vacation, or other leave paid within the 2½ months following date of termination.

[(2)] Safe harbor 401(k) plans and plans containing an "integrated" profit sharing formula cannot elect this option. Other plans may be subject to special "IRC 414(s)" testing annually to test plan compensation definition for nondiscrimination (additional fees apply).

For an employee's first year of participation, this compensation shall be recognized from:

☐ The first day of the plan year ☐ The day the employee is eligible to enter the plan

D. Employee Contributions

401(k) deferrals are pre-tax contributions made to a plan at the election of an employee, in lieu of receiving such amounts as cash compensation. Roth deferrals are similar to 401(k) deferrals, only they are contributed by employees on an after-tax basis.

An automatic enrollment feature allows an employer to enroll employees in a 401(k) plan without the employees' affirmative election, as long as the employees have the right to "opt out" of contributing or change the amount of automatic deferral. Adding an automatic enrollment feature to a 401(k) plan generally increases the level of employee participation in the plan.

A Qualified Automatic Contribution Arrangement (QACA) is a special type of automatic enrollment feature that also satisfies safe harbor contribution requirements (see Safe Harbor Contributions).

401(k) Deferral limit is ______% of included compensation. If percentage is not indicated, 401(k) deferrals will be limited by the IRS limitations only. Limits also applies to Roth Deferrals (if applicable).

D. Employee Contributions *(continued)*

An employee may start or modify a 401(k) deferral election on the following frequency:

☐ Per Payroll ☐ Monthly ☐ Quarterly ☐ Semi-annually

Will plan provide for automatic enrollment? ☐ No, *if no skip to section E* ☐ Yes

Automatic enrollment default percentage: _______% (minimum 3%)

Is feature to qualify as a QACA? ☐ No ☐ Yes

What is default escalation schedule: ______________________________

What is vesting schedule? ☐ 100% immediate ☐ 2-year cliff

E. Safe Harbor Contributions

A safe harbor 401(k) plan is a type of 401(k) that automatically satisfies ADP/ACP testing requirements. A safe harbor 401(k) plan will also automatically satisfy top heavy minimum contribution requirements for a year in which the only contributions made to the plan are elective deferrals (pre-tax or Roth) and safe harbor contributions (i.e., no profit sharing contributions).

Eligible safe harbor contributions include:

1. 4% matching contribution
2. 3.5% matching contribution (QACA safe harbor plans only – see Employee Contributions section)
3. 3% non-elective contribution

These contributions are non-discretionary (required) contributions. They must be subject to 100% vesting and not be subject to any allocation conditions.

☐ Effective date of safe harbor feature:

☐ Plan Effective Date

☐ Date _______________

Safe harbor effective date will affect plan compensation for the 1st plan year. For example: if a calendar year plan selects a January 1, 2012 effective date, safe harbor contributions will be calculated based on full 2012 compensation. If a mid-year date is elected, safe harbor contributions will be based on pro-rated compensation.

E. Safe Harbor Contributions *(continued)*

Choose one of the two safe harbor contribution options below:

☐ Safe Harbor Matching Contribution—choose only one of the three following options:

☐ Basic formula: 100% of applicable contributions up to the first 3% of Compensation, plus 50% of applicable contributions up to the next 2% of Compensation

☐ Enhanced Formula: ______% of applicable contributions up to ______% of Compensation

☐ QACA formula: 100% of applicable contributions up to the first 1% of Compensation, plus 50% of applicable contributions up to the next 5% of Compensation (QACA plans only)

The Safe Harbor matching contribution formula elected above is applied separately for each:

☐ Per Payroll ☐ Monthly ☐ Quarterly ☐ Annually

☐ Safe Harbor Non-Elective Contribution

________% (no less than 3%) of included compensation

F. Matching Contributions

The plan may provide for a matching contribution based on the elective deferrals made by participants. The matching formula also may be discretionary, so that the employer will determine each year what the rate of match should be.

The following factors might be taken into consideration in designing a matching contribution formula: (1) whether the employer wants discretion in setting the amount each year, (2) whether the formula should be tiered (i.e., a different rate of match for different levels of elective deferrals), and (3) whether the amount of the match should be capped to a specific percentage of compensation or a specific dollar amount.

F. Matching Contributions *(continued)*

If the match is funded after the close of the year, the plan can require participants to satisfy certain allocation conditions in order to receive a contribution. For example, the plan can require participants to work a certain number of hours during the plan year (up to 1,000 hours) and/or be employed on the last day of the year.

The employer match will be: ☐ **Discretionary** ☐ **Fixed (i.e., Required)**

If fixed, describe match formula: _______% of 401(k) up to _______% of Compensation

Matching Contributions will be allocated to participant accounts at the following time(s):

☐ Per Payroll ☐ Monthly ☐ Quarterly ☐ Annually

Allocation restrictions *(if applicable)*—check either a or b and/or c:

☐ a. An employee must be employed with the employer on the last day of the plan year OR must have more than 500 hours of service for the plan year,

\- OR -

☐ b. An employee must be credited with at least _________ hours of service (may not exceed 1,000) during the plan year

☐ c. An employee must be employed with the employer on the last day of the plan year

Note: If any of the above are checked, the employer match must be funded annually (not per payroll). If the plan is a safe harbor 401(k) plan any allocation restriction will subject ALL matching contributions to non-discrimination testing.

G. Profit Sharing Contributions

A key advantage of a profit sharing contribution feature is that the employer can have flexibility in determining its annual contribution to the plan because of the ability to use a discretionary contribution formula. This way the employer is able to contribute more in years of high profitability, and to contribute less when business is not as good, without having to amend the plan's contribution formula.

G. Profit Sharing Contributions *(continued)*

There are three principle profit sharing allocation formulas:

- Pro Rata – allocates a uniform contribution percentage amongst participants
- Integrated – provides a greater allocation on compensation earned in excess of the "integration level" (usually the Social Security taxable wage base)
- New Comparability – permits different allocation rates based on employee class assuming nondiscrimination testing is passed

If the profit sharing is funded after the close of the year, the plan can require participants to satisfy certain allocation conditions in order to receive a contribution. For example, the plan can require participants to work a certain number of hours during the plan year (up to 1,000 hours) and/or be employed on the last day of the year.

The Profit Sharing contribution will be: ☐ **Discretionary** ☐ **Fixed (i.e. Required)**

The Profit Sharing formula will be:

☐ Pro Rata ☐ Integrated (integration level will be ________________% of SSA Taxable Wage Base)

☐ New Comparability—one group per participant (additional fees apply)

Profit Sharing Contributions will be allocated to participant accounts at the following time(s):

☐ Per Payroll ☐ Monthly ☐ Quarterly ☐ Annually

Allocation restrictions (if applicable) – check either a or b and/or c:

☐ a. An employee must be employed with the employer on the last day of the plan year OR must have more than 500 hours of service for the plan year.

- OR -

☐ b. An employee must be credited with at least _________hours of service *(may not exceed 1,000)* during the plan year

☐ c. An employee must be employed with the employer on the last day of the plan year

Note: If any of the above are checked, the Profit Sharing must be funded annually (not per payroll). If the plan is a safe harbor 401(k) plan, no restrictions on discretionary match should apply.

H. Retirement Age

At normal retirement age, participant accounts become immediately 100% vested. The maximum retirement age allowed by law is the later of 1) age 65 or 2) 5th anniversary of plan participation. The most commonly used retirement age is 65.

The plan's Normal Retirement Age (NRA) will be:

☐ Age 65 ☐ Age______ ☐ Age ______ and ______ years of participation

I. Vesting

401(k) and most safe harbor contributions must always be 100% immediately vested. Other contributions may be subject to a vesting schedule. When a participant terminates, they are only entitled to the vested portion of their account balance. Any unvested portion of their account must be forfeited to the plan. The plan can use these forfeitures to pay plan expenses or reduce future employer contributions. Generally, employers with transient work force favor lengthier vesting schedules in order to use forfeitures.

EMPLOYER CONTRIBUTION VESTING SCHEDULE(S)	Match	Profit Sharing
100% immediate	☐	☐
3-year cliff *(1-2 yrs = 0%, 3 yrs = 100%)*	☐	☐
6-year graded *(20% each yr after 2 yrs)*	☐	☐

1 Year _____% 4 Year _____%

2 Year _____% 5 Year _____%

3 Year _____% 6 Year _____%

Will the following service be excluded for vesting purposes?

Service before the original effective date of this plan ☐ No ☐ Yes

Years of service before the employee's 18th birthday ☐ No ☐ Yes

Special 100% vesting—an employee's vested percentage is increased to 100% if the employee:

☐ Dies ☐ Becomes disabled

J. Distributions

Often, plans will only permit the lump sum form of distribution when a participant separates from service and is entitled to a distribution. Under the lump sum option, a participant must take their entire vested account balance in a single distribution. Other distribution forms available include installment payments and partial payments.

The plan can permit a participant to take a distribution while still employed. These are called "in-service" distributions. These distributions can be available upon the attainment of a certain age (59½ or greater) or a "hardship" event. Eligible hardship events are defined by the law.

The plan may permit the involuntary cash-out of small account balances. Balances under $1,000 may be distributed in cash to the participant. Balances under $5,000 may be involuntarily rolled into an IRA for the benefit of the participant.

Will the lump sum form of distribution be the plan's sole form of distribution?

☐ No ☐ Yes

If no, optional forms available:	☐ Partial payments	☐ No	
Are Hardship withdrawals permitted?	☐ No	☐ Yes	
Sources Available:	☐ All *(excludes safe harbor)*	☐ Employee contributions only	
Are In-Service withdrawals permitted?	☐ No	☐ Yes	
Age:	☐ 59½	☐ NRA	☐ Age____
Sources Available:	☐ All	☐ Employee contributions only	

K. Loans

The employer can allow or disallow loans. Loans are often very popular with employees but add administrative complexity for the employer, who often must sign off on loan requests.

Will Plan permit loans? ☐ No ☐ Yes

Maximum number of loans permitted? ☐ One ☐ *Other*__________

Loan repayments are deducted by payroll deduction and remitted along with payroll contributions