

Did

YOU KNOW?

Plan compliance doesn't have to be difficult if you have all the information you need to understand and **follow the rules that apply to you as a retirement plan sponsor.**

Some of **the most important things plan sponsors need to know** about retirement plans in order to follow federal law and avoid fines **are in this document.**

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Top Heavy Plans

What is Top-Heavy?

- A plan is Top-Heavy if, as of the determination date (last day of the prior plan year) the total of the accounts of all key participants exceed 60% of the total of the accounts for all participants in the plan.

Who is a Key Employee?

- A more than 5% owner of the employer (family attribution rules apply);
- A more than 1% owner of the employer with annual compensation greater than \$150,000 (family attribution rules apply); or
- An officer of the business earning more than the threshold amount adjusted annually for inflation (\$230,000 for 2025).

Who is an Officer?

- An administrative executive who is in regular and continuous service with an organization. The determination of an employee as an officer is made on the basis of all facts and circumstances – including, for example the source of the employee's authority, the term for which the employee was elected or appointed and the nature and extent of the employee's duties.
- Sole proprietorships, partnerships, unincorporated associations, trust and labor organizations may have officers.
- The number of employees that can be considered officers is equal to 10% of all employees or 3, whichever is greater. In no case can the total number of officers exceed 50.
- If in doubt of whether an employee is an officer, please contact your BPP Retirement Plan Specialist. BPP cannot make the determination, however we can provide detailed Revenue Rulings to help you make the determination

What happens when a start-up plan is Top-Heavy?

- A 3% contribution has to be contributed for each Non-Key Employee who has completed one year of service.
- Terminated Participants do not receive the 3% Top-Heavy contribution

What happens when an Existing Plan becomes Top-Heavy?

- If the Top-Heavy "determination date" is based on the last day of the plan year (*which all of BPP documents are*);

- A 3% Employer Top-Heavy contribution must be contributed in the following year based on existing plan participants.
- Terminated participants do not receive Top-Heavy Contributions

When does the Top-Heavy Contribution have to be made?

- Twelve months after the close of the plan year, or
- If the employer's Tax Return is extended, the extension due date so that it may be deducted in that tax year.

If the Plan is Top-Heavy, can the Employer get out of making a 3% contribution?

Possibly—

- If the Plan is Safe Harbor and eligibility to receive the Safe Harbor Contribution is the same as eligibility to make Salary Deferrals and no other Employer Contribution (match, profit share or forfeitures) is contributed, then the plan has met Top-Heavy.
- In the Plan Year following the Top-Heavy Determination Year, if the Key Employee(s) do not contribute any money from their salary or receive any Employer Contributions such as match, forfeitures or profit share, then Top-Heavy is met and no additional money must be contributed.
- If each Key Employee's total percentage (salary deferral, match, profit share & forfeitures) is less than 3%, then the Non-Key Employees would only have to receive the same percentage as the Key Employees.

Audit Level Plans

Are all 5500 Tax Returns required to have an Independent Auditor's Report?

For an "Existing Plan"

- The 80/120 Rule
 - If at the beginning of the year the plan:
 - had 80-120 participant balances, and
 - filed a small plan 5500 for the prior year
- In other words, if the plan was filed the prior year as a small plan, you can file as a small plan this year if the plan has <121 participants with balances at the start of the plan year.

For a "First Year Plan"

- File as a large plan and must have the Independent Auditor's Report if the plan had at least 100 participant balances at the end of the first plan year.

- You can file as a small plan if the plan had fewer than 100 participant balances at the end of the plan year.

If the “Number of Participants” is <121, does this mean the plan is exempt from needing an audit?

Not necessarily. The “Number of Participants” is based upon the number of participants with an account balance. Employer mergers, acquisitions, spin-offs, et cetera, could increase the participant count as of the 1st day of the plan year.

A Plan can also be subject to a CPA audit if there are certain assets in the trust that are not considered qualifying plan assets and those assets are not properly bonded.

Can all CPA firms produce the Independent Auditor Report?

No, you will need to check with your CPA firm.

Are Independent Auditor Report’s expensive?

The reports usually cost from \$8,000 - \$12,000 each year depending on many variables relating to the Plan and Auditor.

Highly Compensated Employees

Highly Compensated Employee (HCE)—defined as a more than 5% owner in the tested plan year or the look back plan year (stock attribution rules apply), for the 2025 plan year, an employee who earned more than \$155,000 in 2024 is an HCE.

ADP/ACP Refunds

One of the required tests is the Average Deferral Percentage (ADP)/Average Contribution Percentage (ACP) nondiscrimination test. The ADP test compares the average salary deferral percentage (ADP) of the HCEs to the ADP of the NHCEs. The ACP test compares the HCE and NHCE averages of the matching contributions.

The IRS has established limits on the differences allowed between the two groups’ ADP/ACP. The rules state that the percentage for the HCEs cannot be more than 2% over the percentage of the NHCE group. If the test fails, and the HCEs with the highest deferral amounts and/or matching amounts will receive a distribution, including gain/loss (Earnings), of those excess amounts.

When a plan fails, it basically means that the plan had more HCEs that are participating and deferring at a higher percentage than NHCEs.

The refund amount would be considered taxable income in the year in which it is distributed and the individual will receive a Form 1099-R the following January indicating the refund received.

In a safe harbor plan, where it's a 3% Safe Harbor Non Elective or the basic or enhanced Safe Harbor Matching, most plans are written to state the plan is intended to satisfy both ADP (Code section 401(k)(12)) and ACP (Code section 401(m)(11)). This would mean that both ADP and ACP testing is considered "deemed to pass" when it comes to the safe harbor contributions.

Long-Term, Part-Time Employees

A long-term, part-time employee ("LTPT") is any employee who in each of the last two consecutive years (long term) worked at least 500 but less than 999 hours (part time).

They also need to attain any age requirements (generally age 21 for participation).

Under the SECURE Act, LTPT employees must be allowed to enroll and be able to contribute their own contributions to the plan, however the plan sponsor is not required to provide any employer contribution.

Requirements for Deposit of Contributions

As a general rule, deposits must be made by the earliest date on which such contributions or payments can reasonably be segregated from the employer's general assets. In the case of plans with less than 100 participants, if the deposit is made within 7 business days, the deposit will be considered timely under DOL safe harbor regulations.

If deposits are not made within this timeframe, there are no exceptions to this rule, there are late deposit earnings that will need to be calculated and deposited by the company and a 15% penalty tax will need to be sent to the Department of the Treasury.

Compensation Considerations

Can there be a separate 401(k) deferral election for bonus payments?

Depends. Unless there is a separate exclusion written into the adoption agreement's definition of compensation, or the participant signs a separate election with respect to bonus or special compensation, the participant's salary deferral election applies to all of their compensation.

Does 401(k) come out of severance payments?

No. A payment of severance when an employee terminates, is not eligible to be used for any type of plan related purpose.

However, the term "post severance" in the plan's adoption agreement should not be confused with a severance payment made under an agreement upon separation from employment. When the document refers to "post severance compensation", this refers to payments to an employee after their termination date (up to 2 ½ months later or the end of the plan year) for PTO or vacation that would have normally had their 401(k) election applied. Unless the plan excludes "post severance", then their deferral percentage would continue to applied to this compensation as well.

I'm a self-employed owner. What is considered compensation for plan purposes?

For purposes, a self-employed individual's compensation is "Earned Income". "Earned Income" means the net earnings from self-employment in the business.

For Partnerships, that means the amount in Box 14 (Self-Employment Earnings) less any S179 deduction in Box 12 on Form 1065 K-1.

For Sole-Proprietor, that means the amount in in Box 31 (Net Profit/Loss) plus any amounts in Box 19 (Pension and Profit Sharing Plan) on Form Schedule C

The self-employed individual must have enough earned income to support the elective deferrals. Any amount less than the elective deferrals made, or if there is a loss with no earned income, elective deferrals must be refunded to the owner.

Employee Rehires

When may a rehired employee join the 401(k) plan?

If an employee was eligible to participate in the plan when they terminated, they are typically immediately eligible upon rehire. A plan sponsor will want to offer the opportunity to re-enroll into the plan as soon as possible following the rehire date.