

SECTION 401(a)

SECTION 414(q)

SECTION 414(s)

# Overview to Non-discrimination

# INTERNAL REVENUE CODE §401(a)

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§401(a) has a “laundry list” of items that are required for a plan to be qualified:

- §401(a)(3) §410 minimum participation
- §401(a)(4) Nondiscrimination
- §401(a)(5) Special rules - Nondiscrimination
- §401(a)(6) Quarterly test for §401(a)(3)
- §401(a)(7) §411 minimum vesting
- §401(a)(9) Required distributions
- §401(a)(10) Owner ees / Top Heavy
- §401(a)(11) Joint and Survivor annuity
- §401(a)(12) Merger / consolidation / transfer
- §401(a)(13) Assignment and alienation
- §401(a)(14) Benefit commencement
- §401(a)(15) Social Security increase can not decrease benefit
- §401(a)(16) §415 limits
- §401(a)(17) Compensation limit

# **INTERNAL REVENUE CODE §401(a) WRERA 08**

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- §401(a)(25) Actuarial assumptions for benefits preclude employer discretion**
- §401(a)(26) Minimum participation reqts**
- §401(a)(27) Profit sharing plans**
- §401(a)(28) ESOP requirements**
- §401(a)(29) Benefit limitations**
- §401(a)(30) Elective deferrals - limitations**
- §401(a)(31) Direct transfer of rollover**
- §401(a)(32) Liquidity shortfall – No effect if certain payments not made**
- §401(a)(33) No benefit increase in bankruptcy**
- §401(a)(34) Benefits of missing participants at Plan termination**
- §401(a)(35) Diversification requirements for certain DC plans**
- §401(a)(36) Distributions during working retirement**

# **INTERNAL REVENUE CODE §401(b) ++**

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- §401(b) Retroactive changes in plan**
- §401(c) Self-employed + owner-employees**
- §401(d) Contribution limit: owner-employees**
- §401(h) Medical benefits for retirees**
- §401(k) Cash or deferred arrangements**
- §401(l) Permitted disparity**

# IRC §401 Summary

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§401(a)(5)(F) *[Historically not tested]*

Can treat SSRA as uniform retirement age for nondiscrimination testing

§401(a)(9)(C) *[SECURE act]*

Required beginning date for distributions is April 1 of calendar year following later of

(i) calendar year EE attains age **applicable age**,  
or

(ii) calendar year in which EE retires.

Note: for 5% owners distributions must start after meeting **applicable age** requirement (i), there is no requirement to retire (ii)

**Applicable age** equals 70½, 72, 73 or 75 depending on year of birth, see A.3.6 2024 update

# IRC §401 Summary

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Accrued benefit must be actuarially increased to take into account the period after age **70 ½**

§401(a)(13)(C) *[Historically not tested]*

Exception to assignment and alienation requirement for offset against benefit due to certain judgment or settlement

§401(a)(26)(A)

Defined benefit plan must benefit at least lesser of 50, or greater of (40%, or 2 employees [or 1])

*See lesson C*

§401(a)(36) *[SECURE act]*

Plans may provide distributions to employees at age **59½** even though employee has not separated from service

# EXCISE TAXES

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## §4974 Minimum Required Distributions

- Tax is 50% of the difference between required and actual distribution
- Tax is paid by the participant
- For taxable years starting after 12/29/2022, tax is 25%; tax changes to 10% if the distribution is made within the “correction window” specified in the law *[Sec 302 of SECURE Act 2.0]*

*Personal opinion: this is more of a DC issue and unlikely to be tested on EA2L*

# EXCISE TAXES

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## §4975 Prohibited Transactions

- Tax is 15%
- IRS can increase to 100% if not corrected
- Usually entire amount is subject to tax

## Revenue Ruling 2002-43

- If PT spans multiple years, new PT occurs at start of each taxable year
- Loans have special rules
  - Amount subject to tax is loan interest
  - Produces increasing excise taxes

Year	Loan int	Excise tax
200X	A	.15(A)
200Y	B	.15(A+B)
200Z	C	.15(A+B+C)



## §401(a)(17) COMPENSATION LIMIT

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§401(a)(17) defines includable compensation. DB plan benefits (or DC allocations) can't use pay over this amount:

2022	305,000
2023	330,000
2024	345,000

For non-calendar year plan year, use value for calendar year in which plan year begins

## §414(q) HIGHLY COMPENSATED EES (HCE)

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Can be HCE solely based on stock ownership,  
or based on pay

§414(q)(1)(A)	"5% owner" during current or prior year, <u>OR</u>
§414(q)(1)(B)(i)	Employee with prior year compensation in excess of 155,000, AND
§414(q)(1)(B)(ii)	If the employer elected this clause in prior year, was in top-paid group in prior year

155,000 is the limit for 2024 (see next page)

# **§414(q) HIGHLY COMPENSATED EES (HCE)**

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## **§414(q)(1)(A)**

- **IRC §318 Constructive ownership rules apply - see page 14**
- **IRC §416 defines this as "greater than 5%"**

## **§414(q)(1)(B)(i)**

### **HISTORICAL VALUES**

<b>2022</b>	<b>135,000</b>
<b>2023</b>	<b>150,000</b>
<b>2024</b>	<b>155,000</b>

- **For non-calendar year plan year, use value for calendar year in which plan year starts**

## **§414(q)(1)(B)(ii)**

- **The top-paid group is the highest 20% of employees, ranked by compensation**

## **§414(q)(1)(B)(ii) HIGHLY COMPENSATED EES TOP-PAID GROUP EXCLUSIONS**

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**Election to use top-paid group can reduce number of employees considered HCEs**

**414(q)(5) defines exclusions that apply to the total employee head count.  $20\% \times (\text{head count})$  gives maximum employees included in paid group.**

- A. Ees with less than 6 months of service**
- B. Ees who work less than 17 ½ hours per week**
- C. Ees who work less than 6 months during a year**
- D. Ees who are less than age 21**
- E. Ees covered by a collective bargaining agreement (CBA)**

**Calculate age and service at end of prior plan year**

**Employer may elect to use shorter service, smaller hours / months, or lower age**

## **1.414(q)-1T HIGHLY COMPENSATED EES TOP-PAID GROUP EXCLUSIONS**

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**E. Employees covered by a collective bargaining agreement (CBA):**

- i. 90 percent or more of all employees are covered under a CBA, AND**
- ii. Plan being tested only covers employees who are not covered under a CBA**

**These details are in the regulation, not in IRC §414**

**Tested numerous times on the exam!**

## §318 - CONSTRUCTIVE OWNERSHIP

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Individuals are considered as owning the stock owned directly by their:

- Children
- Grandchildren
- Parents
- Spouse

“Spouse” does not include a legally separated spouse

“Children” does include a legally adopted child

More complex rules for attribution to / from partnerships, estates, trusts, corporations

## **§414(s) COMPENSATION**

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**401(k) and other deferrals are included by default**

- **Plan definition of compensation for testing purposes can override 414(s) defaults**
- **Compensation for testing purposes can be different than that used for plan benefits**
- **An alternative definition is NOT allowed if it discriminates in favor of the HCEs**

## **§414(s) COMPENSATION – DISCRIMINATORY?**

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**1.414(s)-1(d)(3)(i) defines the test for an alternative 414(s) compensation definition:**

- 1. Calculate ratio of 414(s) comp to total comp for each employee.**
- 2. 1.414(s)-1(d)(3)(ii) states that the total compensation must be limited by 401(a)(17)**
- 3. Compare average of ratios for HCEs versus non-HCEs**
- 4. 414(s) comp definition is nondiscriminatory if difference does not exceed de minimis amount**
- 5. The de minimis amount is based on facts and circumstances**