



2011 Plan Year

PENSION ANALYST

Important information—Plan administration and operation



Prudential
Bring Your Challenges™

2011 Plan Year: Year-End compliance reminders

For defined contribution plans subject to ERISA

This information applies to qualified defined contribution plans and 403(b) plans that are subject to Title I of ERISA.

Every year, plan sponsors must make sure their plans meet certain compliance requirements, including those listed below. This publication identifies the materials you need to review and will help you prepare for year-end.

If any of these compliance tests or services are included in your Services Agreement, you will receive the *Compliance Testing Data Submission Guidelines* package under separate cover at a later date. This package will contain additional information you will need to know to initiate the testing process.

- **2011 Compensation limit is \$245,000.** When determining 2011 contributions and tax-deductible contribution limits and performing most of the 2011 plan year nondiscrimination tests (e.g., Actual Deferral Percentage Test, Actual Contribution Percentage Test), plan sponsors may only take into account each participant's compensation up to \$245,000.
- **Minimum coverage test.** The percentage of Non-Highly Compensated Employees (NHCEs) benefiting under the plan must be at least 70% of the percentage of Highly Compensated Employees (HCEs) who benefit under the plan. This is called the Ratio Percentage Test. If a plan does not pass this test, it must pass the more complex Average Benefits Test. The plan must pass one of these tests on either a daily basis, a quarterly basis, or on an annual basis as of the last day of the plan year. The 401(k) and 401(m) portions of a plan each must meet the minimum coverage requirement on an annual basis as of the last day of the plan year.

Minimum coverage testing may be performed every third year if the employer reasonably concludes that there are no significant changes in the following two plan years. Significant changes may include changes in plan provisions, the employer's workforce, or compensation practices. The determination of whether a change is significant depends upon the relative margin by which the plan passed the coverage requirement in the last year in which the plan was tested and the likelihood that the change would cause the plan to fail coverage testing.

A special transition rule allows plans involved in company level merger and acquisition situations to be treated as satisfying the minimum coverage requirements during a transition period following the transaction. The transition period begins on the date of the transaction and ends on the last day of the following plan year. This special transition rule can be used if a plan has satisfied the minimum coverage requirements immediately before the transaction, and if there have been no specific changes in the plan's coverage aside from the transaction.

- **Annual deferral limit and correction deadline.** For the 2011 calendar year, a participant's deferral contributions to a 401(k) plan, 403(b) program or section 457 plan could generally not exceed \$16,500. A single \$16,500 limit applies to deferral contributions made to any combination of 401(k) plans or 403(b) programs. However, deferrals made to 401(k) plans or 403(b) programs do not reduce the limit on deferrals that may be made to a section 457 plan. As a result, an individual could contribute \$16,500 to a combination of 401(k) plans or 403(b) programs and contribute an additional \$16,500 to a section 457 plan.

Some 401(k), 403(b), or governmental section 457 plans also may have allowed participants age 50 or older in 2011, to contribute an additional \$5,500 of "catch-up" deferrals during the 2011 calendar year. Additional catch-ups (i.e., 15 year catch-up, last three year catch-up) are available under some 403(b) programs and section 457 plans.

©2011, The Prudential Insurance Company of America, all rights reserved.

Prudential, the Prudential logo and the Rock symbol are service marks of Prudential Financial, Inc. and its related entities, registered in many jurisdictions worldwide.

RSMH080

Excess deferrals made in 2011 to a single plan, or to multiple plans sponsored by the same employer (determined on a controlled-group basis), must be distributed to the participant, with related earnings, by April 15, 2012. Failure to make these corrective distributions by April 15, 2012, may result in plan disqualification or loss of the tax deferred status of plan assets. In addition, the amount of excess elective deferral contributions must be included in the participant's income in both the year contributed and in the year eventually distributed.

If your plan needs to distribute 2011 excess deferrals to any participants, complete and return to your Prudential Retirement representative a [Request for Distribution of Excess Elective Deferrals](#) form for each affected participant.

- **Annual additions limit.** Employer contributions, employee post-tax and pre-tax contributions, and forfeitures reallocated to a participant during a limitation year (collectively referred to as "annual additions") are limited to the lesser of \$49,000 or 100% of the participant's compensation. We have included an [Annual Additions Limit Worksheet](#) that you may photocopy and use to calculate each participant's limit and actual annual additions. If you have participants with excess annual additions, contact your Prudential Retirement representative for additional information about acceptable IRS correction methods.
- **Actual deferral percentage (ADP) test.** A 401(k) plan must perform an Actual Deferral Percentage (ADP) Test as of the last day of each plan year to confirm that HCEs do not contribute disproportionately more to the plan than NHCEs. If the plan fails this test, it must correct the resulting excess contributions. If your plan allows employees age 50 and older to contribute catch-up deferrals, the catch-up deferrals made during the plan year (due to the application of the annual deferral limit, annual additions limit, or a plan-imposed limit) are not included in the ADP test.

A 403(b) plan must comply with the universal availability requirement for elective deferral contributions. For more information regarding the nondiscrimination requirements that apply to 403(b) plans, see our June 2008 publication titled ["A New World for 403\(b\) Arrangements."](#)

- **Actual contribution percentage (ACP) test.** Plans, including 403(b) plans, that accept employee post-tax contributions or employer matching contributions must perform an Actual Contribution Percentage (ACP) Test as of the last day of each plan year. If the plan fails this test, it must correct the resulting excess aggregate contributions.

If your plan uses the prior year testing method and your document provides for a discretionary matching contribution, the NHCE ACP will equal 0% in any year you do not fund a match. This 0% will be the limit for the HCEs in the following year. Therefore, if you have a discretionary match and it is likely that you will not fund an employer match in any given year, you may want to consider amending the plan to use the current year testing method. The change from the prior year method to the current year method may be made at any time during the plan year. However, in general, a plan must use the current year method for five years before changing to the prior year method.

If your plan used a traditional ADP/ACP safe harbor design or a qualified automatic contribution arrangement (QACA) for the 2011 plan year, you may not have to perform the ADP and ACP tests. If your plan will be using a traditional ADP/ACP safe harbor design or a QACA plan design for the 2012 plan year, you will need to give notice to employees within a reasonable period before the beginning of that plan year. A plan satisfies the timing requirements if the notice is given at least 30 days and no more than 90 days before the beginning of the plan year. The traditional ADP/ACP safe harbor requirements are described in detail in our April 2000 publication titled ["Improved ADP and ACP Safe Harbor Plan Designs."](#) The QACA plan design requirements are described in our May 2009 publication titled ["IRS provides final guidance on automatic enrollment plan designs."](#)

- **Correcting ADP test and ACP test excesses.** In general, plans must correct all 2011 plan year excess contributions and excess aggregate contributions *by the last day of the 12th month after the end of the 2011 plan year* (by December 31, 2012, for a calendar plan year). If your plan allows for catch-up deferrals, a portion, or all, of the excess contributions may be reclassified as catch-up deferrals. Any HCE who is age 50 or older and is due a corrective distribution as a result of a failed ADP test will have a portion reclassified as a catch-up deferral to the extent that HCE has not already

contributed the maximum catch-up deferral allowed for the year. This will help reduce or eliminate the amount of corrective distributions or corrective contributions needed.

Corrective distributions. A plan may correct these excesses by making corrective distributions of the excesses and related earnings. *If this is done within 2 ½ months after the end of the 2011 plan year (on or before March 15, 2012, for a calendar plan year),* the plan sponsor will avoid paying a 10% excise tax (if applicable) to the IRS on the amount of the excesses. Corrective distributions are taxable to the participant in the year distributed.

Plan sponsors that have adopted an eligible automatic contribution arrangement (EACA) may distribute excess contributions and excess aggregate contributions to correct failed ADP and ACP tests within 6 months of the end of the plan year without subjecting the employer to a 10% excise tax. The EACA plan design requirements are described in our May 2009 publication titled [“IRS provides final guidance on automatic enrollment plan designs.”](#)

If Prudential Retirement provides ADP or ACP testing services for your plan, along with the test results for your plan, you will receive a letter explaining the ADP and/or ACP corrective distribution process.

If Prudential Retirement does not provide ADP or ACP testing services for your plan, you should complete and return to your Prudential Retirement representative the [Request for Distribution of ADP/ACP Excess](#) form for each affected participant to request ADP and/or ACP corrective distributions.

Corrective contributions. Alternatively, in some situations a plan may correct a 2011 plan year excess by making Qualified Nonelective Contributions (QNECs) or Qualified Matching Contributions (QMACs) to some or all NHCEs if the plan provides for these types of contributions. The employer must make the QNECs or QMACs by the last day of the 12th month after the end of the 2011 plan year (by December 31, 2012, for a calendar plan year). The 10% excise tax on ADP and ACP excesses does not apply, even if QNECs or QMACs are made more than 2½ months (more than 6 months for certain EACAs) after the end of the plan year. These types of corrective contributions are not available to correct failed ACP tests for 403(b) plans.

If you make QNECs or QMACs, you must notify us at the time you make contributions that they are QNECs or QMACs. These contributions must be 100% vested, are subject to special withdrawal restrictions, and cannot be combined with other employer contributions for recordkeeping purposes.

Keep in mind if you have elected to use the prior year testing method, a QNEC or QMAC contribution is generally not available as a corrective measure.

- **2011 forfeitures.** In general, defined contribution plans may not carry unallocated suspense accounts from one plan year to the next. The IRS makes specific exceptions to this rule for suspense accounts arising from the correction of excess annual additions, assets transferred from a terminated defined benefit plan to be allocated over a seven-year period, and leveraged ESOPs. Otherwise, the IRS expects all plan assets to be allocated among participant accounts at year-end. Generally, whether your plan reallocates forfeitures, applies them as a credit toward employer contributions, or applies them as a credit toward plan expenses, there should be no unallocated forfeitures remaining at year-end. Your plan document may contain language specifically addressing the timeframe by which forfeitures must be applied. For more information on this topic, see our June 2010 Compliance Bulletin titled, [“Forfeiture suspense accounts should have limited lifespans.”](#)
- **Form 5500 annual reporting.** Each year, most plan sponsors must file a Form 5500 series report with the IRS and DOL. This filing is due by the last day of the seventh month after the end of the plan year. Plan sponsors may request a 2½-month filing extension by completing and submitting to the IRS a Form 5558. Prudential Retirement provides a Form 5500 Preparation Service.

In general, an independent qualified public accountant must conduct an audit of a qualified plan's financial statements, including a review of the plan's Form 5500, Schedules, internal control practices, and other information. This audit requirement does not apply to plans that are eligible for the "Small Plan" exception. For information regarding the "Small Plan" exception, refer to our January 2002 publication titled "[New Year Brings New Rules for Small Plans.](#)"

ERISA 403(b) plans are generally subject to [standard Form 5500 filing requirements](#). In addition, large ERISA 403(b) plans with more than 100 eligible participants are subject to the annual independent audit requirement.

- **Keep records of all nondiscrimination testing.** Plan sponsors must keep records to demonstrate that their plans passed the appropriate nondiscrimination tests. If an IRS auditor requests these records and the plan sponsor cannot produce them, the IRS could disqualify the plan.
- **Plan amendments.** [The Worker, Retiree, and Employer Recovery Act of 2008 \(WREERA\)](#) generally required sponsors of defined contribution plans and 403(b) plans to adopt a plan amendment reflecting the plan's treatment of 2009 required minimum distributions by the last day of the first plan year beginning on or after January 1, 2011 (by December 31, 2011, for a calendar plan year). If Prudential Retirement provides document services for your plan, your document has already been updated to reflect these WREERA provisions.

Plan sponsors that have decided to implement optional provisions, such as catch-up contributions or designated Roth contributions must adopt the appropriate plan amendments by the last day of the 2011 plan year. Sponsors of 401(k) plans that decided to offer in-plan Roth rollovers during 2010 or 2011 generally must adopt the appropriate plan amendment by the later of (1) the last day of the plan year in which the amendment is effective, or (2) December 31, 2011. For a safe harbor 401(k) plan, including a QACA, a slightly different extended amendment deadline applies. For these plans, the amendment deadline for in-plan Roth rollovers is the later of (1) December 31, 2011, or (2) the first day of the plan year for which the safe harbor provisions will be effective.

The in-plan Roth rollover amendment deadline for 403(b) plans depends on whether the plan is subject to the extended remedial amendment period. Sponsors of 403(b) plans that decided to offer in-plan Roth rollovers during 2011, but do not qualify for the remedial amendment period, must adopt the in-plan Roth rollover amendment by the last day of the first plan year beginning on or after January 1, 2011. For more information regarding the in-plan Roth rollover amendment deadline, see our December 2010 *Pension Analyst* titled, "[IRS provides preliminary guidance on in-plan Roth rollovers.](#)"

If Prudential Retirement does not provide document services for your plan, it is important that you send Prudential copies of all amendments that you've adopted, or plan to adopt, during the 2011 plan year. Timely providing copies of all amendments to Prudential ensures that our recordkeeping system accurately reflects the provisions of your plan, and avoids operational errors that may otherwise arise.

- **Loan program review.** As part of a periodic review of plan administration, you may wish to review the operation of your loan program, if applicable, to determine whether loans bear a "reasonable rate of interest" as required by the prohibited transaction exemption for loans. The Department of Labor (DOL) has interpretive authority regarding the "reasonable rate" requirement, and has previously indicated that "reasonableness" is a facts and circumstances determination. To date, the DOL has not provided any type of guideline rate. However, an IRS staffer recently stated in an informal telephone forum that IRS revenue agents who examine plans generally consider a "prime plus 2%" interest rate to be reasonable, while at the same time acknowledging that other rates may be reasonable.

This apparent disconnect between DOL and IRS guidance may raise questions for plan sponsors with loan programs that charge less than "prime plus 2%" interest. Sponsors that are concerned about the interest rate charged under their plan loan programs should discuss the matter with legal counsel. To keep the IRS statement in proper perspective, plan sponsors should remember: this statement is not formal guidance; it acknowledges that rates other than "prime plus 2%" may be reasonable; and the IRS position would not necessarily prevail in an audit of a plan subject to ERISA. If you decide to make changes to your loan program, please contact your Prudential Retirement representative to make sure that documentation and recordkeeping systems are appropriately updated.

The following items apply to defined contribution plans other than 403(b) plans:

- **Stock attribution.** Stock attribution rules for family members apply when determining ownership for purposes of identifying HCE 5% owners and Key Employee 1% and 5% owners.
- **2012 Top-Heavy determination.** To determine if your plan is top-heavy for the 2012 plan year, you must first identify your “Key Employees.” An employee is a Key Employee only if he is:
 - A 5% owner in 2011, or
 - A 1% owner who received more than \$150,000 compensation from the company in 2011, or
 - An officer of the company who received more than \$160,000 compensation in 2011.

Employees who performed no services for your company during the one-year period ending on the last day of the 2011 plan year are disregarded in determining top-heavy status.

Also, the lookback period for adding back distributions to account balances depends on the type of distribution made. A five-year lookback applies to in-service withdrawals, including hardship withdrawals. However, other distributions (e.g., due to retirement, disability, death or termination of employment) are added back only if they were made during the one-year period ending on the last day of the 2010 plan year.

If Prudential Retirement does not provide top-heavy testing services for your plan, you may use the [Top-Heavy Test Worksheet](#) we have provided to perform this test or make other arrangements to do this testing.

- **2011 Top-Heavy contributions.** If your plan was Top-Heavy for 2011, based on 2010 plan year-end data, you generally must make a minimum contribution to satisfy the Top-Heavy requirements. This contribution is subject to the same timing requirements as any other 2011 employer contribution.

If you have questions about plan amendments, testing requirements, Prudential’s testing services, ADP/ACP safe harbor plan design, automatic enrollment plan design, or other compliance requirements, please contact your Prudential Retirement representative.