

Benefits, Rights and Features



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If you have benefits in your plan based on years of service or on higher deferral rates or just to owners, you may have a problem...

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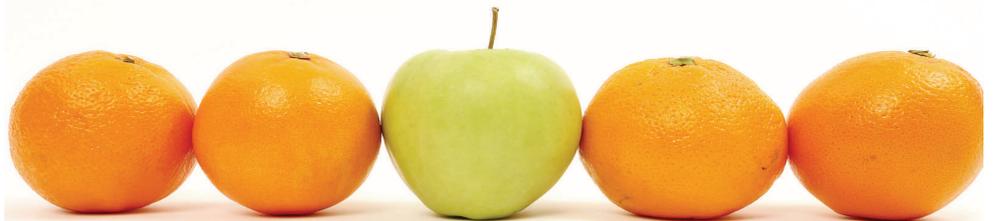
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The entire foundation of retirement plans is to provide benefits on a non-discriminatory basis. Plans must not discriminate in favor of the Highly Compensated Employees (HCEs) in the plan (generally, more than 5% owners or those making over \$110,000). There are many tests to quantify if contributions and benefits are non-discriminatory, but there are other issues that can be applied on a discriminatory basis that are often overlooked.

Benefits can be described as optional forms of benefits and ancillary benefits provided by the plan. These include timing and payments of distributions as well as availability of life insurance and other benefits. (Note: This does not apply to the allocation of a profit sharing contribution. A plan may allow each employee to be in their own group and receive a different rate of contributions because there is a special test that must be passed in order to demonstrate non-discrimination.)

Rights and features include such items as the right to take a loan, the right to direct investments and the right to a certain type of investment.

A current availability test and an effective availability test must be applied to determine if the benefits, rights and features of a plan are non-discriminatory.



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The first item to consider is the benefit formulas in your plan. A plan could offer two different rates of match. For example, a plan could provide a 50% match for those employees with 0-10 years of service and a 100% match for those above 10 years of service. The normal test to determine if the match is given on a non-discriminatory basis is the Actual Contribution Percentage (ACP) Test. This type of formula could pass the ACP test with flying colors, but it may violate the Benefits, Rights and Features test. The problem could be that only HCEs have over 10 years of service, so only HCEs have the higher match amount available to them. Some plans also have an escalating match where the match formula is such that a 50% match is given to those who defer less than 10% and a 100% match is given to those who defer over 10%. If only your HCEs are deferring over 10%, it becomes a discrimination issue.

Rights and features must also be provided on a non-discriminatory basis. Often, we encounter a plan where the owner (an HCE) has their assets invested in a separate account with an investment advisor while the rest of the participants in the plan are invested in a pooled account. In this case, the right to direct the investment has not been given on a non-discriminatory basis. All participants should have the ability to invest in a separate account with the assistance of an investment advisor. Similarly, if investing in life insurance inside the plan is only offered to a select group of HCEs, the right to have life insurance is a discriminatory benefit. The life insurance investment should be open to all plan participants.

The plan's method of allocating expenses can also be an issue. In this regard, a timing of a change in the method of allocation could raise an issue. The IRS provides an example of a plan that always had individual participants pay for the charges associated with a Qualified Domestic Relations Order (QDRO). If the owner suddenly changes the expenses allocation to spread the costs of QDROs to all participants when he had an impending divorce, then the change in the allocation method could give rise to a discrimination issue.

To prove non-discrimination, the plan must pass an average benefits test to prove that the current availability is non-discriminatory. This is a number-based test that compares the number of HCEs receiving the benefit against the number of Non-Highly Compensated Employees. The plan must also pass a facts and circumstances test to prove that the effective availability is also not discriminatory.