If your plan fails ADP/ACP testing

What do we do if our plan fails the ADP test? (Not applicable to 403(b) plans)
The corrective measures to be taken when the ADP test fails depend on your plan document. Please refer to your plan document to determine your options. These options normally include:
- Refunding the excess contributions (deferral amounts which cause the test to fail), adjusted for gains and losses, to the HCEs
- Making a QNEC (or QMAC) to the NHCEs
- Recharacterizing excess contributions as after-tax contributions
- Refunding the excess contributions and making a QNEC (or QMAC)

If you elected to test your plan based on prior year information, a QNEC (or QMAC) is not an option; contact your plan services consultant for additional information.

When do we need to make a QNEC or QMAC?
QNECs or QMACs must be made before the end of the plan year following the plan year of the failure. The contribution amounts should be reported on your plan’s Form 5500. This means that you will need to make the contribution immediately so we can finalize your annual report and include the amounts on your Form 5500 (if AUL has been contracted to provide assistance with this item). The Form 5500 filing is normally due 7 months after the end of the plan year.

What do we do if our plan fails the ACP test?
The corrective measures taken when the ACP test fails depend on your plan document. Please refer to your plan document to determine your options. These options normally include:
- Returning the vested portion (and forfeiting the non-vested portion) of the excess aggregate contributions (matching or voluntary after-tax amounts which cause the test to fail), adjusted for gains and losses, to the HCEs
- Making a QNEC (or QMAC) to the NHCEs
- Refunding the excess aggregate contributions and making a QNEC (or QMAC)

If you elected to test your plan based on prior year information, a QNEC (or QMAC) is not an option; contact your plan services consultant for additional information.

How are ADP/ACP excess refunds calculated?
The Code requires that the plan distribute the excess (or excess aggregate) contribution amount among the HCEs based on the dollar amounts deferred or contributed. The HCE who deferred the largest dollar amount (or received the largest match or made the largest after-tax contribution) will receive the biggest refunds of excess (or excess aggregate) contributions.

What is related match?
Related match amounts are those dollars associated with ineligible deferrals or ineligible employee after-tax contributions. Ineligible deferrals and ineligible employee after-tax contributions include:
- Excess deferrals because of a deferral limit test failure
- Excess contributions from an ADP test failure
- Excess aggregate contributions (for plans that allow after-tax contributions) because of an ACP test failure

If these amounts are not forfeited, your plan could effectively be providing a higher rate of match for your HCEs in relation to the amount of match that is provided to your NHCEs. This means that your plan may have a discrimination issue that could jeopardize the qualified status of your plan.

AUL will determine if there are related match amounts to forfeit by applying the match formula you supplied to us to deferrals remaining after ADP correction and comparing the new match amount to the original match that you reported on your census. AUL’s match calculations will be prepared using an annual period. If the revised match is less than the original match, the difference is forfeited and not included on your ACP test.

If you are using a document other than an AUL prototype, your document may permit the calculation of related match to occur after ACP test correction. Related match amounts will be offset by any excess aggregate contributions that were returned.
What is the deadline for refunds to be processed if corrective QNECs or QMACs aren’t made? If distribution of excess (and/or excess aggregate) contributions is not completed within 2½ months (6 months for plans with EACA provisions that apply to all employees, not just new employees) after the end of the plan year in which the excess amounts occurred, the plan sponsor must pay an excise tax (penalty) of 10% of the excess amount and file a Form 5330. We will prepare a Form 5330 for you and publish this form on the eSponsor website with the failed test results.

To avoid disqualification, recovery must be completed by the end of the plan year following the plan year in which the excess contributions or excess aggregate contributions occurred. That is, by the end of the year following the plan year tested. Related match amounts should be forfeited when the corrective distributions are made. For example, related match amounts for the plan year ended December 31, 2013, should be forfeited by December 31, 2014.

How are employees’ income tax returns affected? Distribution of excess (and/or excess aggregate) contributions are taxable in the year of the distribution.

Individuals will have to report these distributions on their tax returns for the year of distribution (2014).

Affected distributions must be reported on Form 1099-R; AUL will prepare these forms in January 2015.

The distribution of an excess contribution attributable to pre-tax deferrals is taxable in its entirety. If the distribution of excess contributions is derived from Roth deferrals and earnings, only the earnings are taxable.

The distribution of excess aggregate contributions derived from matching contributions and earnings is taxable in its entirety. If employee after-tax contributions and related earnings are distributed as excess aggregate contributions, only the earnings are taxable.

Can a 401(k) plan ever be exempt from testing? Annual addition limit testing is necessary for all plans and coverage testing is necessary for all plans except those that are an adoption of a standardized adoption agreement. There are three types of qualified plans that do not require ADP or ACP testing. The types of plans are SIMPLE 401(k) plans, safe harbor 401(k) plans and 401(k) plans with a QACA provisions. These plans require:

- A mandatory employer contribution (QMAC, QNEC or match) that must be 100% vested
- An annual notice

SIMPLE 401(k) plans have a lower deferral limit ($12,000 for 2013) and catch up limit ($2,500 for 2013). SIMPLE 401(k) plans may only be sponsored by employers with 100 or fewer employees who had compensation in excess of $5,000 in the prior calendar year.

There are many issues to consider when deciding whether to switch from a 401(k) plan to a SIMPLE 401(k) plan or to add QACA provisions. Please contact your Regional Pension Sales Office or your plan services consultant for assistance.

Can a 403(b) plan ever be exempt from testing? Coverage testing of employer contributions and annual addition limit testing is necessary for all plans. Safe harbor 403(b) plans and 403(b) plans with QACA provisions do not require ACP testing. These plans require:

- A mandatory employer contribution (QMAC, QNEC or match) that must be 100% vested
- An annual notice

There are many issues to consider when deciding to switch from a 403(b) plan to a safe harbor 403(b) plan or to add QACA provisions. Please contact your Regional Pension Sales Office or your plan services consultant for details.