THE EMPLOYEE BENEFIT
Forum
current issues in retirement benefit planning

qualified PLANS LLC

Return of a Former Employee

SITUATION: Our 401(k) plan uses a six-year graded vesting schedule for employer-matching contributions. We recently rehired an employee who left the company four years ago. At the time, he had five years of service and was 80% vested in the matching contributions that the company had made to his plan account. He cashed out his vested portion when he left.

QUESTION: Do we have to credit him for his pre-break years of service for purposes of future vesting in our plan?

ANSWER: Yes, you'll need to count your employee's pre-break years of service for purposes of vesting in post-break employer contributions.

DISCUSSION: Under the tax law's break-in-service rules, 401(k) plans generally must credit a rehired employee's service prior to a break in employment. However, if your plan has a waiting period for receiving vesting credit for pre-break years, you don't have to credit the employee's prior service until that waiting period is completed. For example, if your plan has the maximum one-year waiting period, you won't have to credit any service until the employee completes one year of service after rehire. Then, you'll have to credit him with six years of service, and he'll be 100% vested in any post-break employer-matching and nonelective contributions made to his account — as well as in any post-break salary deferrals he makes.

If your plan has a cash-out/buyback rule for determining when a forfeiture of nonvested employer contributions occurs after termination, your rehired employee may have the opportunity to restore forfeited matching contributions by repaying the total amount distributed to him.

Employer-matching and Nonelective Contribution Vesting

While plan participants are always 100% vested in their salary deferrals to a 401(k) plan account, a plan can delay vesting in employer-matching and nonelective contributions, such as profit sharing contributions, under a three-year cliff vesting schedule, a six-year graduated schedule, or more quickly.

	Graduated Formula						Cliff Formula	
Years of Service	Less than 2	2	3	4	5	6 or more	Less than 3	3 or more
Vested Percentage	0%	20%	40%	60%	80%	100%	0%	100%

New After-tax Rollover Guidance

The IRS recently issued guidance for allocating pretax and after-tax distributions from 401(k), 403(b), and 457(b) plans to multiple retirement accounts. Plan participants can now arrange for direct rollovers of eligible distributions to be split so that after-tax amounts are transferred to a Roth IRA and pretax amounts to another employer's retirement plan, a traditional IRA, or both. The pretax and after-tax distributions must be made at the same time.

Prior to the new guidance, a participant could split pretax and after-tax amounts into different accounts by taking a cash distribution from his or her plan account and indirectly rolling over each of those amounts within 60 days. Eligible rollover distributions paid to a participant trigger mandatory 20% federal income-tax withholding. So, to make a complete rollover, the participant had to make up the withheld amount from other sources.

The new rules generally apply to distributions made on or after January 1, 2015, but may be applied to distributions made on or after September 18, 2014.

2015 Cost-of-Living Changes

The IRS has released the annual cost-of-living adjustments for various retirement plan limitations. Many of the limitations have increased for 2015. However, the maximum annual benefit from a defined benefit pension plan and the compensation amount for determining key employees both remain unchanged.

Also, the Social Security Administration announced a $1,500 increase in the Social Security taxable wage base effective January 1, 2015. This change affects retirement plans that consider Social Security in determining benefits or contributions.

	2015	2014
Defined contribution plan dollar limit on annual additions	$53,000	$52,000
Defined benefit plan limit on annual benefits	$210,000	$210,000
Maximum compensation used to determine benefits or contributions	$265,000	$260,000
401(k), SARSEP,* 403(b), and 457 plan deferrals/catch-up	$18,000/$6,000	$17,500/$5,500
SIMPLE IRA deferrals/catch-up	$12,500/$3,000	$12,000/$2,500
Compensation defining highly compensated employee	$120,000	$115,000
Compensation defining key employee (officer)	$170,000	$170,000
Social Security taxable wage base	$118,500	$117,000

* SEP plans established before 1997

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Giving Your Plan's Investments a Checkup

Once your 401(k) plan is in place, you should monitor plan investments periodically to make sure they're meeting the needs of plan participants. According to a survey by the Plan Sponsor Council of America,* in 2012 (the most recent data available), most plan sponsors (67.1%) monitored investments every quarter. More than half of the surveyed plans (51.1%) changed the investments they offer plan participants, and 21.1% added or deleted asset classes. Below, we answer questions you may have about reviewing and revising plan investment choices.

Why should we periodically review plan investments? Pension law (ERISA) and the U.S. Department of Labor hold plan fiduciaries, including plan sponsors, responsible for the prudent selection of plan investment options. As a plan sponsor and fiduciary, you must carefully evaluate the continuing suitability of your plan's current investment choices. Do your investment choices offer participants enough variety given current economic conditions and potential long-term performance?

What should we consider when we review investments? For each investment choice, evaluate its performance, style, and risk. Each investment your plan offers was originally chosen for a reason. Are those reasons still relevant? If not, you may want to continue monitoring the investment or consider replacing it. "Style drift" and/or active management may cause an investment to carry more risk than it once did. On the other hand, if your work force has become younger, your investment choices may be too conservative and may not provide enough growth potential for younger employees. Consider the demographics of your employees when evaluating and/or adding target date funds to your plan's investment choices. Make sure you offer enough choices to meet the needs of all age groups.

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To give us a frame of reference, what are other plan sponsors doing? The PSCA's survey noted that most plan sponsors (89.1%) use an investment policy statement (IPS) to choose investments for their plans. In 2012, plans offered participants an average of 19 investment choices, unchanged from 2011. Many of the plans offer between 16 and 20 investment funds. The five most frequently offered investments are actively managed domestic equity funds (85.9%), actively managed international equity funds (82.7%), domestic equity index funds (80.3%), actively managed domestic bond funds (77.3%), and target date/lifecycle funds (64.5%).

The use of target date funds continues to rise. In 2012, 64.5% of plans offered target date funds compared with 63.6% in 2010, 57.7% in 2008, and 33.4% in 2006. Target date funds also are the most common default investment for automatic deferrals. The percentage of plans that have a target date fund as their default increased significantly to 73.3% in 2012, up approximately 20 percentage points from 53.1% in 2010. Meanwhile, the use of balanced funds as a default dropped to just 10.6%, down from 11.8% in 2010.

How often should we review our plan investments? You should monitor plan investments as often as necessary to ensure you're meeting the needs of plan participants. While the majority of sponsors review investments quarterly, some do an annual or semiannual review.

* *56th Annual Survey of Profit Sharing and 401(k) Plans*, Profit Sharing Council of America, 2013

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RECENT DEVELOPMENTS
In Benefit Plans

Social Security Statements. The Social Security Administration (SSA) has resumed the periodic mailing of Social Security *Statements* once every five years to most workers. About three months before their birthdays, workers attaining ages 25, 30, 35, 40, 45, 50, 55, and 60 who are not receiving Social Security benefits and who have not registered for a *my* Social Security account will receive a *Statement*. After age 60, people will receive a *Statement* every year. The SSA encourages individuals to create a secure online *my* Social Security account to access their statements anytime. The *Statement* provides workers age 18 and older with individualized information about their earnings, tax contributions, and estimates for future retirement, disability, and survivors benefits.

Final Cash Balance Rules. The IRS recently published final regulations for hybrid defined benefit plans, such as cash balance plans. Among other changes, the new rules allow plans to provide a fixed interest crediting rate of up to 6%, which is an increase from the maximum 5% rate in the proposed regulations. Also, the rules increase the annual floor that can be used for a bond-based interest crediting rate from 4% to 5%. Plan sponsors can combine that annual floor with any safe harbor rate. The final regulations generally apply to plan years beginning on or after January 1, 2016.