What is the 410(b) Coverage Test?
- Ratio Test
- Average Benefits Test

Who is included the tests?

How do you perform the tests?

Does the plan pass?
410(b) Coverage Tests

- Separate Coverage Test done for:
  - Employer - Includes Employer, Safe Harbor Non-elective and QNEC
  - 401k - Includes Salary Deferrals, both pre-tax and Roth
  - 401m - Includes Matching and QMAC

- Each Coverage Test is run as if it were its own plan

Each portion of the plan must pass 1 of 2 tests:

- Ratio Test; or

- Average Benefits Test
410(b) Coverage Tests

Who is included in the tests?

- All employees except for those who:
  - Fail plan entry requirements
  - Collectively Bargained Employees (when testing a non-union plan)
  - Nonresident Alien
  - Terminate with 500 hours or less and fails to accrue a benefit due to an hours or last day requirement (does not apply to 401k portion and only applies on the 401m if there is a last day and/or hours requirement)

410(b) Coverage Tests

Who is considered Benefitting?

- Employer - those who receive a contribution for the year
- 401k - those eligible to make deferrals
- 401m - those eligible for the match contribution
410(b) Ratio Test

Ratio Test is

- \( \frac{\text{NHCEs Benefiting}}{\text{Total NHCEs in plan}} \)  
  \( \frac{\text{HCEs Benefiting}}{\text{Total HCEs in plan}} \)

- Ratio must be at least 70%

410(b) Average Benefits Test

Average Benefits Test (ABT) is a 2-part Test

1. Nondiscriminatory Classification Test
   - Reasonable Classification Test
   - Nondiscriminatory Classification
     - NHCE Concentration Percentage
     - Ratio Test must be at least equal to Safe Harbor Midpoint

2. Average Benefits Percentage Test (ABPT)
   - Average Rate for NHCEs must be at least 70% of the Average Rate for the HCEs
410(b) Average Benefits Percentage Test

Determining Rates for ABPT

- Allocation Rate
- Converting Allocations to Equivalent Benefit Accruals
  - Annual Accrual Method (used most often)
  - Accrued To Date Method

410(b) Average Benefits Percentage Test

Allocation Rate Method

- Rates are determined for each employee in test
- Include allocations from all sources for 410(b)

Formula:

\[
\frac{(\text{All Contributions} + \text{All Forfeitures})}{\text{Compensation}}
\]
410(b) Average Benefits Percentage Test

Performing ABPT using Allocation Method

- Find Average NHCE Allocation Rate
  - Sum allocation rates from All NHCEs divided by the Total Number of NHCEs in Test
- Find Average HCE Allocation Rate
  - Sum allocation rates from All HCEs divided by the Total Number of HCEs in Test
- Determine Average Allocation Percentage
  - \( \frac{\text{Avg NHCE AR}}{\text{Avg HCE AR}} \geq 70\% \)

410(b) Average Benefits Percentage Test Equivalent Benefit Accrual Rates

Converting Allocations to Benefit Accruals

- Retirement Age Assumptions
- Interest Rates
- Mortality Tables
- Choosing Annual Accrual vs. Accrued to Date
- Imputed Permitted Disparity (optional)
410(b) Average Benefits Percentage
Test Equivalent Benefit Accrual Rates

Annual Accrual Method (include All Sources)

- Step 1: Lump Sum at Testing Age (NRA)
  Allocation * Accumulation Factor
  Accumulation Factor = (1 + Interest Rate)^Years to Retirement

- Step 2: Benefit Accrual
  Lump Sum at Testing Age / Annuity Purchase Rate

- Step 3: Annualize Benefit Accrual
  Benefit Accrual * 12

- Step 4: Equivalent Benefit Accrual Rate (EBAR)
  Annualized Benefit Accrual / Testing Compensation

Performing ABPT using the Annual Accrual Method

- Find Average NHCE EBAR
  Sum EBARs from All NHCEs divided by the Total Number of NHCEs in Test

- Find Average HCE EBAR
  Sum EBARs from All HCEs divided by the Total Number of HCEs in Test

- Determine Average Benefit Percentage
  (Avg NHCE EBAR) / (Avg HCE EBAR) ≥ 70%
410(b) Average Benefits Percentage
Test Equivalent Benefit Accrual Rates

Accrued to Date Method

1. Step 1: Lump Sum at Testing Age (NRA)
   Account Balance * Accumulation Factor
   Accumulation Factor = (1 + Interest Rate)^Years to Retirement

2. Step 2: Benefit Accrual
   Lump Sum at Testing Age / Annuity Purchase Rate

3. Step 3: Annualize Benefit Accrual
   Benefit Accrual * 12

4. Step 4: Average Benefit Accrual (per Year of Service)
   Benefit Accrual / Past Service

5. Step 5: Equivalent Benefit Accrual Rate (EBAR)
   Average Benefit Accrual / Testing Compensation

Performing ABPT using the Accrued to Date Method

1. Find Average NHCE EBAR
   Sum EBARs from All NHCEs divided by the Total Number of NHCEs in Test

2. Find Average HCE EBAR
   Sum EBARs from All HCEs divided by the Total Number of HCEs in Test

3. Determine Average Benefit Percentage
   (Avg NHCE EBAR) / (Avg HCE EBAR) ≥ 70%
Failed Average Benefits Percentage Test

Adjustments to Pass a Failed ABPT

- Test on an Allocations, Accrual or Accrued to Date
- Test with Imputing Permitted Disparity
  - Employer allocations only (excluded Safe Harbor)
  - Integrated allocations are excluded
  - Can only impute disparity on 1 plan for sponsor
- Test Otherwise Excludables Separately
  - Must test 401(a)4 and Gateway separately
  - Both OEX and non-OEX must pass all tests

Testing Otherwise Excludable Employees Separately

Must pass two separate sets of tests

- Not Otherwise Excludable Employees
  - Pass Ratio Test or
  - Pass Average Benefits Test
- Otherwise Excludable Employees
  - Pass Ratio Test or
  - Pass Average Benefits Test

*Note: Please see our upcoming webinar on Otherwise Excludable Employees for more information
Testing Otherwise Excludable Employees Separately

- Example of 401(k) Plan contributions include:
  - Salary Deferrals
  - Matching
  - Profit Sharing
  - Safe Harbor Non-elective

- How many tests will need to pass in order to pass 410(b) Coverage Tests?

Testing Otherwise Excludable Employees Separately

- Not Otherwise Excludable Tests
  - Employer
  - 401(k) Portion
  - 401(m) Portion

- Otherwise Excludable Tests
  - Employer
  - 401(k) Portion
  - 401(m) Portion
Failed 410(b) Test Adjustments

Other Adjustments to Pass when failing ABT

- Adjust allocations
  - Increase allocations to NHCE group(s)
  - Decrease the allocation to HCE group(s)
- Future Plan Adjustments
  - Remove last day requirement
  - Remove hours requirement
- Watch for changes in Demographics

410(b) Average Benefits Percentage Test

Summary of Rates used in ABPT

- Allocation Method
  - Allocation / Compensation
- Annual Accrual Method
  - Allocation \* \( \frac{(12 \times \text{Accum Factor} / \text{Annuity Pur Rate})}{\text{(Compensation)}} \)
- Accrued To Date Method
  - \( \frac{(\text{Account Balance}) \times (12 \times \text{Accum. Factor} / \text{Ann. Pur. Rate})}{\text{(Past Service)}} \) (Average Compensation)
- Allocations from All Source allocations
- Acct Bal from All Sources where allocations are possible