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Pre-approved Plan Design and Compliance

A Practical Guidance® Practice Note by Carol V. Calhoun, Venable LLP

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This practice note describes the requirements for implementing pre-approved plans and advantages, disadvantages, and best practices concerning the implementation and legal review of pre-approved plans. A pre-approved plan document can be used for most types of plans qualified under section 401(a) of the Internal Revenue I.R.C. (I.R.C.) (qualified plans). Tax-sheltered annuities or custodial accounts described in I.R.C. § 403(b) (403(b) plans) can also take the form of pre-approved plans, but the procedures are rather different and are described in a different practice note. See Pre-approved 403(b) Plans.

This practice note discusses the following topics:

- Pre-approved Plan Designs and Favored Regulatory Status
- General Advantages and Disadvantages of Pre-approved Plans
- Types and Requirements of Pre-Approved Plans
- Limitations on Plans That May Be Pre-approved
- Pre-approved Plan Providers
- Implementing Pre-Approved Plans
- Obtaining IRS Opinion Letters

For information on the extent to which pre-approved plan documents may be used for various types of retirement plans, see Pre-approved Plan Eligibility Checklist, Pre-approved 403(b) Plans and Pre-approved Plan Adoption Agreement Checklist. For background on qualified plan requirements, see Qualified Retirement Plan Fundamentals.

Pre-approved Plan Designs and Favored Regulatory Status

The IRS no longer distinguishes pre-approved plans between "master," "prototype," and "volume submitter." See IRS, "Types of Pre-approved Retirement Plans." Also, under the new terminology, a pre-approved plan can either be of the standardized type or of the non-standardized type. In addition, as discussed below, the entities who offer a pre-approved plan are no longer referred to as either a sponsor or practitioner but simply as a provider. See section 4.01(15) of Revenue Procedure 2023-37.

Pre-approved Plan Designs

Pre-approved plans are retirement plans that an entity (Provider) creates for adoption by a number of unrelated employers. In contrast, individually designed plans are retirement plans that an employer sponsor or a law firm creates usually for exclusive use by the employer sponsor (and members of its controlled group).

Pre-approved plans fall into one of two categories: standardized and non-standardized plans. In both cases, the plan's Provider submits the plan document to the Internal Revenue Service (IRS) to review and opine on whether the written form of the plan satisfies the legal requirements for qualified status. After the IRS pre-approves the plan, the Provider offers the plan to employers to adopt.

For a discussion regarding the differences between pre-approved standardized plans and preapproved nonstandardized plans, see 401(k) Answer Book (CCH) Q 3:2, and 401(k) Answer Book (CCH) Q 3:3 , "What are the differences between pre-approved standardized plans

and preapproved nonstandardized plans?" and "What are the advantages and disadvantages of standardized and nonstandardized plan?"

Favored Regulatory Status of Pre-approved Plans

Regulatory agencies favor pre-approved plans because they:

- Are efficient to produce
- Are relatively easy to implement (compared to individually designed plans)
- Reliably reflect the many and ever-changing provisions required by the Employee Retirement Income Security Act of 1974 (ERISA) and the I.R.C.

The favored status of pre-approved plans has increased over time. Beginning in 2017, the IRS generally restricted the ability of individually designed plans to obtain favorable determination letters except upon the plan's establishment or termination. I.R.S. Announcement 2015-19; I.R.S. Rev. Proc. 2016-37 (as modified by Rev. Proc. 2017-41, Rev. Proc. 2020-40, and Rev. Proc. 2021-38). By eliminating an individually designed plan's ability to receive interim approval of the plan's form, federal regulators have tacitly endorsed pre-approved plans as the model for future plan implementations. See, also, I.R.S. Notice 2016-03, Rev. Proc. 2016-37, Section 18 (extending the deadline for adoption of pre-approved plans in certain instances in recognition of the abolition of the remedial amendment program for individually designed plans), and I.R.S. Notice 2020-35 (regarding deadline relief due to the impact of the coronavirus outbreak).

General Advantages and Disadvantages of Pre-approved Plans

Use of a pre-approved plan has advantages both for the adopting employer and for the plan Provider over adoption of an individually designed plan. However, you should weigh these advantages against the disadvantages and limitations applicable to the various pre-approved plan types. Advantages, disadvantages, and certain other concerns from the perspective of the employer are discussed in the sections that follow. Also discussed are the advantages for the plan Provider.

Since the advent of "pooled employer plans," or PEPs, employers have the additional option of choosing to participate in a PEP. For a discussion on that topic, see Pooled Employer Plans and Other Multiple Employer Plans.

Advantages, Disadvantages and Other Concerns from the Employer's Perspective

Advantages for Employers

For employers, the major advantages of a pre-approved plan are simplicity, cost, and assurances of IRS approval. An employer can adopt a pre-approved plan merely by selecting among available options (any of which will satisfy IRS requirements), having the documents approved by the board of directors or other person(s) having authority, and signing. Thus, the employer saves the cost of having a plan drafted and obtaining an IRS determination letter on its qualification.

Simplicity in Form

As mentioned above, because pre-approved plans are submitted for IRS approval prior to their adoption by an employer, they are to a certain extent set in form. Nevertheless, they still allow adopting employers to make certain customization decisions. For example, the employer will decide whether to allow plan loans or provide for matching contributions, and how long a vesting schedule to provide. After the adopting employer makes these elections electronically, software systems generate the documents required for the plan.

IRS Approval

The sponsor of a new individually designed plan must apply for a determination letter in which the IRS opines on the plan's qualified status (in form). In addition, under the revised determination letter program, such sponsor can no longer get IRS assurances on the plan between inception and termination. However, a pre-approved plan Provider gets an IRS opinion letter on the pre-approved plan, and the adopting employer can generally rely on this letter. Moreover, the Provider can get a new letter on the pre-approved plan every six years, to reflect changes in the plan and changes in applicable statutes, regulations, and other guidance.

Bundled Third Party Administrative Services

A pre-approved plan is often part of "one-stop shopping" for the employer. The plan Provider or an affiliate may also be providing investment choices under the plan, third party administrative services, etc. This saves the employer from having to find different vendors for each of the functions under the plan. Particularly for a small employer, the simplicity of a pre-approved plan is often what enables the employer to adopt a plan at all without undue expense and use of employer personnel.

Disadvantages for Employers

The major disadvantage of a pre-approved plan is that it limits the employer's flexibility for design options. Following are examples as to why an employer might generally prefer

to sponsor its own (individually designed) plan over a pre-approved plan:

- **Limited ability to implement stand-alone amendments.** Employers adopting pre-approved plans generally have to completely restate the plan (and make sure that existing benefit structures are preserved) when moving to a new investment provider.
- **Limited ability to vary coverage among participants.** Employers adopting pre-approved plans generally cannot have different groups of employees covered by different plans or benefit structures.
- **Inflexibility of options for certain types of plans.** Many employers prefer to adopt plan types (e.g., many defined benefit, cash balance, and stock bonus plans) that are ineligible to use pre-approved plan documents or for which pre-approved plan documents are not commercially available. (See Types and Requirements of Pre-Approved Plans, for more information.
- **Additional costs due to plan document inflexibility.** One typical example where an employer adopting a pre-approved plan may incur an additional cost is where the pre-approved plan document requires employer contributions for all participants who have completed at least 500 hours of service during the plan year, even if they terminate employment before year end. The expense of providing contributions for individuals who are no longer working for the employer (and thus for whom the employer's cost for the contributions is not justified by the plan's advantages in attracting and retaining employees) may outweigh the cost savings of having a pre-approved plan, in which case the employer may prefer to design its own plan instead.

The difficulties discussed above are most often a concern to larger employers who may want to adopt more complex plans or to handle investments in-house, and who have greater costs associated with their large numbers of plan participants. However, a smaller employer that wants to maximize benefits for the owners may also prefer an individually designed plan.

Other Considerations for Employers

Two major cost-related considerations for employers are (1) whether the employer intends to purchase bundled and/or additional services (one-stop shopping) and (2) the extent to which legal review of a pre-approved plan may be necessary.

Effectiveness of One-Stop Shopping

First, to the extent an employer chooses a pre-approved plan for the purpose of one-stop shopping, the plan may be less effective than anticipated. Employers must consider the following:

- **Variability of fiduciary-related costs.** Though pre-approved plan Providers may provide certain bundled services, they will typically not be fiduciaries within the meaning of ERISA (for ERISA plans), or relevant state law (for governmental and non-electing church plans). This means that employers may incur unexpected costs associated with necessary delegations of fiduciary duties (e.g., the prudent selection and monitoring of investments in cases where the employer does not have investment expertise). See What Your Prototype Plan Provider Doesn't Tell You by Carol Buckmann, Cohen & Buckmann, P.C.
- **Desirability of Provider investment platforms.** Pre-approved plan Providers often provide an investment platform for the plan as an additional service to employers. Employers will evaluate the cost of this (and any other bundled) services, the availability of investment options in potential Providers' platforms, and the risk evaluation performed on these investments. Based on these considerations, an employer may decide that the potential Providers do not provide enough investment alternatives or may simply prefer to manage investments in-house.
- **Lack of substantive legal review.** The plan Provider (other than a law firm that provides pre-approved plans for its employer-clients) will typically not be an attorney or authorized to provide legal advice. While the plan documents will typically specify that legal advice should be sought, many employers nevertheless just sign the documents without any legal review.

Need for Legal Review

Even without legal review, an adopting employer has assurances that a pre-approved plan meets qualification requirements. However, this does not eliminate the need for legal review. Some issues that may come to light in connection with a legal review (apart from documentary qualification issues) include:

- **Provider issues.** These include issues with indemnification, responsibilities, and resolution of claims against the Provider. For example, the plan may provide that such claims must be resolved through arbitration rather than lawsuits, or that lawsuits must be filed in the plan Provider's home state (which may be far from where the employer is located). If reviewing a pre-approved plan, you should ensure that your client is aware of the existence of any such provisions and has taken them into consideration when choosing the particular plan.
- **Insufficiency of plan provisions to protect the employer.** While the opinion letter on a plan will generally provide comfort that the plan is qualified in form, it may omit crucial protections for the employer. For example, if the plan document does not give the employer the

right to interpret the terms of the plan, a court may hold that provisions have a meaning quite different from that which the employer assumed. In addition, the plan may either omit a statute of limitations on bringing claims for benefits or provide one that is shorter than the maximum statute of limitations available under state law. You should explain any existing issues of this type to the adopting employer.

- **Foreign trust situs.** A qualified plan must have a U.S. domestic trust. If the Provider has only executives located outside of the U.S., this requirement may not be met in operation, even if the trust document requires it. You should advise clients considering adoption of such a plan that this is a key element that they must investigate.
- **Poor plan communications.** Many lawsuits are based on plan communications. You should ensure, therefore, that the summary plan description (SPD) of the plan and all other employee communications accurately describe the essential provisions of the pre-approved plan.

Advantages from the Perspective of the Provider

For Providers of pre-approved plans, the use of pre-approved plans is primarily a marketing decision. An investment company, payroll provider, insurance company, or third-party administrator may sponsor a pre-approved plan so that it can sell its services by providing the employer with a quick and inexpensive way to get the plan set up. If the sponsor had to provide an individually designed plan for each employer, the up-front cost would make the transaction less profitable to the sponsor.

Law firms may provide pre-approved plans for use by their clients as a plan that has received legal review, but is less costly than an individually designed plan and can receive IRS assurances on its status.

Types and Requirements of Pre-Approved Plans

Requirements Applicable to All Pre-Approved Plans

In some respects, the rules for standardized and non-standardized plans are similar. Both are plans that are designed by a Provider for use by adopting employers (per adoption agreements). Both types of plans must include a procedure for Providers to amend a plan on behalf of an adopting employer. Rev. Proc. 2023-37-, Section 13.01. In addition, pre-approved plans are subject to the following requirements:

- **Prohibition on incorporation of certain I.R.C. sections by reference.** Pre-approved plans cannot incorporate by reference the I.R.C. § 415 limitations on benefits and contributions), the average deferral percentage test under I.R.C. § 401(k)(3), or the average contributions percentage test under I.R.C. § 401(m)(2), I.R.S. Rev. Proc. 2023-37, Sections 10.02(a) and (b). Plan Providers often wish to incorporate I.R.C. sections by reference, so as to avoid lengthy provisions in the plan of the required provisions and to avoid needing to amend the plan if the I.R.C. section is amended. However, the IRS is concerned that the absence of the full provision in the plan may lead to inattention to the provisions in administering the plan.
- **Preclusion of form flexibility that would violate qualification requirements.** Any blanks or fill-in provisions for the employer to complete must have parameters that preclude the employer from completing the provisions in a manner that could violate the qualification requirements. I.R.S. Rev. Proc. 2023-37, Section 10.02(d).
- **Inclusion of USERRA compliance provisions.** All pre-approved plans must contain language within the underlying plan document (as opposed to the adoption agreement) to comply with the Uniformed Services Employment and Reemployment Rights Act of 1994, 38 U.S.C. §§ 4301-4335. I.R.S. Rev. Proc. 2023-37, Section 9.02(12).
- **Inclusion of trust provisions.** All pre-approved plans must include a trust or custodial account document separate from the plan document, unless the plan uses an annuity as a funding method. Rev. Proc. 2023-37, Section 4.01(4).

Differences among the Various Types of Pre-approved Plans

Single or Multiple Funding Media

In some pre-approved plans, each employer that adopts the plan uses a single funding medium (for example, a trust or custodial account document) as all other employers who adopt the same plan. In others, each employer who adopts the plan has a separate funding medium.

Differences between Standardized and Non-standardized Plans

There are two subsets of pre-approved plans: standardized and non-standardized. I.R.S. Rev. Proc. 2023-37. The difference between them is the method by which they comply with the rules preventing discrimination in favor of highly compensated employees.

A standardized pre-approved plan is designed so that it is impossible by its terms for it to violate any of the tests of I.R.C. § 401(a)(4) and (5) (relating to discrimination in benefits), and I.R.C. § 410(b) (relating to discrimination in

plan coverage). Together, these rules constitute the I.R.C.'s non-discrimination rules. (An employer must still ensure that 401(k) contributions meet the actual deferral percentage (ADP) test of I.R.C. § 401(k)(3) and that employer matching contributions and employee after-tax contributions meet the actual contribution percentage (ACP) test of I.R.C. § 401(m).) A non-standardized plan requires the employer to monitor the plan to ensure that, as applied to its employees, the plan satisfies the I.R.C.'s non-discrimination rules.

Structure of Pre-approved Plans

A pre-approved plan can consist of a single plan document, or a basic plan document plus an adoption agreement. A pre-approved plan must also have a trust or custodial agreement, separate from the plan document(s). However, the IRS will no longer rule on whether a trust agreement for a pre-approved plan is tax-exempt under I.R.C. § 501(a).

In the case of a pre-approved plan that consists of a basic plan document plus an adoption agreement, the basic plan document provides all provisions that could possibly apply to the plan, while the adoption agreement permits the employer to select among such provisions. For example, the basic plan document for a profit-sharing plan might provide for 401(k) contributions, matching contributions, and/or contributions that are the same percentage of compensation for all employees. The adoption agreement could allow an employer to choose to have the plan provide for only contributions that are the same percentage of compensation for all employees, only 401(k) contributions, only 401(k) and matching contributions, or all three types of contributions.

A single plan document can be structured so as to have alternative versions of certain provisions, so that a particular employer's plan can omit provisions inapplicable to that employer.

An adopting employer cannot vary the provisions of a pre-approved plan at all, beyond the options provided in the single plan document or the adoption agreement, except:

- Amendments to the plan to add or change a provision (including choosing among options in the plan) and/or to specify or change the effective date of a provision, provided the employer is permitted to make the modification or amendment under the terms of the Pre-approved Plan as well as under § 401 or 403(a), and, except for the effective date, the provision is identical to a provision in the Pre-approved Plan
- Sample or model amendments published by the IRS that specifically provide that their adoption will not cause such plan to fail to be identical to the Pre-approved Plan
- Amendments that adjust the limitations under §§ 415, 402(g), 401(a)(17), and 414(q)(1)(B) to reflect annual cost-of-living increases, other than amendments that add automatic cost-of-living adjustment provisions to the plan
- Plan language completed by the employer if such language is necessary to satisfy § 415 or 416 because of the required aggregation of multiple plans under these sections
- Interim amendments or discretionary amendments that are related to a change in qualification requirements
- Amendments that reflect a change of a Provider's name, in which case the Provider must notify the IRS, in writing, of the change in name and certify that it still meets the conditions to be a Provider
- Amendments to the administrative provisions in the plan (such as provisions relating to investments, plan claims procedures, and employer contact information), provided the amended provisions are not in conflict with any other provision of the plan and do not cause the plan to fail to qualify under I.R.C. § 401 –and–
- Amendments with respect to which a closing agreement under the Audit Closing Agreement Program or a compliance statement under the Voluntary Correction Program of EPCRS has been issued.

Rev. Proc. 2023-37, Section 13.02.

Standardized Plans

To ensure that it meets the I.R.C.'s non-discrimination rules for any employer that adopts it, a standardized plan is limited in the options it can provide. For a qualified plan:

- The plan must cover all employees, other than those who have less than one year of service (YOS), who are under age 21, who are covered by a collective bargaining agreement, or who are nonresident aliens with no U.S.-source income. However, in the case of employees acquired through an asset or stock acquisition, merger, or other similar transaction involving a change in the employer of the employees of a trade or business, the plan can exclude them until the last day of the first plan year beginning after such transaction.
- Some or all of the otherwise excludible employees as described in the preceding paragraph can be included only if the criteria for excluding such employees apply uniformly to all employees.
- The plan may deny an accrual or allocation to an employee based on hours of service or participation on the last day of the plan year only if the employee **both** has less than 500 hours of service and has terminated employment before the last day of the plan year.
- Allocations of contributions or benefits must be based on total compensation (i.e., a definition that constitutes a safe

harbor definition under I.R.C. § 414(s)). I.R.S. Rev. Proc. 2011-49. (For additional information, see Compensation Definition Rules for Qualified Retirement Plans.)

- Unless the plan is a target benefit plan or a § 401(k) and/or 401(m) plan, the plan must, by its terms, satisfy one of the design-based safe harbors to ensure compliance with I.R.C. § 401(a)(4) and (5).
- All benefits, rights, and features under the plan (other than those, if any, that have been prospectively eliminated) are currently available to all employees benefiting under the plan.
- Any past service credit under the plan must meet the 401(a)(4) safe harbor.
- Section 401(k) plans that provide for in-service hardship distributions must only provide for safe-harbor distributions. (See discussion of hardship distributions, below.)

I.R.S. Rev. Proc. 2023-37, Section 9.03.

Non-standardized plans

A non-standardized plan does not contain the above provisions that ensure that the plan will meet the I.R.C.'s non-discrimination rules, and:

- May (but is not required to) contain the requirement that hardship distributions under a 401(k) plan must be limited to safe-harbor distributions –and–
- May (but is not required to) give the adopting employer the option to select total compensation as the compensation to be used in determining allocations or benefits

Rev. Proc. 2023-27, Section 4.01(12). If a non-standardized plan permits non-safe-harbor hardship distributions, such distributions must be subject to nondiscriminatory and objective criteria contained in the plan. Rev. Proc. 2023-27, Section 10.02(1)(c).

Thus, except in the case of a governmental or nonelecting church plan, inappropriate selections regarding coverage or benefits can cause a non-standardized plan to lose the protection of IRS pre-approval. However, pre-approval still provides assurances that the plan will meet IRS requirements other than the Non-discrimination Rules.

Limitations on Plans That May Be Pre-approved

Not all types of plans eligible for qualified status can be pre-approved. The IRS sets forth certain types which are allowed, and excludes plans with certain features, as described below. Rev. Proc. 2023-27.

Plans Permitted

Pre-approved plans can include plans qualified under Internal Revenue I.R.C. (I.R.C.) § 401(a) or 403(a) (qualified plans), including plans that permit employee pretax salary deferral contributions (also known as (401(k) contributions or elective deferrals).

Most pre-approved qualified plans are profit-sharing plans. To the extent that they provide 401(k) contributions, they are known as 401(k) plans. However, most other types of qualified plans can also be pre-approved. Qualified plans eligible for the pre-approved form include:

- Money purchase plans (which may be combined with a 401(k) or other profit sharing plan in the same plan document)
- Defined benefit plans, including cash balance plans (but the types of cash balance plans permitted are limited)
- Effective February 1, 2017, employee stock ownership plans within the meaning of I.R.C. § 4975(e)(7) (ESOPs), other than ESOPS that
  - Are a combination of a stock bonus plan and a money purchase plan –or–
  - Provide for the holding of preferred employer stock

Restrictions on Plans

Certain types of qualified plans cannot be pre-approved plans:

- Multiemployer plans
- Collectively bargained plans (although a pre-approved plan can cover collectively bargained employees, so long as its terms are not modified by the collective bargaining agreement)
- Stock bonus plans other than ESOPs
- ESOPs that are a combination of a stock bonus plan and a money purchase plan
- ESOPs that provide for the holding of preferred employer stock
- Statutory hybrid plans other than cash balance plans
- Cash balance plans that contain a variety of provisions prohibited by Rev. Proc. 2023-27, or fail to contain a variety of provisions mandated by that revenue procedure
- Any defined benefit plan that provides a benefit derived from employer contributions that is based partly on the balance of the separate account of a participant
- Target benefit plans, other than plans that satisfy the 401(a)(4) safe harbors
- Governmental defined benefit plans that include "deferred retirement option plan" (DROP) features, or similar provisions in which a participant earns additional

benefits for continued employment post-normal retirement age in the form of credits to a separate account under the same plan

- Fully-insured § 412(e)(3) plans (plans funded by individual insurance contracts), other than non-statutory hybrid plans that by their terms satisfy the safe harbor in § 1.401(a)(4)-3(b)(5)
- Plans that provide for medical accounts under I.R.C. §§ 401(h) or 105
- Eligible combined (defined benefit/defined contribution) plans
- Variable annuity plans and plans that provide for accruals that are determined in whole or in part based on the value of or rate of return on identified assets, including plan assets
- Plans that include so-called fail-safe provisions for I.R.C. § 401(a)(4) or the average benefit test under I.R.C. § 410(b)

Rev. Proc. 2023-37, Section 10.02(2).

Pre-approved plans can include governmental plans and church plans that have not elected to be covered by ERISA (non-electing church plans). However, because such plans are exempt from ERISA and from many of the I.R.C. qualification requirements, but are subject to special requirements under state law, the plan documents used for governmental plans and nonelecting church plans must be separate from each other, and also separate from the documents used for ERISA-covered plans. Rev. Proc. 2023-37, Section 14.06(1)(b).

Pre-approved Plan Providers

Plan Providers

The IRS provides different procedural requirements to apply for an opinion letter, depending on whether the plan is or is not a "mass submitter" plan as described below. Mass submitters usually have reduced procedural requirements and get expedited treatment from the IRS, because of the high volume of Providers they represent, and the number of identical or near-identical plans they submit to the IRS. This makes it easier and more efficient for review purposes. "Substantially identical" plans may receive expedited review, even if they are not mass submitter plans.

Provider. A Provider of a pre-approved plan must be a U.S. business that has at least 15 employer-clients that it reasonably expects to adopt the sponsor's lead basic plan document. A sponsor that meets the 15 employer-clients requirement can request opinion letters for a number of additional basic plan documents and adoption agreements provided it has at least 30 employer-clients in the aggregate, each of which is reasonably expected to adopt at least one of the Provider's basic plan documents. Although there is no specific deadline for having the 15 or 30 employer-clients adopt the plan, the IRS reserves the right at any time to request from the Provider a list of the employers that have adopted or are expected to adopt the Provider's pre-approved plans, including the employers' business addresses and employer identification numbers.

Providers must make reasonable and diligent efforts to ensure that adopting employers of the Provider's plan have actually received and are aware of all plan amendments.

Mass submitter. A "mass submitter" is a U.S. business that submits opinion letter applications on behalf of at least 30 unaffiliated Providers that have "word-for-word identical" basic plan documents to the mass submitter's lead plan. In addition, if the mass submitter has additional plans, it can submit applications regardless of the number of Providers for the mass submitter's other plan(s).

Mass submitters who have met the "30 Provider" requirement can submit additional applications for Providers with identical plans and Providers that have "minor modifications" to the mass submitter's plan. The IRS will review submissions with respect to minor modifications on an expedited basis and opinion letters will be issued to the Provider as soon as possible.

Mass submitters usually have reduced procedural requirements and get expedited treatment from the IRS, because of the high volume of Providers they represent, and the number of identical or near-identical plans they submit to the IRS. This makes it easier and more efficient for review purposes.

All of these terms have specific meanings. For example, the term "word-for-word identical plan" includes a "flexible" plan. This feature permits the prototype's Provider to remove certain sections of a mass submitter's plan because they do not apply or because the financial institution offering the plan does not offer the provision. If the prototype's Provider does not offer loans, for example, then the section in the plan and the adoption agreement that refers to loans is removed and generally replaced with "reserved." Plans can have as many as six administrative flexible provisions and six investment flexible provisions.

A "minor modification" is a minor change to an otherwise word-for-word identical plan of the mass submitter that does not require an in-depth technical review. For example, a change from five-year 100% vesting to three-year 100% vesting is a minor modification. On the other hand, a change in the method of accrual of benefits in a defined benefit plan would not be considered a minor modification. A minor modification must be submitted by the mass submitter on behalf of the Provider that will adopt the modified plan.

Implementing Pre-Approved Plans

At minimum, implementing a pre-approved plan requires multiple documents. For a plan taking the form of a basic plan document plus an adoption agreement, it requires a:

- Basic plan document containing non-elective provisions, which also explains the elections made in the adoption agreement
- Trust agreement that describes requirements for plan asset segregation and management in a separate document –and–
- Adoption agreement in which the employer adopting the plan selects elective provisions

Alternatively, the plan can take the form of a single plan document plus a trust or custodial account document.

For either type of plan, the following additional documents are also required:

- **SPD.** In the case of an ERISA plan, the SPD must conform with the requirements of ERISA §§ 101(a), 102(a)(1) and 104(b), and 29 C.F.R. §§ 2520.104b-1 and 2520.107. While a non-ERISA plan is not required to have an SPD, most do in order to provide a simplified method for participants to understand the basic terms of the plan.
- **Resolution.** Corporate resolution by which the employer adopts the plan.

The plan Provider will also need to provide each adopting employer with a copy of the opinion letter applicable to the pre-approved plan.

Additional requirements for these documents are provided below.

Basic Plan Document or Single Document

A Provider's document system will generate the basic plan document or specimen plan, and a copy of the opinion letter by which the IRS approved the written form of the plan. (See below regarding IRS approval.) Neither document allows for customization, but both are essential to the plan.

A basic plan document reflects the regulatory requirements for all plans that are covered by the pre-approved plan document, even if all the features discussed in the basic plan document are not elected in the adoption agreement. For example, a basic plan document may incorporate both profit sharing and 401(k) plan statutory requirements, even a specific employer elects in the adoption agreement to provide only profit sharing features but not 401(k) features. Essentially, the basic plan document reflects all the regulatory basis for every possible election in the adoption agreement.

Alternatively, a plan can elect to use a single plan document that incorporates only those features that a specific adopting employer elects. In the case of a plan with this form, all references to the adoption agreement below should be read as referring to the single plan document.

General Information Required of All Adopting Employers

All document systems require certain information about the employer adopting the plan, the plan itself, and the document being generated. General information includes:

- Employer name, address, fiscal year, Employer Identification Number, NAICS I.R.C. that identifies industry subtypes;
- Plan design type (i.e., DC or defined benefit), employer's plan number (because employers may have multiple plans), plan name, effective date;
- Pre-approved document type (profit-sharing only, 401(k))
- The preferred style of document (such as a "check-the-box" style adoption agreement, or a single plan document that emulates an individually designed plan)

After drafting the adoption agreement or the single plan document, the system user must register the document in the Provider's system. Registration enables the Provider to notify adopting employers when plan revisions are required by law, or simply to adopt such revisions itself. Without such automated "upkeep" of implemented plans, the plan's pre-approval can essentially expire for failure to have updated the plan as laws, regulations, or other guidance changes. Failing to adopt and approve an updated pre-approved plan in a timely manner can result in disqualification of the plan. Plan sponsors may be able to avoid disqualification by correcting the failure under the IRS's Employee Plans Compliance Resolution System (EPCRS) Voluntary Correction Program. See, e.g., I.R.S. VCP Submission Kit—Failure to adopt a new Pre-approved Defined Contribution Plan by the April 30, 2016 Deadline.

Shared Information for Plan Documents, Administration, Reporting and Disclosure

Often, companies that provide plan document systems also offer plan administration and plan reporting systems. Such systems work together, culling data from one system for use in the others. For example, the information provided to the document system about the adopting employer will be reflected in the plan's annual tax return. Such shared information includes:

- Plan trustees and contact information (captured in SPD);
- Adopting employer information (captured in the plan's annual tax return for which the employer is responsible);

- Whether the plan employer is part of "commonly controlled group" of corporations, or an "affiliated service group" of corporations (captured by plan administration system for nondiscrimination testing purposes).

Since the same information has multiple applications, there is inherent risk that erroneous information may compromise related plan service systems. In practice, such risks may be minimized before the plan goes into operation—via diligent review by Providers, plan administrators, and adopting employers.

Adoption Agreement

Eligibility and Service Provisions

Every plan must define when an employee will become eligible to participate. The selection of eligibility and service provisions, including eligibility exclusions, is often a function of the demographics of the employer's workforce (provided the selected eligibility and service requirements adhere to I.R.C. requirements, and ERISA requirements in the case of an ERISA plan, and are applied consistently). For additional information on coverage and minimum participation requirements see ERISA § 202 (29 U.S.C. § 1052); I.R.C. § 410; Treas. Reg. § 1.401(a)(26)-6(b). Governmental and church plans are exempt from statutory eligibility and participation rules, but plan documents for them must still specify what eligibility and participation rules will apply.

Eligible Employees

An employer may *exclude* from the definition of "eligible employee" any employee who:

- Does not meet the plan's minimum age and/or service requirements
- Is a nonresident alien who receives no earned income from sources within the United States –or–
- Is covered by a collective bargaining agreement between that employer and a union

I.R.C. §§ 401(a)(26)(B) and 410(b); Treas. Reg. §§ 1.401(a)(26)-6(b) and 1.410(b)-6.

However, the employer may elect in the adoption agreement to **include** nonresident aliens and collectively bargained employees described above, provided the inclusion is consistently applied. Treas. Reg. §§ 1.401(a)(26)-6(a) and 1.410(b)-6(b)(3).

In a non-standardized plan, an employer may choose to exclude certain classifications of employees based upon the plan's design. Such "design-based" exclusions include:

- Leased employees (defined in I.R.C. § 414(n))
- Key employees (defined in I.R.C. § 416(i))
- Highly compensated employees (HCEs) defined in I.R.C. § 414(q)
- HCEs who are key employees
- Self-employed individuals defined in I.R.C. § 401(c)
- Employees paid solely in commissions
- Employees paid on an hourly basis
- Employees paid on a salaried basis, regardless of the number of hours they work
- Employees ineligible for employer-provided health and welfare benefits
- For collectively bargained plans, and if applicable to the collective bargaining agreement, employees whose compensation does not include prevailing wage payments –and–
- Other exclusions designed for the employer, provided that such exclusions do not cause the plan to cover only those non-HCEs who are the lowest paid or who have the shortest periods of service, and who represent the minimum number of non-HCEs necessary for the plan to pass annual coverage testing under I.R.C. § 410(b)

Some large employers sponsor different plans for different employment classifications, i.e., hourly, salaried, commissioned salespeople, collectively bargained employees and partners/owners. Employees may also be excluded on the basis of being employed by a separate line of business (as defined in I.R.C. § 414(r)) for the purpose of nondiscrimination testing under I.R.C. § 410(b)(6)(C).

Employers often permit their entire full-time workforce to participate after satisfying the plan's age and/or service requirements – but may wish to exclude part-time employees. Part-time employees **cannot** be excluded based solely on their part-time status: if they satisfy the plan's service requirements they must be permitted to enter the plan. I.R.C. § 410(a). Conversely, the adoption agreement may allow exclusions based on other criteria that may also apply to part-time employees (such as ineligibility for employer-paid health and welfare benefits).

Service Requirements and Entry Date

ERISA covered plans reference YOS to determine much about an employee's rights in a plan. YOS serves many purposes, including as:

- A requirement to participate in the plan
- The measure by which a participant's employer-funded contributions (i.e., profit sharing or matching contributions) vest and become non-forfeitable –and–
- The basis for determining whether a break in service has occurred that may cause the participant to forfeit benefits previously earned

In a non-ERISA plan, service can be based on years of employment, years of participation, or other creditable years of service as defined in the plan document.

To apply service requirements consistently, the plan must also define the terms used to calculate plan service, including:

- **The required amount of service.** This must be based on YOS, defined as a maximum of 1,000 hours of service (HOS) either in the first year of employment, or by the end of a defined computation period.
- **Service-counting.** Counting service can be accomplished by counting the hours actually worked during a year (known as "counting/actual hours method") and extrapolating whether a YOS has been satisfied by assuming a certain number of HOS for every day, week, two-week or month worked, or by determining YOS based on the years of service (YOS) and fractional YOS (known as "elapsed time method").
- **Variation.** YOS definitions will vary for different plan purposes - such as service for eligibility purposes, versus, service for vesting purposes.
- **Prior service recognition.** Whether service with a prior employer or predecessor plan will be counted must be clear, and the purposes for which such service will be considered. This election often arises as the result of corporate acquisitions of other employers.

For a discussion of counting years of service, see Counting Service in Retirement Plans.

Each type of contribution permitted in a plan can be subject to uniform or varied eligibility requirements. Examples of varied eligibility requirements include:

- Elective deferrals (funded by employees) that have no requirement other than employment
- Employer-funded profit sharing and matching contributions that require one YOS
- Age requirements (up to age 21) –and–
- Eligibility requirements less restrictive than the statutory maximum waiting periods

After satisfying the plan's eligibility requirements, the eligible employee becomes a plan participant on the plan's "entry date." Like eligibility requirements, entry date can vary for different types of contributions. Entry dates may be:

- After the eligibility requirements are satisfied, whether semiannually, quarterly, monthly, or the next plan year
- The first or last day of the plan year nearest satisfaction of eligibility requirements
- The plan's defined anniversary date –or–
- Immediate upon satisfaction of the requirements

For more information about participation requirements generally, see I.R.C. §§ 401(a)(26), 410(a) and 410(b); for 401(k) plans see I.R.C. § 401(k)(2).

Plan Date Provisions

ERISA and I.R.C. compliance is often date-driven. Dates that are crucial to plan administration (but of little interest to employers and participants) include:

- "Anniversary date" which is often defined as the first or last day of the plan year, but any day of the plan year may be elected in the adoption agreement
- "Valuation date" to determine the value of the assets in plan accounts and the plan's trust or custodial account, which may be the last day of the plan year, semiannual on the last of each six month period, the last day of each quarter or month
- "Limitation year" which is used to determine compliance with maximum allocations under I.R.C. § 415, and which may be the plan year, the calendar year coinciding with or ending within the plan year; a 12-consecutive month period ending on a specified date; the employer's fiscal year ending with or within the plan year; or a designated 12-month period

Because these dates impact plan administration, the employee benefits practitioner is advised to consult with the plan administrator, the third-party plan administrator (if any) and/or the plan's actuary to determine an appropriate dates and periods.

The dates of greatest interest to employers and participants involve retirement. Except in the case of a governmental plan, "normal retirement age" (NRA) although not a calendar date, must be elected in the plan. A pre-approved can, for example, provide NRA options of:

- Age 65 or the 5th anniversary of participation in the plan (the statutory NRA, which is also the latest NRA permitted by ERISA for ERISA plans)
- A younger age (but not less than 55)
- Age between 55 and 65, plus a selected number of YOS or years of participation (YOP)
- Combined age and YOS or YOP that equals a fixed number
- Age and the sum of age and YOS or YOP equaling a fixed number
- Age and a defined anniversary of employment or participation in the plan –or–
- Another formula, provided it does not result in NRA later than the statutory NRA.

Whatever NRA is selected must be applied consistently. Additional information about retirement ages can be found at Treas. Reg. § 1.401(a)-1(b); ERISA § 3(24) (29 U.S.C. § 1002(24)); I.R.S. Notice 2012-29.

The normal retirement date (NRD) is the date on which a participant who has terminated employment can begin taking unreduced retirement distributions. In some instances, the plan will also permit in-service distributions beginning on NRD, or permit a participant to delay distributions beyond NRD until they are mandated under the required minimum distribution rules: soon after age 72 in the case of a 5% owner of the employer, or the later of termination of employment or turning age 72 in the case of other participants (increased from age 70½ under the Setting Every Community Up for Retirement Enhancement (SECURE) Act (Pub. L. No. 116-94, Div. O, § 114)). Except in the case of a governmental plan, the adoption agreement must designate the NRD because rights and obligations toll from that date. The employer designates the plan's NRD by reference to the NRA:

- Actual date NRA is attained; month in which NRA is attained; month following NRA
- Anniversary date of plan year in which NRA is attained; anniversary date nearest NRA; anniversary date following NRA
- Last day of month NRA is attained; last day of month nearest NRA; last day of month coincident with or next following NRA.

A plan may, but is not required, to permit an "early retirement age" (ERA) – and corresponding "early retirement date (ERD)," at which an employee who has terminated employment can receive actuarially reduced benefits. If selected by the employer, ERA can be:

- A designated age that does not exceed NRA
- An age, plus a YOS or YOP requirement
- A number of years before NRA
- Sum of age and YOS or YOP that equals a designated number
- Age and the sum of age plus YOS or YOP equaling a selected number
- A number of YOS or YOP, without an age requirement
- An age and a designated anniversary of employment or plan participation

For large employers, ERA/ERD may be used to promote succession, or to provide early retirement windows when a company finds itself top-heavy with senior employees. Early retirement benefits are relatively rare among small employers, and if permitted, are typically in plans that cover few employees other than the business owner and his immediate family.

Some plans elect to provide retirement benefits in the event the participant becomes disabled before attaining retirement age. If so, the adoption agreement must define "disability" that permits payment of benefits before ERA or NRA is attained. Disability retirement options include:

- Suffering from a medically determinable impairment expected to result in death or last for at least 12 or more months
- Determination by the Social Security Administration that the participant is eligible to receive Social Security disability benefits –or –
- The participant has begun to receive payments under the employer's long term disability program

Compensation Provisions

Compensation is among the most complex topics under ERISA and the I.R.C. Like service provisions, compensation is a concept used for several plan purposes, including:

- Contribution allocations - to determine the amount contributions that will be allocated to participants' accounts
- Maximum benefit limitations - to ensure that plan allocations do not exceed maximum allocation limitations (I.R.C. § 415) and additional allocations will be required if higher paid and key employees disproportionately benefit under the plan (I.R.C. § 416)
- Safe harbor contributions - to ensure that requirements of this feature (which enables employers to avoid complex nondiscrimination testing) have been satisfied.

In a non-standardized plan, compensation can also be variously defined. Nevertheless, a non-standardized plan must give the adopting employer the option to select total compensation as the compensation to be used in determining allocations or benefits. The differences between types of compensation are subtle when read, but significant in application. The adoption agreement should designate a compensation definition that is appropriate to how compensation is paid to plan participants. Optional compensation definitions include:

- W-2 compensation, which is wages, tips and other compensation entered on Box 1 of Form W-2
- I.R.C. § 3401(a)compensation, which is used for FICA purposes
- I.R.C. § 415(c)(3)compensation
- Simplified I.R.C. § 415(c)(3) compensation, as defined in Treas. Reg. § 1.415(c)-2(d)(2)

The compensation definition can be further modified by applying certain exclusions from compensation. Generally, employee deferrals to other plans sponsored by the employer can be excluded from the definition of compensation. Possible exclusions include deferrals to:

- Simplified Employee Pensions under I.R.C. § 402(h)(1)(B);
- Cafeteria plans under I.R.C. § 125;

- Transportation plans under I.R.C. § 132(f)(4);
- I.R.C. §§ 401(k) and 403(b) plans;
- I.R.C. § 457(b) plans;
- Simple Retirement Accounts under I.R.C. § 402(k).

In a non-standardized plan an employer can also choose to exclude types of pay from the plan's definitions of compensation, including overtime, commissions, discretionary bonuses, bonuses, taxable employee benefits, compensation in excess of a specified dollar amount, and a designated exclusion that does not discriminate in favor of HCEs. Other possible inclusions/exclusions can be selected for salary paid in the first few weeks of the next limitation year; for salary continuation during military leave or for disabled participants; or for post-severance compensation.

The adoption agreement must also designate the "computation period" for compensation, for each purpose to which the compensation definitions apply. Computation periods can be an entire plan year; the plan's limitation year; the calendar year ending with or within the plan year; a pay period, monthly, bi-monthly, quarterly, semi-annually, bi-weekly, or weekly; or a 12-month period ending on a designated date.

As with any administrative provisions, the employee benefits practitioner should consult the plan administrator before selecting compensation definitions.

For a further discussion on permissible definitions of plan compensation, see Compensation Definition Rules for Qualified Retirement Plans.

Contributions and Benefits

For a defined contribution plan, the adoption agreement must specify the type of contributions allowed. For example, in a 401(k) plan, there might be any or all of elective deferrals, matching contributions, and profit-sharing, Roth contributions, employee after-tax contributions, deemed IRA contributions. The employer's contribution may be required at a specified rate under the terms of the plan, or may be determined by the employer each year. Safe harbor contributions may be provided in order to ensure than a 401(k) plan satisfies the ADP and ACP tests. Elective deferrals may be limited to the statutory limitations that apply to elective deferrals under I.R.C. §§ 402(g), 415, 401(k)(3) and 416, or the plan may permit catch-up contributions to the extent permitted by law. (401(k) plans permit catch-ups under I.R.C. § 414(v)). The plan must set forth special contribution rules in case the plan becomes top-heavy.

A defined contribution plan must also specify how contributions are allocated. For example, are profit-sharing contributions allocated strictly in proportion to compensation, or are they coordinated with Social Security under the I.R.C. § 401(l) permitted disparity rules? Are matching contributions allocated in proportion to all employee contributions, or do they match just elective deferrals? Are there maximum limits on the contributions that will be matched?

A defined benefit plan (including a cash balance plan) must specify the benefit formula to be applied. For example, a defined benefit plan might provide that the benefit is X% of final average compensation times years of service. The rate of contributions would then not be specified under the plan, but determined based on actuarial computations of what contributions were necessary to fund the benefits.

Vesting Provisions

"Vesting" refers to the extent to which portions of employer-funded contributions become nonforfeitable over time. Most often, a designated percentage becomes vested in each year of the stated vesting period. The unvested portion of employer contributions can be forfeited, i.e., removed from the participant's account balance, if the participant terminates employment before satisfying the vesting schedule (although certain service reinstatement rules can prevent forfeiture). In contrast, employee-funded contributions are always fully vested and can never be forfeited by the participant.

Vesting Schedules and Events

If the plan provides employer contributions, the adoption agreement must specify their vesting periods. A plan can designate a single vesting schedule for all employer-funded contributions, or individual vesting schedules for each type of employer contribution. ERISA and the I.R.C. limit the time over which employer contributions can vest. For an ERISA plan, the longest permissible graded vesting period is six years. Cliff vesting cannot require more than three vesting YOS. For additional information on minimum vesting requirements, see I.R.C. § 411(a)(2); Treas. Reg. § 1.411(a)(1); Treas. Reg. §§ 1.411(a)-3T.

Permissible vesting schedules in an ERISA plan include:

- Six-year graded vesting – 0% vesting for the first year of vesting service, then 20% vesting service at the completion of years two through six
- Cliff vesting – 100% vesting upon completion of designated years of vesting service
- Immediate vesting – 100% upon participation in the plan
- Another vesting schedule designated by the employer – provided that 100% vesting occurs not later than completion of the sixth year of vesting service

Top-heavy contributions to an ERISA plan are subject to special vesting requirements. Foremost, the vesting schedule

for top-heavy contributions must be at least as favorable as the vesting schedule for other employer contributions. In practice, plans that provide a vesting schedule for non-safe harbor employer contributions often designate the same vesting schedule for top-heavy contributions.

Certain contributions are also subject to statutory vesting schedules. For example:

- Employee contributions (including employee deferral contributions after-tax contributions) must vest immediately, never to be forfeited by the participant.
- Safe harbor nonelective (SHNE) contributions (contributions designed to help a 401(k) plan to meet ADP requirements) and safe harbor matching (SHM) contributions (contributions designed to help a 401(k) plan other than a nonelecting church plan to meet ACP requirements) must also vest immediately.
- Plans that require two years of service before a participant can enter the plan must immediately and fully vest employer contributions.

For a governmental plan, the IRS provides a safer harbor for vesting at least as favorable as the following schedule:

- **15-year cliff vesting.** 100% vesting upon 15 years of creditable service (service can be based on years of employment, years of participation, or other creditable years of service).
- **20-year graded vesting.** A participant is fully vested based on a graded vesting schedule of five to 20 years of creditable service (service can be based on years of employment, years of participation, or other creditable years of service).
- **20-year cliff vesting for qualified public safety employees.** A participant is fully vested after 20 years of creditable service (service can be based on years of employment, years of participation, or other creditable years of service). This safe harbor would be available only with respect to the vesting schedule applicable to a group in which substantially all of the participants are qualified public safety employees (within the meaning of I.R.C. § 72(t)(10)(8)).

The plan's selected vesting schedule notwithstanding, the employer can choose whether to "accelerate" vesting upon a participant's attainment of early retirement age, death, or disability. The employer can also choose to count a participant's time of disability toward their vesting service (as though s/he was still employed). Like all adoption agreement provisions, however, the administrator must apply vesting acceleration on an equal and nondiscriminatory basis.

Prior and Transferred Assets Vesting Schedules

After a corporate merger, acquisition or spin-off, an employer may require a new plan or amendment of its existing plan, to provide plan coverage to employees of the entity that was the subject of the corporate transaction. For example, an employer that acquires another business can cover the acquired employees in the employer's existing plan or may sponsor a new plan for the acquired company. If the acquired company has a pre-existing plan, the employer may become the sponsor of the acquired plan, may sponsor a new plan for the affected employees, or may merge the prior plan into an existing plan.

ERISA's provisions relating to mergers and acquisitions exceed the scope of this note. But in relevant part, affected employees may not lose the benefits allocated to them under a prior employer's plan: each affected participant is entitled to receive a benefit after a corporate transaction that is at least equal to the benefit the participant would have received before the transaction. I.R.C. §§ 401(a)(12) and 414(l); Treas. Reg. §§ 1.401(a)-12, 1.414(l)-1. For additional information on ERISA's requirements regarding retirement plans involved in mergers & acquisitions, see Retirement Plan Issues in Corporate Transactions.

When implementing (or amending) a pre-approved plan that will cover acquired employees, the adoption agreement must indicate:

- Whether a prior vesting schedule exists for affected participants prior account balances
- Whether the vesting schedule that applied to prior account balances ("old money") is more or less generous than the vesting schedule for new contribution allocations ("new money") –and–
- The vesting schedule under the prior plan

In summary, old money must vest at least as quickly as it would under the prior plan, but new money can vest at the existing plan's schedule, whether slower or faster than the former plan's vesting schedule.

Similarly, if two plans merge and assets are transferred from the acquired plan into a new or existing plan, the transferred assets must continue to vest at the same or faster rate as they would have under the former plan. The adoption agreement will require you to designate each account type that is the source of transferred assets, i.e., non-elective contribution account or matching contribution account, and the vesting schedule that applied to the transferred assets.

Breaks in Service and Reemployment

An account balance in an ERISA plan that becomes forfeitable is not immediately forfeited: the participant must attain a designated number of years of "breaks in service" before the balance is deducted from the participant's employer contribution account. If the participant returns to service

before the maximum break in service is completed, then the participant's account balance attributed to unvested employer contributions can be reinstated. (But compare employer contributions that are fully and immediately vested, which can never be forfeited.)

In order to permit forfeitures, an adoption agreement must indicate the service rules that apply to forfeitures, including how breaks in service are counted (by incorporating HOS and YOS - both of which are defined in "Service Requirements and Entry Date" above under "Eligibility Requirements"). The most typical break in service and reemployment provisions are:

- A "one-year break in service" is a plan year during which the participant failed to complete a designated number of HOS up to 500 hours –and–
- YOS completed after a break in service can be disregarded for vesting purposes unless the participant is reemployed within five years

Some plans (more typically defined benefit plans) apply a "rule of parity" that allows a plan to disregard YOS completed before a break in service, if the number of consecutive one-year breaks equals or exceeds the **greater of** five, or the participant's years of service before the break began. In contrast, although relatively rare, employers can choose to count all service toward vesting, including service completed after a break in service, regardless of the length of the break in service.

Governmental plans are not subject to statutory rules regarding forfeitures, but must nevertheless specify what forfeiture rules are being used. See Eligibility, Participation, and Vesting Rules for Qualified Retirement Plans.

Forfeitures

Forfeitures are the result of a participant's failure to complete the plan's vesting schedule. For example, if a plan has three-year cliff vesting, employer contributions will vest when the participant completes three years of service, but if the participant terminates employment after two years, the account balances become forfeitable.

The adoption agreement must reflect the plan's rules for how forfeitures will be deducted from participants' accounts. A plan can permit forfeitures to occur at:

- Various dates tied to other plan definitions (such as valuation date, the designated number of consecutive breaks in service)
- Upon certain distribution events (such as distribution of the entire vested interest, or pro-rata as the vested interest is distributed over time)

Consult the trustee (or trust custodian charged with valuing account balances) before electing these provisions. For additional information on forfeitures, see I.R.C. §§ 411(a)(6).

Forfeited assets cannot revert to the employer; therefore, the adoption agreement must detail when and how forfeitures of employer contribution accounts will be applied in the plan. Once forfeited, unvested employer non-elective and matching contributions can be used by the employer to:

- Reduce administrative expenses (to pay permissible plan expenses)
- Restore forfeited account balances of rehires (to replace forfeitures previously taken from an account if the participant is reemployed by the employer)
- Reduce employer contributions (to fund current employer contributions with forfeited balances)
- Supplement employer contributions (to give additional contributions to participants)

For a further discussion of forfeiture rules regarding breaks in service, see Eligibility, Participation, and Vesting Rules for Qualified Retirement Plans.

Asset Distribution Provisions

End-of-Service Distributions

Plans must permit distribution of benefits (if requested by the participant or beneficiary) as the result of retirement, termination of employment or death. If elected in the adoption agreement, a plan may treat a participant's full disability (as defined in the plan) as a distribution event.

In all cases, the adoption agreement must designate the forms of distribution permitted by the plan. Options include:

- Lump sum in cash (the minimum form required of all DC plans)
- Partial non-periodic ad hoc distributions paid at times and in amounts requested by the participant or beneficiary
- Installment payments made in substantially equal annual, quarterly or monthly installments over a number of years designated in the adoption agreement, or over a period of years selected by participant that is less than her life expectancy, or another schedule designated in the adoption agreement
- Annuities (payments made by purchasing an annuity contract providing for equal periodic payments for the life of participant, and possibly after participant's death for the life of a designated beneficiary or spouse)

For additional information on permitted distribution types, see I.R.C. §§ 401(a)(15), 401(a)(11), 411(d)(6). More varied distribution types are permitted in governmental and nonelecting church plans, which are not subject to those I.R.C. sections.

If permitted by the employer's election (and if later elected by the participant) a plan can provide joint and survivor annuities, which pay for the life of the participant, and at

participant's pre-death election, continue payments to a designated beneficiary a fixed proportion of the annuity contract value for a specified period.

Pre-approved plans may permit various annuity options, and those provided in support of annuity products often provide extensive ones. In a defined benefit plan, the normal form of benefits must be a qualified joint and survivor annuity for the participant and spouse if the participant is married, and otherwise a life annuity for the participant. A preretirement survivor annuity in favor of the spouse must also be provided if the participant dies before termination of employment. If a married participant wants to elect a different form of benefits, the election is possible only if the spouse consents.

Depending on the annuity options provided by the pre-approved plan's provider, the adoption agreement may require decisions on:

- The periods permitted for annuities
- Whether they will carry over from the participant's life to another's life
- The designated percentage payable to the non-spouse beneficiary or surviving spouse
- Whether payments will be guaranteed for a period of years

For additional information on statutory annuity requirements, see I.R.C. §§ 401(a)(11), 417; Treas. Reg. § 1.401(a)(20).

In-Service Distributions

Plans are not required, but may in some circumstances permit, participants to access portions of their account balances while still employed by the adopting employer. For participants, the availability of in-service distributions is a double-edged sword: they calm employees' fears that money saved for retirement will be inaccessible until retirement, but removing assets and losing investment income reduces retirement readiness. Notably, although a plan can permit premature distributions (taken before the plan's earliest retirement date) a 10% penalty tax will be deducted from the premature distribution.

Once elected, the ability to remove in-service distributions is limited. The availability of in-service distributions are "protected benefits": once provided, they must always be available for account balances that exist **before** the removal of the protected benefit. Although subsequent allocations are not subject to an eliminated protected benefit, the plan will incur additional administration costs to administer a protected benefit for portions of participants' account balances. See Anti-cutback Rules for Qualified Retirement Plans (IRC § 411(d)(6)) for additional information on protected benefits.

In-service distributions can be provided only if the adoption agreement provides for them. Distributions of employee deferrals under a 401(k) plan can be permitted only on or after a participant's attaining an age specified by the employer that is no earlier than 59½, or upon hardship (see below).

The adoption agreement may also apply non-age requirements to access account balances that would be used for in-service distributions. Additional requirements can include:

- The participant's attainment of early or normal retirement age under the plan
- Assets having been allocated for at least two years
- Participation in the plan for at least five years –or–
- A combination of both allocation and participation requirements

In a defined benefit plan, in-service distributions can be permitted only upon attainment of the earlier of age 59½ (lowered from 62 in legislation passed along with the SECURE Act (Pub. L. No. 116-94, Div. M, § 104))) or normal retirement age under the plan. Various rules limit the normal retirement age that can be specified for this purpose.

The adoption agreement must also specify the accounts from which in-service distributions can be deducted. If elected, in-service distributions of 401(k) elective deferrals can be made from accounts holding:

- Employee non-elective contributions (i.e., employee deferrals)
- Matching contributions
- SHNE and SHM contributions
- Various types of rollover accounts (in which employees place distributions from a prior employer's plan)
- Employee voluntary contribution accounts

For additional information on in-service distributions, see I.R.C. §§ 401(k)(2)(B)(i)(III), 401(k)(10).

Hardship Distributions

For a 401(k) plan, another permissible in-service distribution is the hardship distribution. Hardships distributions must be granted on the basis of immediate and heavy financial need, which must be defined in the plan, and the funds must be necessary to satisfy the financial need. I.R.C. § 401(k)(2)(B)(i)(IV); Treas. Reg. § 1.401(k)-1(d)(3)(i). The single plan document or adoption agreement must designate the accounts from which hardships can be paid. Like in-service distributions, the availability of hardships is a protected benefit under I.R.C. § 411(d)(6) Hardship distributions are also subject to the 10% premature distribution penalty under I.R.C. § 72(t), unless an exception there applies. Most pre-approved plans define "hardship" as meeting the "safe harbor

hardship" standards of Treas. Reg. § 1.401(k)-1(d)(3)(iii). If a safe harbor hardship is elected in the single plan document or adoption agreement, the safe harbor's "deemed hardship" criteria cannot be changed, and any distribution paid on this basis will be deemed necessary to satisfy the participant's immediate and heavy financial need. Safe harbor distributions can be used to pay:

- Deductible medical expenses
- A down payment on the purchase of a principle residence
- Tuition and related educational needs
- Amounts required to prevent eviction or foreclosure
- Funeral or burial expenses –and–
- Significant repair or rebuilding costs arising from a casualty to the participant's principal residence–and–
- Expenses and losses (including loss of income) resulting from a disaster declared by the Federal Emergency Management Agency (FEMA) that was within the area of the participant's home or principal place of work

Most of these expenses can relate to expenses incurred by the participant, the participant's spouse, tax dependent or primary beneficiary. Treas. Reg. § 1.401(k)-1(d)(3)(iii)(B); Treas. Reg. Treas. Reg. § 1.401(k)-1(d)(3)(ii)(B)(1)-(7) (83 Fed. Reg. 56,763, 56,767 (Nov. 14, 2018)).

In addition, before obtaining a hardship distribution, a participant must have obtained all other distributions under the plan. For years prior to 2020, a safe harbor provides that the distribution will be considered necessary to satisfy the financial need if the participant is required to cease contributing elective deferrals and voluntary employee contributions for six months following the hardship distribution. Treas. Reg. § 1.401(k)-1(d)(3)(iv)(E). However, for plan years beginning on or after January 1, 2020, the six month suspension of contributions following a hardship distribution was eliminated as a safe harbor by Section 41113(a)(1) of the Bipartisan Budget Act of 2018, Pub. L. No. 115-123 (2018 Budget Act). Indeed, Treas. Reg. Treas. Reg. § 1.401(k)-1(d)(3)(iii)(C) now prohibits such a suspension. The regulations provide that a pre-approved plan was permitted to eliminate the six-month suspension and move to the new standard for determining whether a distribution is necessary to meet the financial need as early as plan years beginning on or after January 1, 2019, and was even permitted to end prior six-month suspensions the day prior to the new plan year. Treas. Reg. Treas. Reg. § 1.401(k)-1(d)(3)(v)(B).

Although atypical in a pre-approved plan, in lieu of the safe harbor standards, an employer can define its own non-safe harbor criteria for hardship distributions. However, a unique definition must be consistently applied, and the employer should expect the plan's review, approval and recordkeeping processes to invite stricter scrutiny in a financial or agency audit of the plan. See I.R.C. § 401(k)(2)(B)(i)(IV).

Finally, Treas. Reg. § 1.401(k)-1 as amended to implement Section 41113(a) of 2018 Budget Act eliminates the rules in previous Treas. Reg. § 1.401(k)-1(d)(3)(iv)(B) (under which the determination of whether a distribution is necessary to satisfy a financial need is based on all the relevant facts and circumstances) and provide one general standard for determining whether a distribution is necessary. Under this general standard, a hardship distribution:

- May not exceed the amount of an employee's need (including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution)
- The employee must have obtained other available distributions under the employer's plans (both qualified and nonqualified) and have elected, if applicable, to receive all employee stock ownership plan (ESOP) dividends (where the employer sponsors an ESOP) permitting the cash payment of dividends –and–
- The employee represents, in writing or electronically, that he or she has insufficient cash or other liquid assets to satisfy the financial need, and the employer does not have actual knowledge to the contrary

Treas. Reg. § 1.401(k)-1(d)(3)(iii)(C).

See Hardship and Unforeseeable Emergency Distribution Checklist for additional information on hardship distributions, including the changes made to the hardship distribution rules by the 2018 Budget Act and the Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97.

Plan Loans

Although not technically an in-service distribution, a defined contribution plan can permit plan loans that enable participants to access their account balances before terminating employment. Plan loans are paid from the participant's accounts, and must be repaid with interest. Plan loans that have not been repaid are deducted from the participant's accounts; there is no premature distribution penalty associated with plan loans. For a plan covered by ERISA, married participants must provide their spouse's consent to obtain plan loans.

If plan loans are permitted, the adoption agreement must specify the number, frequency, minimum and maximum amounts permitted, applicable interest rate and default provisions relating to plan loans. For information on plan loans see I.R.C. § 72(p)(2) and Plan Loan Rules for Qualified Retirement Plans

Other Administrative Provisions

Besides statutory and design options, the adoption agreement must specify how plan asset and trust or custodial account provisions will apply. These include:

- The date as of which earnings on contributions will be credited to a participant's account
- Whether the plan's forfeiture account will be subject to trust earnings
- Whether plan participants may make their own investment choices from a slate of investment alternatives that have been vetted by the plan trustees
- If the plan permits participant-elected investments, to which accounts a participant's investment control will apply
- Whether life insurance can be purchased as a form of benefit
- The extent to which the plan will accept rollover contributions from other plans (if at all) –and–
- How many trustees are required to take action on behalf of all trustees

Additional Documents Required to Implement a Pre-Approved Plan

Other documents required to generate a pre-approved plan may also require some additional information.

Trust Agreement

If plan assets are held in trust (as opposed to an annuity contract), separate trust agreement must set forth the trust provisions. The trust agreement or custodial account agreement must be in a document separate from the rest of the plan. The IRS will not rule on the exempt status of a pre-approved plan's related trust. The trust agreement enumerates ERISA's fiduciary requirements that apply to trustees' management of plan assets. "Named trustees" are generally employees of the adopting employer, who exercise some discretion in the administration of the plan. Most typical in pre-approved plans, named trustees select the plan investments that a participant can apply to his individual accounts. Conversely, some pre-approved plans require trustees to make all investment decisions for the plan's aggregated accounts. For additional information on trust requirements, see ERISA § 403 (29 U.S.C. § 1103).

In either case, the trust agreement must specify the names of the plan's trustees, and since circumstances (such as retirement) cause trustees to change, the trust agreement will require periodic amendment.

Summary Plan Description

In brief, the SPD describes the plan's benefits and participant rights in "plain English" intended to be understood by the average plan participant, including eligibility, contributions, vesting/forfeiture, distributions, where to get additional information about the plan.

Choices elected in the adoption agreement will also be captured in the system-generated SPD. However, additional plan policies may need to be completed to enable the document system to generate a complete (and ERISA compliant, in the case of an ERISA plan) SPD. Additional policies that would impact the SPD include the plan's:

- Loan policy (if the plan permits loans)
- Expense policy (denoting administrative expenses charged to participant accounts, such as to apply for a plan loan) –and–
- Insurance policy (describing how contribution accounts can be applied to life insurance premiums)

Detailed information about ERISA's requirements for SPDs is located at ERISA § 102 (29 U.S.C. § 1022); 29 C.F.R. § 2520.102-3. While non-ERISA plans are not subject to statutory or regulatory requirements for SPDs, they will nevertheless typically provide a plan summary to inform employees of the essential plan terms.

Corporate Resolution

The corporate resolution is the instrument with which the employer adopts the plan and approves the plan documents. The information required for the resolution is usually captured from the employer's general information that was entered into the adoption agreement.

However, some situations will require either unique or multiple resolutions. Besides allowing you to select certain routine resolutions (i.e., appointing and/or removing a plan trustee), the resolution module should allow you to draft unique resolutions that are not pre-programmed as a module option (such as allocating contributions to specified ineligible employees to correct cross-testing failures under Treas. Reg. § 1.401(a)(4)-11(g)).

Notices to Participants and Beneficiaries

Many plan provisions that can be elected by the employer also require special disclosures to plan participants. For example, SHNE and SHM contributions, as well as automatic deferral contributions, each require the administrator to provide annual notice to participants. Certain events, such as plan mergers, cause a transfer of investments between investment platforms and a "blackout period" during which participants cannot access their accounts or change their investments. The plan administrator must provide detailed blackout notices to participants and beneficiaries well before the blackout begins.

Some document systems generate such participant notices but only after you provide relevant event-specific

information. When the notice relates to plan features, the relevant information is captured from the adoption agreement. But when a notice relates to an event that isn't a plan feature - such as a plan merger - additional information is required to generate a compliant notice.

Obtaining IRS Opinion Letters

The IRS issues opinion letters on pre-approved plans. The opinion letter explains the:

- Scope of the IRS's pre-approval of the plan that is being used by the employer
- Body of law and certain assumptions that are basis for the pre-approval –and–
- Extent to which the adopting employer is protected by pre-approval of plan

The IRS announces the date by which employers must adopt pre-approved plans for each six-year cycle.

For instructions on how to apply for an opinion letter, see Pre-Approved Plan Submission Procedures. For a detailed discussion on determination letter applications (including information on how to apply), see Determination Letter Application Procedures.

If a mass submitter files on behalf of a flexible plan, it must bracket and identify the optional provisions when submitting such plan and must also provide the IRS a written representation describing the choices available to Providers and the coordination of optional provisions. Thus, such a representation must indicate whether a Provider's plan may contain only one of a certain group of optional provisions, may contain only a specific combination of provisions, or may exclude the provisions entirely. Similarly, if the inclusion (or deletion) of a specific optional provision in a Provider's plan will automatically result in the inclusion (or deletion) of any other optional provision, this must be set forth in the mass submitter's representation.

Adopting employers that have made minor modifications to the terms of a nonstandardized pre-approved plan may request a determination letter using Form 5307. In the case of a standardized plan, the same is true only if the amendments are solely to obtain reliance for §§ 415 and 416 given the required aggregation of plans. Adopting employers that have not made any changes to the terms of the pre-approved plan (except to select among options under the plan) should not submit Form 5307. These employers may rely on the opinion letter issued for the plan.

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Carol Calhoun has significant experience with employee benefits matters, including qualified retirement plans, health and welfare arrangements, executive compensation, and insurance and annuity products. Carol has significant experience with standard pension plans – both defined benefit and defined contribution; 401(k); the full array of government and nonprofit plans, including 403(b) and 457; excess benefit plans; cafeteria/flexible spending; and a wide variety of welfare plans (e.g., health, life, and disability).

Carol assists employers of all kinds with their benefit plans. She also represents boards of trustees of multiemployer and governmental plans, and agencies charged with administering employee benefit plans.

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