

Detail Item	Explanation	Importance
<p><b>Identifying “the employer”</b></p>	<p>The “employer” for plan purposes is not just the business entity that directly employs an employee, but also every other business entity that is in the same ”<b>controlled group</b>” with the entity that directly employs the employee.</p> <p>The typical types of controlled groups include; “<b>parent-subsidiary</b>” entities where one entity is 80% or more owned by another, “<b>brother-sister</b>” entities where 5 or fewer persons own 2 or more other entities and “<b>affiliated service groups</b>” and “<b>management function organizations</b>”, where service providing entities, particularly professional service providers, derive a significant percentage of their income and/or employee support functions from each other.</p> <p><i>Tax-exempt employers are also subject to these rules although “board control” is substituted for “ownership”.</i></p>	<ul style="list-style-type: none"> <li>• Tax-qualified plans have to satisfy “<b>coverage</b>” and “<b>nondiscrimination</b>” tests. These tests compare the participation and benefits of “highly compensated employees” (employees earning over \$110,000 for 2011 HCEs) to the participation and benefits of “non-highly compensated employees” (NHCEs). In performing these tests <b>all</b> of the employees of <b>all</b> controlled group employers are must be taken into account. The purpose of this rule is to ensure that any plan maintained by any employer in the controlled group hasn’t been set up merely to benefit the controlled group’s HCEs.</li> <li>• Plans often require that an employee have a minimum period of employment with the employer to enter the employer’s plan and/or “vest” in the plan benefit after entry. Periods of employment with <b>all</b> controlled group employers count in determining an employee’s initial plan eligibility and future vesting.</li> <li>• Plans often have “break-in-service” rules that result in forfeiture of non-vested benefits if a terminated employee has a 5-year break-in-service period following termination of employment. The former employee’s rehire within the 5-year period with <b>any</b> controlled group member employer negates the potential forfeiture and the individual’s new period of employment with the new employer will count in increasing his/her vesting in the pre-termination benefit. In addition, the prior period of employment will count for eligibility and vesting with the new employer</li> </ul>

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<p><b>Identifying “the employee”</b></p>	<p>Individuals performing “employee type” services for an employer may need to be taken into account when the employer’s plan is tested for coverage and nondiscrimination.</p>	<ul style="list-style-type: none"> <li>• Employers often “lease” the services of individuals to do work that are in support of the employer’s business, but are the common-law employees of another employer (or who treat themselves as “self-employed”). Employers leasing these individuals will need to take these <b>“leased employees”</b> into account after a year of “full-time” service” in showing that the employer’s plan satisfies coverage and nondiscrimination tests.</li> <li>• In addition, the period of service performed by these individuals may need to be taken into account as plan eligibility and vesting service if they ever transition to common-law employment with the employer that had previously leased their services.</li> </ul>

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<p><b>Leaves of absence and periods of employment in determining “breaks-in-service”, plan eligibility and vesting</b></p>	<p>An employee’s absence from employment may need to be treated as a period of employment for plan purposes, regardless of whether the absence qualifies as an approved leave.</p>	<ul style="list-style-type: none"> <li>•The 5-year break-in-service period (mentioned previously) of any employee who is absent from work on account of the pregnancy, birth or adoption of a child must be delayed a year following the employee’s absence. In effect, such an employee or former employee must incur a 6-year break-in-service before any forfeiture of a non-vested benefit can occur.</li>   <li>• The period of absence of an employee in the military who has reemployment rights under <b>USERRA</b> must be credited as actual service under the plan’s eligibility and vesting rules if the individual is reemployed within the applicable reemployment period. In addition, the employee must be provided the <b>same</b> employer contribution or benefit accrual he/she would have received, based on his/her pre-leave pay, for the period of absence. Finally, the employee must be given the opportunity to make employee contributions missed during the period of absence.</li>   <li>• An employee who terminates and is reemployed within 12 months of the prior termination date must be given service credit for the period of absence under the “elapsed time” method of counting eligibility and vesting service upon reemployment.</li> </ul>

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<p><b>“W-2 Pay” vs. “Plan-Eligible Compensation”</b></p>	<p>An employer’s plan will contain a definition of the pay that is to be used in determining the employee’s ability to contribute to the plan or receive employer contributions and/or benefits. In addition, the IRS’ tax rules limit the type and amount of pay that can be considered as plan-eligible pay.</p> <p>Contributions made and benefits accrued under the plan must be based on the plan’s eligible pay definition and the IRS’ rules governing the type and amount of pay that can be considered.</p>	<p>Errors in recognizing and calculating plan-eligible pay are common. Typical errors include:</p> <ul style="list-style-type: none"> <li>• Severance pay is pay triggered merely on account of an individual’s termination of employment. (Unused vacation and sick pay and an employee’s last paycheck are not severance pay since these amounts would have been paid in any event.) 401(k) and 403(b) deferrals <b>cannot</b> be made on severance pay under IRS rules. The IRS’ position is that only pay received as an employee can be deferred. Severance is paid after employment is terminated. In addition, severance pay cannot be counted in determining plan contribution and benefit limits. As a result, it is rarely included in the plan’s definition of plan-eligible pay for employer contribution and/or benefits purposes.</li> <li>• Many plans define eligible pay in a general way as total W-2 pay up to the IRS limit on pay (\$245,000 for 2011). As a result, items of pay such as spot bonuses, commissions, taxable expense reimbursements and non-cash compensation can be overlooked.</li> <li>• Some employers pay employees on military leave <b>“differential pay”</b>, which is some or all of the difference between what the employee on leave is being paid by the military and what he/she had been earning with the employer. This pay <b>must</b> be counted for contribution and benefit limits and <b>can</b> be counted as plan eligible pay for voluntary 401(k) and 403(b) deferral purposes.</li> </ul>