

# PLAN TERMINOLOGY DEFINITIONS

Provided to you by **ERISA Consultants**

The following explanations are intended to provide a *general* understanding of the more common terminology associated with qualified plans. Formal, technical definitions must be obtained from the plan document and/or government regulations.

**1099-R** Refers to IRS Form 1099-R. Retirement plans file this form to report payments made to Plan participants to the IRS and state tax authorities.

**401(k)** The Internal Revenue Code subsection allowing an arrangement where employees can defer income by making pretax contributions to certain qualified plans.

**401(k) Plan** A retirement savings plan that allows employees of for-profit corporations and non-profit organizations to reserve money for retirement on a pre-tax basis through a plan sponsored by their employer. The Federal government has created special tax advantages for contributions made into 401(k) plans, including, but not limited to, allowing contributions deducted directly from employee pay before taxes are calculated and allowing the earnings on funds in the employee's 401(k) account to grow tax-deferred until withdrawn at retirement.

**401(m)** The Internal Revenue Code subsection governing matching contributions in a 401(k) plan.

**403(b) Plan** A tax-deferred retirement plan offered by nonprofit organizations, public schools, and municipal agencies. Generally, 403(b) plans follow 401(k) rules for contributions, rollovers, and withdrawals. Employees contribute to the plan via payroll deduction. Income taxes are deferred on the contributions and any plan earnings until the employee withdraws the funds. Withdrawals may begin without penalty at age 59 ½, however become mandatory after age 70 ½. Investment choices in 403(b) plans are typically more limited than 401(k) plans.

**410(b) Test** A coverage test specified in section 410(b) of the Code that is designed to ensure that qualified plans benefit a sufficient number of non-highly compensated employees.

**5% Owner** Any employee who directly or indirectly owns more than 5% of the stock in the corporation, or more than 5% of the capital or profit interest if the employer is not a corporation.

**5500** A form used to report information concerning employee benefit plans, including 401(k) retirement plans, to the Internal Revenue Service, Department Of Labor and the Social Security Administration. This form must be completed and filed annually.

**Account Balance** Amount of money held in a qualified retirement plan on behalf of an employee participating in the plan.

**ACP Test** The Actual Contribution Percentage test; a non-discrimination test applied to employer matching and employee (after-tax) contributions.

**ADP Test** The Actual Deferral Percentage test, a special test that limits the extent to which elective contributions to a 401(k) plan made by highly compensated employees can exceed elective contributions made by non-highly compensated employees.

**Affiliated Service Group** A group of employers, having some common ownership, which provide services to each other or to third parties, and which, under rules provided in IRC Section 414(m), must be treated as a single employer for qualified retirement plan purposes.

**After Tax Contributions** Although many plans do not offer this option, this is an amount or percentage of pay an employee elects to contribute from pay, after taxes are calculated and withheld. Also known as "voluntary" contributions.

**Age Weighted Plans** Age weighted plans are profit sharing plans in which plan contributions are allocated in proportion to some multiple of compensation and age or years of service. The result is that a lesser amount is contributed to young employees and larger contributions are made to older employees with higher salaries (presumably including the owner).

**Alternate Payee** A spouse, former spouse, child, or other dependent of a participant who is recognized by a Qualified Domestic Relations Order as having a right to receive all or a portion of the benefits for a participant payable under the plan.

**Annual Additions Limitation** Refers to the IRC Section 415(c) limitation. It's a term used in connection with the limits on allocations of employee and employer contributions, as well as forfeitures, to a participant's account in a defined contribution plan. The limitation on the amount of contributions to a plan participant's account is the lesser of \$44,000 (in 2006) or 100% of the plan participant's compensation, as indexed. Includes all employee contributions, both pre-tax and after-tax, employer contributions and any forfeitures reallocated to a plan participant's account during the applicable limitation year.

**Annual Report** As prescribed by the Department of Labor, A document that must be filed annually to report pension plan information for a particular year, including such items as participation, funding, and administration. Form 5500 is utilized for this purpose

**Automatic Enrollment** The practice of enrolling all eligible employees in a plan and beginning participant deferrals without requiring the employees to submit a request to participate. Plan design specifies how these automatic deferrals will be invested. Employees who do not want to make deferrals to the plan must actively file a request to be excluded from the plan. Participants can generally change the amount of pay that is deferred and how it is invested.

**Beneficiary** A person, persons or trust designated to receive the plan benefits of a participant in the event of the participant's death.

**Cash or Deferred Election** A participant request to defer compensation, on a pre-tax basis, to a CODA plan under Internal Revenue Code Section 401(k).

**Compensation** As defined in the plan document, this usually includes salary, commissions, bonuses, and overtime paid to the plan participant during the plan year. For the self employed, annual

compensation means earned income as defined by the plan in the plan's Basic Plan Document. The amount of annual compensation that can be considered by the plan on an annual basis is limited by the IRS - this limit is \$220,000 for 2006.

**Conduit IRA** An IRA used to temporarily hold a rollover from an employer's qualified retirement plan and eventually transferred to a qualified plan of another employer.

**Contributions** 401(k) plans typically accept contributions from four "sources":

- Elective Deferrals (also called "401(k) deferrals" or "salary reduction")
- Employer matching contributions (contingent on the employee contributing)
- Employer profit sharing (made for eligible employees whether they contribute or not)

**Controlled Group** A group of two or more employers with sufficient common ownership under IRC Section 1563 to require treatment as a single employer for certain qualified retirement plan requirements and limits.

**Corrective Distributions** A distribution made to correct IRC Section 415 excess, an excess contribution under IRC Section 401(k), an excess aggregate contribution under IRC Section 401(m), or an excess deferral under IRC Section 402(g).

**Defined Contribution Plan** Retirement plans that make a defined amount of contribution to the accounts of plan participants. They do not guarantee a specific retirement benefit. Instead, the participant is simply entitled to their account balance.

**Defined Benefit Plan** Retirement plans that guarantee a specific retirement benefit.

**Department of Labor (DOL)** A U.S. Government agency which, as part of its charter, has the authority and responsibility to interpret, regulate, and enforce compliance with the provisions of ERISA.

**Determination Letter** A document issued by the IRS regarding the qualified status of a retirement plan. If a retirement plan is qualified, monies invested in the plan remain tax-deferred until they are distributed. A determination letter may be issued on the plan's initial qualification when the plan is first established, or when the plan is amended or terminated

**Disclosure** Plan sponsors must provide plan participants to access to certain types of information, including the summary plan descriptions, summary of material modifications, and summary annual reports.

**Discretionary Contribution** See "Non-Elective Contribution".

**Distribution** Payment made from the plan to a participant or participant's beneficiary - normally after the participant has separated from service. Most distributions are eligible for rollover to another tax deferred retirement plan.

**Elective Deferral** A contribution made to a 401(k) plan by the employer on behalf of an employee, pursuant to that employee's cash-or-deferred election.

**Eligibility** Eligibility rules can be established by the employer sponsoring the Plan. A minimum age requirement can be set provided that it is no higher than age 21. A minimum waiting period can be set provided that it is no more than 1 Year of Service for elective deferrals and no more than 2 years for employer contributions. If "1 Year of Service" is chosen, then an employee must work (or be paid for) a minimum of 1,000 hours of service in the one year period beginning on his or her date of hire. If a waiting period of less than 1 Year is chosen then no minimum number of hours of service may be required. Thus part-time employees will join the Plan after the waiting period regardless of the number of hours worked.

**Eligible Employee** See "Participant".

**Employee Benefits Security Agency (EBSA)** Formerly known as the PWBA This branch of the Department of Labor protects the pensions, health plans, and other employee benefits of American workers. The EBSA enforces Title I of ERISA, which contains rules for reporting and disclosure, vesting, participation, funding, and fiduciary conduct.

**Employee Retirement Income Security Act of 1974 (ERISA)** A major Congressional act which, when enacted in 1974, completely overhauled federal laws pertaining to qualified retirement plans. ERISA established rules for participation, vesting, funding, handling assets, disclosure, and reporting.

**Entry Date** The official date on which an eligible employee enters his/her employer's retirement plan following satisfaction of any eligibility requirements.

**Excess Aggregate Contributions** The aggregate amount of employee after tax contributions and matching contributions made on behalf of highly compensated employees for a plan year which are in excess of the maximum amount of such contributions permitted under the ACP test.

**Excess "Annual Additions"** The amount of contributions and/or forfeitures, made on behalf of a participant, for a limitation year in excess of the maximum amount of such contributions and/or forfeitures permitted under IRC Section 415.

**Excess Contributions** The amount of the elective contributions, made to a 401(k) plan on behalf of highly compensated employees, for the plan year in excess of the maximum amount of such contributions permitted under the ADP test.

**Excess Deferrals** An employee's elective contributions for the taxable year in excess of an the annual adjusted dollar limit set forth in IRC Section 402(g).

**Fidelity Bond** Protects participants in the event a fiduciary or other responsible person steals or mishandles plan assets. Required by the Department of Labor for any plan covering employees who are not owners or the spouse of an owner.

**Fiduciary** Generally, a fiduciary is a person who exercises discretionary control over the assets of another party and has a responsibility to that party. The ERISA statute sets forth strict standards which govern the responsibilities of a fiduciary and the determination of who is a fiduciary.

**Forfeitures** Any part of benefits that a participant loses if he or she is not 100% vested upon termination of employment. Forfeitures relate only to employer contributions. Pre-tax, after-tax, and rollover contributions that the employee makes are 100% vested at all times. Such forfeitures may be used by the plan to reduce future plan contributions, offset administrative expenses or reallocated among the remaining participants in the retirement plan, depending on the plan provisions.

**Hardship Withdrawal** If allowed by the plan, participants may request a withdrawal from their retirement plan account, their elective deferral contributions and/or their employer non-elective contribution, to address a "hardship". For a withdrawal to qualify as a "hardship", it must satisfy a two-part test: #1- the withdrawal must be requested due to the participant's immediate and heavy financial need; and #2- the withdrawal must be necessary to satisfy such need. Reasons for hardship withdrawals can include: (i) - coverage of uninsured medical expenses for the participant, a spouse or eligible dependents; (ii) - purchase of a primary residence; (iii) - payment of post-secondary tuition costs for the participant, a spouse or eligible dependents; (iv) - payments necessary to avoid foreclosure or eviction from the participant's principal residence. The plan sponsor is responsible for determining whether a certain situation constitutes an emergency.

**Highly Compensated Employee (HCE)** Generally, any employee who during the current or preceding year owned more than 5% of the company or who earned compensation in excess of an annually adjusted dollar threshold in the prior year (\$95,000 for 2005).

**Independent Audit** Federal law requires that all plans with more than 100 participants be audited by an independent auditor. It is also common to refer to a DOL or IRS examination of a plan as a plan audit.

**Integration** A non-elective allocation formula that allows for a higher allocation of the contribution to those employees being discriminated against by some other employer or government sponsored retirement plan such as social security. These plans favor more highly compensated employees, particularly those that earn in excess of the maximum SSI taxable wage base (i.e. \$94,200 in 2006). This may also be referred to as permitted disparity.

**Internal Revenue Service (IRS)** This branch of the U.S. Treasury Department is responsible for administering the requirements of qualified pension plans and other retirement vehicles.

**Involuntary Cash-Out** The distribution of assets from a qualified plan to a participant prior to retirement, typically occurring when a participant has a balance under \$5,000 and leaves a company without requesting to have their assets rolled over into an IRA or into a new employer's plan. Cash-outs are subject to federal withholding tax, and are subject to the 10% early withdrawal penalty if not rolled over.

**Key Employee** As defined by the IRS, employees who meet certain compensation, ownership and authority criteria. This determination of key and non-key employees is necessary when performing top-heavy tests.

**Loans to Participants** If permitted by the plan document, participants may borrow up to one-half of their vested account balance (\$50,000 maximum). Repayment is made through payroll deduction and the loan is typically amortized over a five-year period. The interest rate is usually the prime rate

plus 2% and both principal and interest are credited to the participant's account. The loan repayments are made with after-tax dollars.

**Matching Contribution** An employer contribution made to a qualified retirement plan that is given to participants who make elective deferrals. The type and amount of employer matching contributions can vary but it is typically equal to a percentage of the amount contributed by the participant (i.e. 50% of the first 6% deferred).

**New Comparability** A non-elective allocation formula in which a uniform percentage of contribution can be offered to "groups" of participants. The groups can be arranged in various ways as long as the required discrimination testing is met. Disparity in age and compensation levels is helpful, but not required, for this formula to work. A typical example of allocation groups might be "Shareholders" and "Non-share- holders," but more groups may be designated. An important rule for this plan design is that the lowest amount that can be contributed to a non-owner group is the lesser of one-third of the highest group's percent- age, or 5 percent. In some cases, the owners may be eligible for 20 percent and the employees 5 percent.

**Normal Retirement Age** Specified in the plan document, the normal retirement age (usually age 65) means the age at which time a participant shall become fully vested in his or her account.

**Non-Elective Contribution** An annual discretionary contribution made by the employer after an employee satisfies the plan's eligibility requirements. This "profit sharing" amount is determined at plan year-end. These contributions will be generally allocated in the ratio that a participant's eligible compensation bears to the total compensation paid to all eligible participants for the plan year. However, employer can design their plan to have this contribution allocated based on integration with Social Security, on an age-weighted based or in conjunction with a new comparability formula.

**Participants** Employees who have met the criteria for participation in the 401(k) plan (age and service requirements as well as any classification requirements). An employee who has met the eligibility requirements is considered a participant regardless of whether or not they choose to make elective deferrals to the plan.

**Participant Directed Account** An account which allows for participants to choose investment options. A plan may allow participants to select the investment options on their entire account balance or just on certain money types (i.e. their own elective deferrals).

**Party in Interest** A fiduciary, provider of services, participant, plan sponsor, beneficiary, or some other party with a relationship to the plan. Parties in Interest are prohibited from entering into certain transactions with the plan.

**Plan Administrator** The individual, group or corporation named in the plan document as responsible for day to day operations. The plan sponsor is generally the plan administrator if no other entity is named.

**Plan Sponsor** The entity responsible for establishing and maintaining the plan.

**Profit Sharing Contribution** See "Non-elective" contribution.

**Qualified Domestic Relations Order (QDRO)** A judgement, decree, or order made pursuant to a state domestic relations law. Relates to the child support, alimony payments, or marital property rights of an alternate payee.

**Qualified Joint & Survivor Annuity** An annuity paid for the life of a participant, with a survivor annuity for his or her spouse. The survivor annuity must be at least 50 percent, but not more than 100 percent, of the annuity received by the participant during his or her lifetime. This form of distribution must be offered in money purchase, target benefit and defined benefit plans.

**Qualified Plan** Any plan that qualifies for favorable tax treatment by meeting the requirements of section 401(a) of the Internal Revenue Code and by following applicable regulations. Includes 401(k) and deferred profit sharing plans.

**Rollover** Funds transferred into the plan by employees from their previous employer's Plan or an IRA.

**Salary Deferrals** See "Elective Deferral".

**Salary Reduction** See "Elective Deferral".

**Summary Plan Description (SPD)** A document describing the features of a employer-sponsored plan. The primary purpose of the SPD is to disclose the features of the plan to current and potential plan participants. ERISA requires that certain information be contained in the SPD, including participant rights under ERISA, claims procedures and funding arrangements.

**Trustee** The individual, bank or trust company having fiduciary responsibility for holding plan assets and the transactions involving plan assets.

**Vesting** The process by which a plan participants earns the right to keep his or her employer-financed accounts upon termination of employment. Note that the employees own contributions are always 100% vested - vesting schedules only apply to employer derived funds. Each plan has a vesting schedule that defines the percentage of the account that the participant keeps. The remainder is forfeited by the participant and reverts back to the Plan (not the employer). For example, if the vesting schedule on the employer match is "20% per year of service," an employee who quits after three years of service will keep 100% of his or her own contributions (plus investment gains or losses) but only 60% of the employer matching account.

**Year of Service** A 12-month period during which an employee is credited with at least 1,000 hours of service.