5 THINGS TO KNOW ABOUT MANAGING A 401(K) FOR EMPLOYEES ON A LEAVE OF ABSENCE

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When an employee takes a leave of absence, it's important to understand their rights when it comes to their 401(k). This is especially true if an employee is on military leave, because the rules are quite different.

From handling of 401(k) loan payments to allowing the employee to make missed contributions, there are a lot of places that employers can make a mistake, so it's best to understand the rules!

Loan Suspension & Repayment | In a situation of a non-military leave of absence, 401(k) loan payments may be suspended for up to one year. This means that even if the participant takes a two year leave, they can only suspend their loan payments for one. And when they return, they will need to play catch up by making a lump sum payment or by re-amortizing to the original payoff date.

For a plan participant on military leave, however, loan payments can be suspended for the entire time the employee is on leave. Further, when a participant on military leave returns, they have until their original payoff date PLUS the length of time they were on leave to pay back the loan.

Some Examples:

| Example No. 1

- *A non-military employee takes out a 5 year loan with a payoff date of September 30, 2022.*
- *The employee then goes on 1 year of leave.*
- *The employee is allowed to suspend payments for the year they are on leave, but the loan must still be paid back by September 30, 2022.*
- *If this employee went on military leave for 1 year, then they would have until September 30, 2023 to repay the loan.*

| Example No. 2

- *A non-military employee takes out a 5 year loan with a payoff date of September 30, 2022.*
- *The employee then goes on 2 years of leave.*
- *The employee is allowed to suspend payments for the first year they are on leave, but then they must resume making payments.*
- *The loan must still be paid back by September 30, 2022.*
- *If this employee went on military leave for 2 years, however, they would be able to suspend payments for the entire 2 years of leave and have until September 30, 2024 to repay the loan.*

Military Plan Participants Could See a Reduced Interest Rate on 401(k) Loans | The Service Members Civil Relief Act of 2003 sets forth conditions for which a plan participant on military leave might expect a reduced interest rate on a 401(k) loan:

- The employee on military leave is on Active Duty.
- The employee on military leave is called to service for more than 30 consecutive days.

If the participant meets these conditions, the interest rate on the loan is capped at 6% for the entire period of military service. However, this relief only applies to 401(k) loans incurred before military service. Additional loans taken after the employee enters military service might not be eligible for interest rate relief.

Employer Contributions to the 401(k) May Include Differential Wages for Military Leave | When managing a plan, it's important to consider whether Differential Wages are included when considering contributions. Differential Wages are payments made by the employer to a participant during the participant's active military service. These wages represent all or a portion of the wages the participant would have received if they were performing services for the employer.

If a plan document calls for employer contributions on differential wages, it's important to make sure appropriate contributions are made to the plan participant's 401(k). Plan sponsors should double check plan documents to understand the terms when an employee goes on military leave.

Participants Returning from Active Duty Have the Right to Make Missed Contributions | It might be difficult for employees on military leave to make contributions to a 401(k) while they are serving the country. As a result, the Uniform Services Employment and Reemployment Rights Act of 1994 (USERRA) requires employers to allow plan participants to make missed contributions when they return from active duty.

Employers should take care to follow proper protocol when an employee returns from military service. Some of the administrative requirements include:

- Notify the participant of a right to make up missed contributions.
- Let the participant know about the time period for making missed contributions. Employees returning from military leave have three times the participant's qualified military service, but no longer than five years from re-employment. So, if an employee was on leave for 1.5 years, they have 4.5 years to make up their contributions.
- Plans involving matching contributions must be honored. An employer must make matching contributions when returning employees make their own make-up contributions.
- Catch-up contributions are included as well for employees returning from military leave.
- Missed deferrals and match contributions made under USERRA regulations are not included in the current ADP/ACP Testing.

What About Other Types of Defined Contribution Plans? | In addition to these requirements, employers need to be aware that there are regulations surrounding defined contribution plans that don't require employee contributions, such as profit sharing plans and money purchase plans. When an employee returns from military leave, the employer is required to make the contributions that would have been made on the employee's behalf had they been providing services to the employer during the period of military service. Employers must make these contributions within 90 days of the date of re-employment or when contributions are normally due for the year in which the military service was performed, whichever is later.

Staying on top of requirements when an employee is on leave is a vital part of managing benefits. Ask your advisor or plan administrator if you have any questions about how to handle a specific leave situation.

For more information, please call **407.585.1160**

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