# Coverage Test

Test Required to Ensure Employees are Being Included in the Plan

## What is the Coverage Test?

Qualified retirement plans were created by Congress as a system to help U.S. workers save for retirement. Special tax incentives are provided to encourage employers to adopt plans, promote savings, and make contributions.

All qualified retirement plans are required to pass the annual Coverage Test to demonstrate that a minimum number of employees are benefiting from the plan. A plan can pass the Coverage Test using one of two methods: (1) the Ratio Percentage Test or (2) the Average Benefits Test.

## What is the Ratio Percentage Test?

The Ratio Percentage Test is the most common and simplest method used to pass Coverage Testing. A plan passes the Ratio Percentage Test if the ratio of Non-Highly Compensated Employees (NHCEs) to Highly Compensated Employees (HCEs) that are benefitting under the plan is at least 70%. A separate test must be calculated for each source of money provided for under the plan, including Employee Salary Deferrals, Employer Match, and other Employer Contributions.

## What is the Average Benefits Test?

If a plan fails the Ratio Percentage Test, it may still pass Coverage Testing by passing the Average Benefits Test. The Average Benefits Test requires a more complicated calculation of the rate in which employees benefit under the plan and has two parts. The details of these calculations are complex and beyond the scope of this document.

## About Safe Harbor Plan Designs

Many plans are designed to automatically pass the Coverage Test. These plans must allow participation in employee and employer contributions by employees that meet minimum eligibility requirements:

- **Length of Service** – Employees that have been employed one year or more.
- **Minimum Age** – Employees that have attained age 21.
- **Class Exclusions** – Employers are allowed to exclude certain employee groups, including Union Employees and Non-Resident Aliens and still automatically pass Coverage Testing.

## Why Might a Plan Fail Coverage Testing?

Below are common reasons a plan may fail coverage testing:

- **Class Exclusions** – Plans may exclude classes of employees, including certain divisions, or other companies that are part of a Controlled Group. These exclusions can cause the plan to fail the Coverage Test depending on the ratio of NHCEs to HCEs excluded in a given year.
- **Contribution Accrual Requirements** – Some plans include requirements that participants must meet to receive employer contributions each year. Conditions can include a minimum number of hours worked or a requirement that an employee be employed on the last day of the plan year. These conditions might cause a plan to fail Coverage Testing.

## How is a failed test corrected?

Plans that fail Coverage Testing must remedy the failed test by benefiting a larger ratio of NHCEs to HCEs or by having the NHCEs benefit at a higher rate. This generally means including additional employees in employer contributions for the year in question.

When a plan includes additional employees in the contribution allocation to pass a failed Coverage Test, it must adopt a plan amendment called a Corrective 11(g) Amendment within 9 ½ months after plan year end. If the Coverage Test is not corrected within 9 ½ months of year-end, the plan is required to file through the Voluntary Correction Program to correct the failed test.

Please contact JULY at 888.333.5859 for more information.