PRIMARK BENEFITS

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A Very Quick Introduction to 401(k) Plans

A 401(k) plan is an employer sponsored pension plan in which the primary contributions are made at the election of the employees in the form of a salary deferral. The deferred salary is not subject to current Federal or State income tax.

Types of Contributions to 401(k) Plans

In addition to elective contributions (salary deferrals), a 401(k) plan may include matching contributions, discretionary contributions, or safe harbor contributions.

Elective Contributions / 401(k) Salary Deferrals

An elective contribution, commonly called a salary deferral, occurs when an employee elects to have the employer contribute a portion of his or her salary, bonus, commissions, or other taxable compensation to the plan. The employee must elect to defer before the amount is paid or otherwise becomes currently available to the employee. Elective contributions may be subject to discrimination testing under the average deferral percentage (ADP) test. Elective contributions are 100 percent vested and are subject to the limitations on distributions.

Matching Contributions

A matching contribution is an employer contribution that is allocated on the basis of the employee's elective contribution. A matching contribution may be either mandatory or discretionary. Matching contributions may be made on an ongoing basis, as deferrals are paid to a trust, or after the end of the plan year. Matching contributions may be subject to discrimination testing under the average contribution percentage (ACP) test.

Discretionary Contributions / Profit Sharing

A discretionary contribution, sometimes referred to as a profit sharing or non-elective contribution, in a 401(k) plan is an employer contribution that is allocated on the basis of compensation. An employee's right to receive an allocation of a discretionary contribution cannot depend on whether he or she has made elective contributions.

Example. Emily earns $35,000 and elects to contribute 10 percent of her compensation for the year. Emily's employer provides a matching contribution of 25 percent of the deferral amount and a discretionary contribution of 5 percent. Emily's total allocation for the year is as follows:

Elective contribution(35K x 10%)	$3,500
Matching contribution (3.5K x 25%)	$875
Discretionary contribution (35K x 5%)	$1,750
Total contribution	$6,125

Safe Harbor Contributions

An employer may choose to make a Safe Harbor Contribution in lieu of passing the ADP test. A Safe Harbor Contribution is a commitment on the part of the employer to make a 100% vested contribution for all employees who are eligible to make elective contributions (salary deferrals). The employer must announce the intention to make Safe Harbor contributions at least 30 days prior to the start of the plan year.

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Why Primark Benefits

- ♦ **EXPERIENCE: We've been in business since 1971**
- ♦ **EXPERTISE: Our credentialed staff are experts and leaders in the field**
- ♦ **ACCURACY: We have rigorous quality control and a compliance dept**
- ♦ **ATTENTION: Your satisfaction is our priority**

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A Very Quick Introduction To 401(k) Plans (cont'd)

The employer may choose one of the following Safe Harbor Contribution formulas:

- A guaranteed contribution of 3% of employee compensation, whether or not employees make elective contributions, or
- A dollar-for-dollar matching contribution, up to 4% of employee compensation, for employees who make elective contributions to the plan, or
- A dollar-for-dollar matching contribution up to 3% of employee compensation and a 50¢ on the dollar matching contribution for elective above 3% up to 5%, for employees who make the elective contributions to the plan.

Contribution Limitations

Annual Dollar Limitation
The maximum annual dollar amount that any employee may contribute to any 401(k) plan is $19,500 in 2021. This calendar limit is adjusted annually. This limitation applies to all 401(k), 403(b), and SIMPLE Plans to which one employee may belong during a single calendar year. In addition, plan participants who are age 50 or older may be able to make "Catch-up Contributions". The allowable Catch-up Contribution is $6,500 in 2021.

Overall Contribution Limitation
All 401(k) plans are profit sharing plans. Profit sharing plans have a deductibility limit for employer contributions of 25% of eligible compensation. Employer Contributions include Matching, Discretionary (Profit Sharing), and Safe Harbor contributions. Salary deferral contributions made by the employee are not part of the 25% limit.
The annual allocation limit for each individual employee, which includes the non catch-up salary deferral and all contributions and forfeitures allocated during the plan year, is the lesser of 100% of compensation or $58,000 in 2021. For example, $19,500 401(k) salary deferral plus $38,500 Discretionary contribution = $58,000; this meets the $58,000 limit in 2021. This employee (if age 50 or over) could also defer an additional $6,500 – for a total of $64,500.

FICA and FUTA

Although elective contributions (salary deferrals) are not subject to Federal or State income tax, they are still subject to FICA (Social Security), FUTA, and other employment taxes. However, matching, discretionary, and safe harbor contributions are not subject to FICA, FUTA or other employment taxes or any current Federal or State income tax.

Eligibility

An employer may choose to have no eligibility requirements (employee is eligible on date of hire), may require a certain number of months of employment, or may require up to one year of employment.

Upon completion of the eligibility requirement, the employee enters the plan on the next entry date. The Plan may have daily, monthly, quarterly, or semi-annual entry dates.

The maximum eligibility requirements for 401(k) plans is age 21 and completion of a year of service. A year of service is defined as the completion of 1000 hours during a twelve consecutive month period commencing on the employee's date of employment. If one year of service is required for eligibility, there must be at least two entry dates per plan year.

ADP TESTING

In 401(k) plans that do not elect the previously discussed safe harbor, the salary deferrals made by the group of employees who are "Highly Compensated Employees" (HCEs) cannot exceed a limit which is based on the salary deferrals of the "Non-Highly Compensated Employees" (NHCEs).

HCEs are employees who own more than 5% of the sponsoring employer and certain family members of a more than 5% owner, and employees who earned compensation of more than $130,000 in the prior year (if the prior year was 2020). The compensation limit may be adjusted annually.

The general rule is that the average deferral percentage (ADP) of the HCEs can only exceed the ADP of the NHCEs by two percentage points (2.00%). An employee's deferral percentage is calculated as his deferral divided by his total compensation. The group's ADP is calculated by averaging the deferrals percentages of all employees in the group..

	Compensation	Salary Deferral	Deferral Percentage	Average Deferral Percentage
HCEs				
Employee 1	$200,000	$10,000	5.00%	
Employee 2	$120,000	$9,600	8.00%	6.50%
NHCEs				
Employee 3	$60,000	$6,000	10.00%	
Employee 4	$60,000	$4,800	8.00%	
Employee 5	$45,000	$1,800	4.00%	
Employee 6	$40,000	$0	0.00%	
Employee 7	$38,000	$1,444	3.80%	
Employee 8	$25,000	$0	0.00%	4.30%

Allowable for the HCEs	6.30%
Excess for the HCEs	0.20%

In the example, the average deferral percentage (ADP) of the HCEs exceeded the allowable ADP by 0.20%. This would result in a failed ADP Test. This employer would be able to "fix" this failed test by one of two methods: a) returning enough of the salary deferrals plus earnings to the HCEs to make the test pass, or b) making a 100% vested booster contribution (called a QNEC) to the NHCEs.

Please note that eligible employees who choose to defer nothing are counted as a zero in the average deferral calculation; they must be included in the average.

Employers who make Safe Harbor Contributions may skip the ADP test altogether.

In most cases, restricting participation to employees who have one year of service will generally eliminate employees who are least likely to participate in a 401(k) Plan and thus will increase the amounts that HCEs may contribute to the plan. On the other hand, if the employees are highly motivated and will begin deferrals as soon as possible, it may be advantageous to have more liberal eligibility requirements.

Advantages and Disadvantages of Offering 401(K) Plans

Advantages To The Employer

A 401(k) plan can be a low-cost means of providing visible and appreciated retirement benefits to employees. The plan offers employees a real opportunity to actively participate in saving for their retirement on a tax deferred basis. A sponsoring employer may use a 401(k) plan as its sole retirement plan or as a supplement to an existing plan.

The plan may also be used as a vehicle to attract and retain qualified employees. To the extent the plan has discretionary employer contributions, the plan can be used to reward employees during years when the employer has reached its profitability objective. A matching contribution may provide additional incentive for employee savings.

Disadvantages to the Employer

The 401(k) plan does have some disadvantages from an employer's perspective. The administration of the plan can be time consuming. Discrimination tests are required to make sure all employees are able to take advantage of the plan on a relatively equal basis. A 401(k) plan requires intensive communication throughout its life cycle. If the plan is not adequately communicated, its effectiveness as an employee benefit will be lost.

Certain employers may find that the demographics of their employee base preclude the adoption of a 401(k) plan. In certain industries, particularly those with high turnover or a significant number of lower-paid employees, the employees may prefer immediate cash payments to long-term savings. Since the success of a 401(k) plan is measured by the degree of participation of lower-paid employees, such a plan may have difficulty attracting significant participation.

Advantages to the Employee

From the employee's perspective, the 401(k) plan offers a unique opportunity to defer federal and state income taxes. The tax-sheltered aspects of the 401(k) plan make it an ideal vehicle for retirement savings. The 401(k) plan offers an employee a great deal of flexibility and choice: whether or not to defer, how much to defer, where to invest (if allowed by the plan), and when to change the deferral amount or investments. The optional availability of loans and hardship withdrawals means that invested funds can be used when personal financial circumstances change dramatically. The relative portability of a 401(k) funds allows an employee to change jobs without a significant loss in retirement benefits.

Disadvantages to the Employee

The employee may see some disadvantages in a 401(k) plan. Employees need to understand that the 401(k) plan is not a short-term capital accumulation vehicle, but rather a long-term savings vehicle. Withdrawal rules will restrict access to funds before retirement or termination of employment. If the plan allows an employee to make investment choices, the employee may make poor choices and thus undermine the value of retirement benefits.

Conclusion

The above rules can be tricky and Congress has a tendency to enact new legislation every few years. However, with the assistance of experienced and professional advisors, a 401(k) Plan can be a cost effective enhancement to any employee benefits package.