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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 401K 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. Traditionally, elective deferrals are Pre-Tax.

Roth Contributions

The employee may elect that his or her deferrals be treated as Roth contributions. Rather than having a current deduction (Pre-tax), the employee contributions are still taxable. However, distribution at retirement will be fully tax free. This could be a substantial benefit for employees who either a) are currently in a low tax bracket, or b) have a long time to save – because the majority of their final balance could be earnings that would never be taxed.

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, 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.

An 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

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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)

Plan Contribution Limitations

Annual Dollar Limitations

The maximum annual dollar amount that any employee may contribute to any 401(k) plan is $20,500 in 2022. 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, for a total contribution of $27,000 in 2022.

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 $61,000 in 2022. For example, $20,500 401(k) salary deferral plus $40,500 Discretionary contribution = $61,000. This meets the $61,000 limit in 2022. This employee (if age 50 or over) could also defer an additional $6,500 – for a total of $67,500.

FICA And FUCA

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. discretionary contribution of 5 percent. Emily's total allocation for the year is as follows:

YEAR	Maximum Compensation for pension purposes	Maximum 401(k) salary deferral	Maximum "catch-up" deferral (employee must be age 50 or more)	Annual Allocation limit (excluding Catch-up)	Annual Allocation limit including Catch-up	HCE look-back year compensation
2015	$265,000	$18,000	$6,000	$53,000	$59,000	$120,000
2016	$265,000	$18,000	$6,000	$53,000	$59,000	$120,000
2017	$270,000	$18,000	$6,000	$54,000	$50,000	$120,000
2018	$275,000	$18,500	$6,000	$55,000	$61,000	$120,000
2019	$280,000	$19,000	$6,000	$56,000	$62,000	$125,000
2020	$285,000	$19,500	$6,500	$57,000	$63,500	$130,000
2021	$290,000	$19,500	$6,500	$58,000	$64,500	$130,000
2022	$305,000	$20,500	$6,500	$61,000	$67,500	$135,000

ADP Testing

In 401(k) plans that do not elect safe harbor contributions (see the next section Safe Harbor Contributions), 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 2021). 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 deferral percentages of all employees in the group.

Example of ADP test calculation:

HCEs	Compensation	Salary Deferral	Deferral Percentage	Average Deferral Percentage
Employee 1	$305,000	$15,250	5.00%	
Employee 2	$150,000	$12,000	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) of 0.20% 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.

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 employees are highly motivated and begin deferrals as soon as possible, more liberal eligibility requirements may be advantageous.

Safe Harbor Contributions

Employers who are willing to make minimum "Safe Harbor" contributions may automatically pass the ADP Test, even if deferrals made by Non-Highly Compensated Employees are minimal (or none at all).

Basic Concept
Generally speaking, 401(k) plans must satisfy non-discrimination tests with regard to salary deferrals (actual deferral percentage tests – "ADP") and matching contributions (actual contribution percentage tests – "ACP"). These tests limit the amount of deferrals and matching contributions that can be made on behalf of employees considered to be highly compensated employees ("HCEs").

The limitation is based on the average deferrals and matching contributions made on behalf of the non-highly compensated employees ("NHCEs") and allows the HCEs a slightly higher percentage than the NHCEs. The definition of HCE is generally more than 5% owners and those who earn more than $130,000 in the prior plan year.

The safe harbor 401(k) plan allows an employer to automatically meet one or both of the non-discrimination tests if a contribution requirement and an employee notice requirement are met.

Contribution Requirement
The contribution requirement can be met in one of two ways – either by making a required matching contribution or a required non-elective contribution. Whichever is chosen, the required contribution must be made to all eligible NHCEs and cannot be restricted to those who work a certain minimum number of hours or are employed on the last day of the plan year. HCEs may, but are not required to, receive the contribution. The contribution must be deposited no later than 12 months after the close of the plan year.

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

Safe Harbor Matching Contribution

♦ Two Tier Formula: The safe harbor matching contribution provides that the employer match elective deferrals for all eligible NHCEs at a rate of 100% of the first 3% of compensation deferred and 50% of the next 2% of compensation deferred.

Deferral	2.0%	3.0%	4.0%	5.0%	6.0%
Match	2.0%	3.0%	3.5%	4.0%	4.0%

♦ OneTier Formula: Alternately, the employer may match elective deferrals for all eligible NHCEs at a rate of 100% of the first 4% of compensation deferred.

Deferral	2.0%	3.0%	4.0%	5.0%	6.0%
Match	2.0%	3.0%	4.0%	4.0%	4.0%

♦ Basic Match Under A QACA Safe Harbor 401(k) Plan: With a Qualified Automatic Contribution Arrangement Plan (auto-enrollment), there is a lesser Safe Harbor Match. It is 100% match on the first 1% of compensation deferred plus 50% match on the next 5% of compensation deferred. A participant who defers at least 6% of compensation will receive the maximum basic match of 3.5% of compensation.

Deferral	1.0%	2.0%	3.0%	4.0%	5.0%	6.0%
Match	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%

Safe Harbor Non-Elective Contribution

As an alternative to making a matching contribution, the ADP test can be satisfied by the employer making a non-elective contribution on behalf of each eligible NHCE of 3% of compensation. For this purpose, compensation can be limited to the period of time the employee was a participant in the plan. The contribution would have to be required by the terms of the plan.

Retroactive Safe Harbor 4% Non-Elective Contribution

As an additional alternative to making a matching contribution, the ADP test can be satisfied by the employer making a non-elective contribution on behalf of each eligible NHCE of 4% of compensation. This option is used by employers who miss the deadline date for implementing other forms of safe harbor contributions.

Vesting

Safe Harbor Matching contributions or non-elective contributions must be non-forfeitable (100% vested) at all times.

Plan Years

In order to utilize the safe harbor provisions, the plan year must be 12 months long, except in the case of the first plan year of a newly established plan. In that case, it must be at least three months long, although it can be shorter for a newly established employer.

If safe harbor contributions are made to another plan, the other plan must have the same plan year as the 401(k) plan.