



What if your client fails their 401(k) plan testing? – February 2019

The IRS requires that contributions or benefits provided under a plan must not discriminate in favor of Highly Compensated Employees (HCEs).

For the 2019 plan year an HCE is any individual who has more than 5% ownership in the current or prior plan year, including certain family members of owners, and employees with compensation of \$125,000 or more in the prior plan year.

Employee deferrals are subject to nondiscrimination testing. The average deferral percentage (ADP) test compares the ADP of HCEs to the ADP of non-HCEs. The difference between the percentages must fall within a certain threshold. Therefore, HCE contribution levels are contingent upon non-HCE employee contribution levels.

If a plan fails nondiscrimination testing, HCEs may be required to receive a refund of their excess deferrals (and pay taxes on the refund) in order for the test to pass. As an alternative, the employer may also deposit contributions for the non-HCEs to boost their percentage to a level where the test passes. These additional contributions are referred to as qualified nonelective contributions or QNECs. ADP testing for most calendar year plans is being completed now to avoid unnecessary excise taxes.

Helpful Hint:

There are 2 types of Safe Harbor contributions:

Do you have clients that fail their ADP testing? To avoid testing failure next year, consider adding a Safe Harbor contribution feature to your client's plan.

Safe Harbor Matching Contributions: The employer matches the amount deferred by employees up to a certain percentage of compensation (100% up to the first 3% of compensation deferred and 50% on the next 2% of compensation deferred). So, an employee who defers at least 5% of compensation will receive the maximum 4% contribution.

Safe Harbor Non-Elective Contributions: The employer contributes 3% of compensation for all employees, regardless of whether or not they elect to contribute to the plan.

Contact Dunbar, Bender & Zapf, Inc. to find out if adding safe harbor contributions to your client's plan is a viable option. For your clients not interested in adding employer contributions, ask us about automatic enrollment.