



Non-Discrimination Testing Descriptions

Qualified retirement plans are subject to certain IRS mandated tests each year called non-discrimination tests. The purpose of these tests is to ensure that the plan is set up for the benefit of all employees, not just the owners and highly compensated employees (HCEs). The Top-Heavy Test and ADP/ACP test often cause the biggest problems for employers, however all tests that are run annually must pass to remain compliant.

Below are some ERISA definitions that may help better understand how the testing works:

KEY EMPLOYEE

Key employees are defined as:

- (a) Officers with annual salary greater than \$215,000 for 2023;
 - (b) Employees with more than 5% company ownership (family attribution rules apply);
 - (c) Employees with more than 1% ownership and annual salary greater than \$150,000 (family attribution rules apply).
- To learn more about family attribution rules, please contact Definiti.

HIGHLY COMPENSATED EMPLOYEE DEFINITION

An employee is considered to be highly compensated if:

- (a) They are more than 5% owner of the employer at any time during the current (determination) or preceding (look-back) year (this definition also includes a person who is the spouse, child, parent, or grandparent of someone who is a 5% owner of the employer), or
- (b) They have compensation in the preceding (look-back) year more than a specific dollar amount (\$150,000 for 2023, \$135,000 for 2022).

AUDIT REQUIREMENT

The Employee Retirement Income Security Act of 1974 (ERISA) requires annual audits of plan financial statements by an independent qualified public accountant of plans with 100 or more eligible participants at the beginning of the plan year. Plans meeting these criteria would be considered to be a "large plan." There are certain exceptions, so consult with Definiti about your plan details.

§401(a)(4) Average Benefits Test/Average Benefit Percentage Test

This test verifies that the distinct classifications of your employees do not discriminate in favor of HCEs if a new comparability or age weighted profit sharing contribution is made.

§401(k)/§401(m) Average Deferral Percent/Average Contribution Percent (ADP/ACP) Test

The test compares the average of salary deferral and employer match percentages for HCEs to the average of salary deferral and employer match percentages for non-highly compensated employees (NHCEs). Typically, there can be no more than a 2% spread.

If a plan is safe harbor, this test is automatically deemed to pass.

§402(g) Plan Deferral Limit Test

This is the plan employee deferral limit (or 401(k) contribution limit). This limit is measured on a calendar year basis and is established by the IRS. For 2023 the deferral limit is \$22,500; if over the age of 50 by December 31, 2023, the employee is permitted a catch-up contribution of an additional \$7,500 for a total of \$30,000.

§404(a) Overall Deductibility Limit Test

This test determines the overall deductibility limit for Employer contributions the company allocates to the plan (does not include Employee contributions). The company cannot deduct more than 25% of eligible payroll as an Employer contribution for the plan year. Definiti calculations are based on the information that we have received for the plan including census data and contributions to the plan.

§410(b) Coverage Basics Test

This test measures the percentage of NHCEs covered by the plan as compared to the percent of HCEs covered by the plan for each contribution source. This percentage must be greater than 70%. A plan may pass 401(a)(4) if it does not pass a 410(b). For more information on the 401(a)(4) test, please contact Definiti.

§414(v) "Catch-Up" Contribution

If provided as a participant/Plan option in the Plan Document, a participant who is age 50 or older during plan year may defer on a pre-tax basis an additional amount for the plan year (up to \$7,500 for 2023, indexed annually).

§415 Annual Additions Test

The 415 limitation is an overall limit on the maximum amount that can be contributed to a 401(k) plan participant's account during the year from all sources of contributions. The 415 limit includes the employee's deferral contribution which is limited to a maximum of \$22,500 (or \$30,000 if age 50 or older) in 2023, combined with any matching or profit sharing or other contribution(s) made into the participant's account by the employer. The current 415 limitation is equal to either the employee's total compensation for the year or \$66,000 (\$73,500 if age 50 or older), whichever is less.

§416 Top Heavy Test

Each plan year, it must be determined whether your plan is "top-heavy." A plan is top-heavy if, as of the determination date which is the last day of the plan year, the total account value of key employees exceeds 60% of the total account value of all employees in the plan.

Smaller employers that do not want to contribute mandatory employer money to their plans should pay close attention to this test each year and consult with Definiti if the top-heavy percentage approaches 50% as there are plan design alternatives that will avoid top-heavy testing. Safe Harbor plans are automatically deemed to pass top-heavy testing

HOW TO PASS NON-DISCRIMINATION TESTS

- If your 401(k) plan is safe harbor and it's Top-Heavy, you can avoid making a 3% minimum contribution if your key employees do not salary defer, or otherwise benefit from the plan that plan year.

- To exclude a specific group of NHCEs from participating in your plan, make them an “excluded group” in your plan document. Certain coverage tests must be satisfied before.
- If your plan has HCEs that want to salary defer large amounts, then your plan should have a safe harbor feature to automatically satisfy the ADP/ACP Test.
- Ensure permissive disaggregation is being utilized. With this method, the less tenured employees who do not meet statutory eligibility requirements, who are likely to bring down the testing average due to low deferral rates, can be tested separately.
- Utilize a Top Paid Group election. If more than 20% of the employees are considered HCEs those over that 20% threshold that are not owners can be moved into the NHCE group to bring up the NHCE percentage and therefore pass the testing.