401(k) Plans

A 401(k) is a Defined Contribution Plan that allows both the employee and employer to make contributions into an account for the benefit of the employee in a tax-deferred status. Employees contribute to the plan through salary reduction on either a pre-tax basis or post-tax basis, depending on the provisions of the 401(k) plan. Employers also have several options to choose from when selecting their contribution formula – matching, non-elective or straight profit-sharing contributions. Keep in mind, in order to establish a 401(k) plan an adoption agreement/plan document must be completed and signed by the employer that outlines the parameters of the plan, such as eligibility, vesting, contributions, distributions, etc. prior to the end of the year in which it is effective. Failure to have an adoption agreement/plan document could jeopardize the entire tax-qualified status of the plan.

PLAN FEATURES/TYPES

There are different types and features of 401(k) plans that have evolved over the years. Some of the plans permit employers to minimize the discrimination testing required on 401(k) plans, while others permit employees to make Roth (after-tax) contributions. It is important to understand these are characteristics built into the 401(k) plan, rather than a completely different plan. Below are many of those features, which will be covered later:

- Safe Harbor 401(k)
- Roth 401(k)
- Individual 401(k)
- Profit Sharing – includes integrated Social Security, age-weighted and new comparability

CONTRIBUTIONS

In all 401(k) plans, employees that meet eligibility can make contributions through salary deductions. However, whether or not the contributions are pre-tax will depend on whether the employee is making after-tax contributions, Roth deferrals or pre-tax contributions. This is determined based on what features are available within the Plan Document and what elections are made by the employee on their salary deferral form. An employee is always 100% vested in their own salary deduction contributions. The current contribution limits for an individual employee is as follows:

In traditional 401(k) plans, the highly compensated employee's (as defined in the Plan Document) contributions are limited based on the results of the (ADP/ACP) Discrimination Test. The IRS 401(k) limits are:

YEAR	LIMIT	CATCH-UP*
2019	$19,000	$6,000

* *Individuals age 50 or older (individuals must turn 50 during the calendar year) may be allowed to make annual catch-up contributions to 401(k) plans as outlined in the adoption agreement.*

401(K) SAFE HARBOR FEATURE

General Information

The Safe Harbor provisions of a 401(k) plan allow the employer to avoid discrimination testing (ADP/ACP) usually associated with a traditional 401(k). A Safe Harbor 401(k) provides a way for the Highly Compensated Employees to maximize their salary deferrals through a payroll deduction of $19,000 for 2019. The tradeoff is the employer must make a minimum fully vested Safe Harbor contribution to the plan. The following are the two types of Safe Harbor contributions the employer can choose from.

NON-ELECTIVE CONTRIBUTION	*Under the non-elective formula the employer will provide a minimum of a 3% (or more) Safe Harbor contribution to all eligible employees, regardless of their participation in the plan.*
MATCHING CONTRIBUTION – BASIC	*Under the match formula the employer will provide the Safe Harbor contribution to any eligible employee that elects to participate, through payroll deduction, into the plan. The matching formula is a dollar-for-dollar match on the first 3% of 401(k) contributions and a 50% match on the next 2% of 401(k) contributions.*

Non-Elective Contribution Example – An employee is eligible for the plan and has $20,000 of W-2 wages. The employee will be entitled to a matching contribution of $600 (3% x $20,000). ***Note:*** *The employee receives the contribution whether or not they make a 401(k) contribution, and the contribution is always 100% vested.*

Matching Contribution Example – An employee is eligible for the plan and has $20,000 of W-2 wages and contributes $1,000 to the plan. The employee gets a dollar-for-dollar (100%) match on the first 3% or $600 of his 401(k) contribution and an additional match of fifty cents on the dollar on the next 2% or $200 (2% of $20,000 is $400 and 50% of $400 is $200). The total matching contribution in this example is $800.

Discretionary Employer Matching Contributions

Each year the employer can choose to contribute a matching contribution to employees who made 401(k) contributions during the year. These contributions can be subject to a vesting schedule. An example of this type of contribution is a 50% matching contribution on the first 6% of 401(k) contributions. For example, an employee has $20,000 of W-2 wages and makes a $1,000 (5%) 401(k) contribution. The employer would make a matching contribution of $500 (50% of $1,000). If the employee made a $2,000 (10%) 401(k) contribution, the employer matching contribution would be $600 (6% of $20,000 is $1,200 and the employer matches 50% of the first 6%).

***Discretionary employer contributions are subject to Discrimination Testing each year. The testing is designed to ensure that the highly compensated employees do not receive a disproportionate amount of the contribution.*