



Plan Testing Summary

Qualified retirement plans are subject to certain IRS mandated tests called non-discrimination tests. Their purpose is to insure that the plan is set up for the benefit of all employees, not just the owners and highly compensated employees. These tests must be performed each year. **Please pay special attention to the Top-Heavy Test and ADP/ACP test as these tend to cause the biggest problems for employers.**

Top Heavy – 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 first 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.

For example, if Dr. Feelgood has a plan with \$100,000 in assets as of 1/1/2009 and he owns \$70,000 of these assets, the plan is top heavy for 2009. This means that if Dr. Feelgood wants to participate in 2009 he will be required to allocate 3% of each eligible employee's pay into their account at year end.

Smaller employers that do not desire to contribute employer money to their plans should pay close attention to this test each year and consult with us if their top-heavy percentage approaches 50%.

There is a plan design alternative that will avoid top-heavy testing: A Safe Harbor 401(k) plan in which the only allocations made to the plan are elective deferrals and the safe harbor contributions.

ADP/ACP – Average Deferral Percent/Average Contribution Percent. The test compares the average of salary deferral and employer match percentages for highly compensated employees (HCE) to the average of salary deferral and employer match percentages for non-highly compensated employees (NHCE). Typically, there can be a 2% spread.

For example if Dr. Feelgood is the only HCE and he defers 10% of his income into the plan, then his eligible employees must have an average deferral of 8% to pass this test. If he has two employees and one defers 10% of his pay and the other defers 0%, the test fails because the average is 5%. Dr. Feelgood must take out anything over 7% he put in. He will not feel good about this. To avoid penalty he must take it out prior to March 15th.

If a plan is safe harbor this test is not run and the plan is deemed to pass.

410(b) – Measures percent of NHCE (non-highly compensated employees) covered by the plan as compared to percent of HCE (highly compensated employees) covered by the plan for each contribution source. This percentage must be greater than 70%. A plan may pass 401(a)(4) rather than 410(b).

401(a)(4) – The Average Benefits Test/Average Benefit Percentage Test. This test verifies that the distinct classifications of your employees do not discriminate in favor of the highly compensated if a new comparability or age weighted employer contribution is made.

404(c) – The overall deductibility limit. The company typically cannot deduct as a pension contribution more than 25% of eligible payroll.

402(g) Test: This is the plan deferral limit (401(k) contribution limit). This limit is measured on a calendar year basis and is established by the IRS. For 2009 the deferral limit is \$16,500.00; if over the age of 50 by December 31, 2009 the limit is \$22,000.00.

Annual Additions 415 – The 415 limitation is an overall limit on the maximum amount that can be added to a 401k plan participant's account during the year from all sources of contributions. The 415 limit includes the employee's deferral contributions which is limited to a maximum of \$16,500 (or \$22,000 if age 50 or older) in 2009, 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 \$49,000, whichever is less.

Key Employee - 416(i)(1)

Key employees are defined as:

- (a) Officers with annual salary greater than \$150,000 for 2009 (a constant from 2000);
- (b) Employees with more than 5% company ownership (family attribution rules apply here);
- (c) Employees with more than 1% ownership **and** annual salary greater than \$150,000 (family attribution rules apply here).

Highly Compensated Employee Definition - 401(a)(17)

An employee is considered to be highly compensated if:

- (a) He/she is 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) He/she has compensation in the preceding (*look-back*) year in excess of a specific dollar amount (\$100,000.00 for 2006, \$100,000.00 for 2007, \$105,000 for 2008, \$110,000 for 2009).

Tax Credit for Small Employers

You may be eligible for a tax credit (in lieu of a deduction) of the lesser of \$500 or 50% of the fees paid in conjunction with your new plan in each of the next three years. You may choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective.

These are the qualifications for the credit:

- Fees are paid to establish or administer the plan (i.e., fees paid to The Pension Studio) or expenses for retirement-related education of the employees.
- Your plan is effective after 2001.
- No contributions were made (or benefits accrued) for substantially the same employees covered under this plan during the 3 years immediately preceding the year this plan became effective.
- Your plan covers at least one non-highly compensated participant.
- Your company employed less than 101 employees who received at least \$5000 in compensation from you for the preceding year.

Consult with your accountant about the applicability of the credit for you. Note that it can be carried back one year (but not before 2002) and forward to other years. Expenses in excess of the amounts applied to the credit remain fully deductible as a general business expense. To get the credit, your accountant will need Form 8881, Credit for Small Employer Pension Plan Startup Costs.