


ADP Test – Does your plan pass?

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ADP Test - IRC§1.401(k)(3)

- ADP stands for Actual Deferral Percentage.
- Required for plans that have a Section 401(k) arrangement.
- Compares the ADP of the HCEs to the ADP of the NHCEs.
- Certain plan designs may be considered “deemed to pass” - such as Safe Harbor 401(k) Plans, SIMPLE, etc.



ADP Test - IRC§1.401(k)(3)

- Review Basics – HCE / Family Group / Top 20%, etc.
- Coding in System.
- Review Reports – ADP Test.
- Failed Test (Shifting, Refunds, QNECs, etc.).



Definition – HCE (Highly Compensated Employee)

- Owner – more than 5% owner – no minimum compensation required.
- Family Attribution.
- Compensation Test.
 - from lookback year (compensation amount for 2008 – 105,000).
- Top 20% Election.



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HCE – Top 20% Election

- Top 20% Election
 - Includes all owners.
 - Count down from top paid – don't include employees below the threshold.
- Coding in System



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Current or Prior Year Testing

- Can use current year testing or prior year testing.
- Plan Document – states whether prior or current year testing applies.
- Reg. 1.401(k)-2(a)(2)(ii)



The ADP Test Range

- NHCE ADP is 2% or less – times 2
- NHCE ADP is 2% to 8% - plus 2
- NHCE ADP is more than 8% - times 1.25



Roth 401(k) Contributions - IRC §402A, as added by EGTRRA §617

- Effective January 1, 2006.
- Roth 401(k) Contributions/Deferrals are not excludable from gross income.
- Special tax rules apply to qualifying distributions.
- Need to know the deferrals for 401(k) Roth deferrals and pre-tax deferrals – all salary reduction contributions tested together.



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Testing Options Available

- Otherwise Excludable Employees
 - Statutory – age 21 with 1 year of service, with entry semi-annual.
 - Plan Entry requirements.
- If testing Otherwise Excludable Employees separately – must test all coverage and non-discrimination tests that way – Reg 1.410(b)-6(b)(3); Reg 1.401(a)(4)-1(c)(4).



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Plan Fails – what to do

- Does Otherwise Excludable testing provide better results?
- Does the plan provide Catch Up Contributions - Can any amounts be re-characterized as catch up contributions?
- QNEC – watch for testing issues
- Refund – Gap Period earnings *
- Shifting

*Gap Period Earnings



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Failed ADP Test

Leveling Method – Two-step process

- Step 1 – Calculate the total correction amount
- Step 2 – Divide up the total correction amount amongst the HCEs in descending order of their deferral amounts.
- IRC§401(k)(8)(C) and Treas. Reg. §1.401(k)-2(b)(2)(iii).



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Other Testing Issues

- Deferrals in excess of Section 415 are distributed along with gains and associated match is placed in a forfeiture account.
- Refunds – Gap Rules Changed – applied to 2008, but not to 2009 plan years / calendar years.
- Compensation for ADP Test – can be different than contribution compensation.



Catch Up Contributions - 414(v)

- Catch up contributions are not included in the ADP test if in excess of 415, 402(g) or a plan limit.
- For planning purposes - DO NOT ASSUME using prior year testing with results of 5% will pass if you tell clients 5% + \$5,000 for catch up.



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