

THE BENEFIT BULLETIN

FAST FACTS ABOUT RETIREMENT PLANS

The following article contains general plan facts and is intended for informational purposes only. To ensure that your plan contains specific provisions outlined in this and future articles, please contact your third party administrator or plan ERISA attorney.

ADP/ACP Test

Congress has implemented several tests to prevent qualified retirement plans from discriminatorily favoring highly compensated employees (HCE) over non highly compensated employees (NHCE) in excess of certain limits. One of these tests is the Actual Deferral Percentage/Actual Contribution Percentage (ADP/ACP) test. This two-part test compares the contribution and deferral rates of the HCEs to the NHCEs to determine if the plan is discriminating in favor of the HCEs.

The ADP portion of the test compares the salary deferrals of the HCEs and the NHCEs on an annual plan year basis. The ADP test includes every employee who is eligible to make a salary deferral regardless of whether they are actually deferring. Each employee's individual deferral percentage is calculated by dividing the amount of their salary deferrals by their eligible compensation. Then, the deferral percentage of each employee in the HCEs group and the NHCEs group is averaged to determine the ADP of each group. To pass the test, the ADP of the HCE group may not exceed the ADP of the NHCE group by specific limits.

The ACP portion of the test is calculated in the same manner as the ADP test, except that the ACP test applies to employer matching contributions.

Plan design allows an employer to choose whether the ADP/ACP test will use either the prior year testing method or the current year testing method. The prior year testing method compares the prior year NHCEs ADP/ACP to the current year HCEs ADP/ACP. This makes it easier for the plan to pass the ADP/ACP test because the HCEs can be advised in advance of the maximum that can be contributed to the plan. Under current year testing, the current year NHCEs ADP/ACP is compared to the current year HCEs ADP/ACP. While this method has less certainty, it provides more flexible corrective measures in the event the plan fails the ADP/ACP test.

Under the current year method, if a plan fails the ADP/ACP test, the employer can make a contribution in order to correct the failure. This contribution is automatically 100% vested and must be made within 12 months after the end of the plan year. The plan can also correct the test failure by issuing a corrective distribution. This distribution must be made within 2 ½ months after the end of the plan year in order to avoid an excise tax, but must ultimately be made within 12 months after the end of the plan year to avoid disqualification of the plan. Under the prior year method, only the corrective distribution option is allowed.

A plan may shift from the prior year method to the current year method at any time. However, once the change has been made, the plan may not return to the prior year method for five years.

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