Qualified Pension Professionals, Inc.
*specializing in the administration of 401(k) plans*

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# HERE'S THE SCOOP ON 401(k) & PROFIT SHARING PLAN CONTRIBUTIONS

## DO YOU KNOW WHICH CONTRIBUTIONS YOUR PLAN ALLOWS FOR?

One thing retirement plans have too much of is terminology. There are words that mean several different things and several words that refer to the same thing. This is especially true for plan contribution types. This Scoop will help you better understand the different contribution options.

Your 401(k) plan may allow for optional employer Profit Sharing and/or Match contributions. Employees may be eligible for one type of contribution without qualifying for another. Some contributions can require participants work a specific number of hours each year or require that participants be employed at year-end, while other contributions must be given to all participants who worked even one hour during the year. Your plan document states what specific contributions are allowed and which participants will receive them each year.

## HERE IS A SUMMARY OF THE MOST COMMON CONTRIBUTION TYPES:

### ►401(k) Deferrals

Also known as **Employee Elective Deferrals, Salary Deferrals, Pre-tax Deferrals, Roth Deferrals**

If the plan includes 401(k) contributions, each eligible employee may decide whether or not to contribute them. These contributions are deducted through payroll each pay date. The term deferral refers to the employee deferring receipt of his/her pay by electing to contribute a portion of his/her paycheck to the retirement plan each pay date. 401(k) deferrals are typically deducted through payroll on a pre-tax basis, before federal income taxes are withheld, and therefore the taxes are deferred until the money is withdrawn from the retirement plan.

If the plan allows for it, the employee may choose to contribute 401(k) contributions as Roth deferrals. These contributions are deducted through payroll after federal income taxes are withheld (after-tax). If the Roth deferrals are withdrawn after the 5-year clock and age 59 ½, or death/disability, the contributions and any earnings on the Roth deferrals are withdrawn tax-free.

These contributions are entirely up to each participant's discretion. Once an employee meets the plan's eligibility requirements to participate in the 401(k) portion of the plan, he/she is eligible to contribute deferrals each year regardless of the hours he/she works.

Plans usually allow employees to elect either a percentage of pay or a dollar amount from each paycheck. These contributions must be deposited to the plan account as soon as possible after each pay date.

### ►Match

Also known as **Employer Matching, Discretionary Matching**

These employer contributions are based on the amount of 401(k) deferrals that each participant contributes. Because participants must contribute 401(k) deferrals to receive the Match, it is a good way to encourage employees to save for their retirement and help increase plan participation rates.

The Match formula is stated in the plan document, but is often written so that the employer can decide each year how much it will contribute. The match is usually based on a percentage of the 401(k) deferrals, and can be limited to a set dollar amount or a percentage of pay. For example, the Match formula may be a 50% match of the first 6% of pay an employee elects to defer, for a maximum Match of 3% of pay. Or the Match formula could be 50% of the employee's 401(k) deferrals up to a maximum Match of $1,500 per person.

The Match contribution may be calculated and deposited each pay date or it may be calculated annually and deposited by the due date of the company's tax return; the plan document will state which method is used.

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If the annual allocation method is used, the employer may require that employees work a specified number of hours (up to 1,000) and/or be employed at the end of the Plan Year in order to receive the Match.

The Match may be subject to a vesting schedule whereby the employee's non-forfeitable balance of his/her Match account increases based on the Years of Vesting Service he/she has earned. Typically a Year of Vesting Service is earned for each year that an employee works the required number of hours (up to 1,000 hours per Plan Year). No more than 6 Years of Vesting Service may be required to reach 100% vesting. Alternatively, the company may choose not to deal with vesting and immediately vest all Match contributions.

**►Profit Sharing**

Also known as **Employer Discretionary, Employer Non-elective, or Employer Contribution**

Although these contributions are commonly referred to as Profit Sharing, they are typically not linked to the company's profits. Usually these contributions are written into the plan as an optional contribution and the company chooses each Plan Year how much, if anything, to contribute. The contribution can be determined separately each year; the company may make a contribution one year and make no contribution the next year.

There are many different options for allocating the Profit Sharing contribution and the plan document states which method must be used. These include: pro-rata where each participant receives the same percentage of pay; Integrated/permitted disparity where an additional amount is allocated on participants' pay in excess of the Social Security Taxable Wage Base or another specified level; class allocated/new comparability where each participant is assigned to a class and the company determines how much to contribute to each class. Different types of nondiscrimination testing are required depending on which allocation method is used.

The employer may require that employees work a specified number of hours (up to 1,000) and/or be employed at the end of the Plan Year in order to receive the Profit Sharing contribution. The Profit Sharing contribution is not dependent on whether or not participants contribute 401(k) deferrals.

Like the Match, the Profit Sharing account may be subject to a vesting schedule whereby the employee's non-forfeitable balance of his/her account increases based on the Years of Vesting Service he/she has earned, or the Profit sharing contributions may be 100% vested immediately.

**►Safe Harbor**

May be **Safe Harbor Non-Elective, Safe Harbor 3%, Safe Harbor Match**

Safe Harbor contributions are a special type of contribution that the company agrees to make in order to benefit from special exceptions to certain nondiscrimination testing and possibly Top Heavy requirements. These contributions must be decided before each Plan Year begins, and participants must receive a Safe Harbor Notice. The Safe Harbor contributions are used in 401(k) Plans to allow the highly compensated employees to contribute up to the maximum deferral limits each year.

Under the Non-Elective formula, participants receive the Safe Harbor contribution without regard to whether they made 401(k) contributions. Under the Match formula, participants must contribute 401(k) deferrals in order to receive the Safe Harbor Match contribution.

No matter which Safe Harbor contribution is elected, it must be given to all participants who worked during the Plan Year, regardless of the number of hours or termination of employment.

Participants must be immediately 100% vested in Safe Harbor contributions.

If you have any questions about what contribution options are in your plan, please contact QPPI at 630-469-3581. Your plan may already provide for the contributions you desire, or if not, they may be added.

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