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## Adp acp testing

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For 2025, an HCE is defined as an individual who meets one of the following two criteria: They own more than 5% of the employer (directly or by family attribution) at any time during 2025 or 2024 They received compensation in excess of \$155,000 during 2024. A plan can limit this group to the top 20% of employees, ranked by compensation The Actual Deferral Percentage (ADP) Test The ADP test compares the salary deferrals made by HCEs and NHCEs (both pre-tax and Roth, not including catch-up contributions). To pass the ADP test, the average deferral rate of HCEs cannot exceed the greater of: 125% of the non-HCE average rate, or the lesser of: 200% of the non-HCE average rate, or the non-HCE average rate plus 2%. The non-HCE average can be based on current or prior year contribution rates. Test Example: NHCEs: Employee A: compensation = \$50,000, deferral = \$2,500 (deferral percentage = 5%) Employee B: compensation = \$40,000, deferral = \$2,000 (deferral percentage = 5%) Employee C: compensation = \$30,000, deferral = \$1,500 (deferral percentage = 5%) NHCE average deferral percentage: (5% + 5% + 5%) / 3 = 5% HCEs: Employee D: compensation = \$200,000, deferral = \$20,000 (deferral percentage = 10%) Employee E: compensation = \$180,000, deferral = \$15,000 (deferral percentage = 8.33%) HCE average deferral percentage: (10% + 8.33%) / 2 = 9.165% Results: 125% of NHCE ADP = 6.25% (5% \* 1.25) Lesser of: 200% of NHCE ADP = 10% (5% \* 2) NHCE ADP + 2% = 7% (5% + 2%) The test fails because the HCE ADP (9.165%) exceeds the 7% limit. The Actual Contribution Percentage (ACP) Test The ACP test uses the same methodology as the ADP test to compare the employer matching contributions and voluntary after-tax contributions of HCEs and NHCEs for nondiscrimination. How to Correct a Failed ADP/ACP Test The most common correction method is refunding the contributions made to HCEs in the amount necessary to pass the ADP or ACP test (as applicable). A 10% excise tax will usually apply to contribution refunds made later than 2 1/2 months following the close of the year (March 15 for calendar-based 401(k) plans). The final deadline for refunding excess contributions is 12 months following the close of the year. Thanks to the SECURE Act, a 401(k) plan can adopt safe harbor status up to the last day of plan year following the year in which the plan failed the ADP test by making a 4% nonelective contribution. How to Avoid Future ADP/ACP Test Failures Become a Safe Harbor 401(k) Plan Safe harbor 401(k) plans automatically pass ADP/ACP testing when certain contribution and participant notice requirements are met. To meet the contribution requirement, an employer must make one of the following three contributions to participants: Safe harbor match - The employer may select a "basic" or an "enhanced" match. The basic match equals 100% of 401(k) on the first 3% of compensation plus 50% of 401(k) on the next 2% of compensation (4% total). The enhanced match must be at least as generous as the basic match at each % of compensation. Safe harbor nonelective - The contribution must be 3% (or more) of compensation and be made to all eligible non-HCEs, regardless of whether they made a 401(k) contribution to the plan. QACA match - if a plan meets certain automatic enrollment requirements, a less costly safe harbor match can be made, equal to 100% of 401(k) on the first 1% of compensation plus 50% match of 401(k) on the next 5% of compensation (3.5% total). Safe harbor 401(k) plans must also distribute a notice to employees that explains their plan rights and obligations. Participants must receive this notice within 90 days of their plan eligibility date and 30-90 days before the start of each new plan year thereafter. Increase NHCE Participation 401(k) plans fail ADP/ACP testing when the average contribution rate of the HCE group exceeds the average of the NHCE group by more than the legal limit. A way to decrease this margin is by increasing NHCE participation. This can be done using two methods: Participant education - Many workers are intimidated by 401(k) participation or don't fully understand its benefits. Often, non-HCEs are the most confused - which can lead to low participation by this group. Enrollment meetings or other education initiatives can help increase the non-HCE group's 401(k) knowledge, and in turn, spur their participation. Participant education does not need to be costly. Both the IRS and DOL offer free 401(k) education for workers on their websites. Automatic enrollment - When a 401(k) plan includes an automatic enrollment feature, employees are automatically enrolled in the plan at a default deferral rate (specified in the plan document) if they fail to make an affirmative deferral election. An automatic enrollment feature can improve non-HCE participation because inaction results in automatic 401(k) participation. Employer match - When an employer matches 401(k) contributions, workers are more likely to participate in order to receive the match. Unlike a safe harbor match, discretionary matching contributions can be subject to up to a six-year vesting schedule. A vesting schedule allows a plan to recover non-vested match amounts when an employee terminates and then use these forfeitures to offset future contributions. Take Advantage of your Testing Options 401(k) plans have ADP/ACP testing options. Changing one or more of them can help a plan pass testing, or at least, mitigate corrective returns. 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If you are a business owner, you don't need to settle for annual ADP/ACP test failures - there are steps you can take to avoid or mitigate returns. You just need to know your options. Once you do, you'll be ready to discuss these options with your 401(k) provider.

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Malhusstraat Amsterdam, North Holland 1066JR, NL Get directions Southgate Centre One 319 Wilmslow Road Head Green Chesdale Manchester, SK9 3PW, GB Get directions Camí Antic de València, 54, Sant Martí, Barcelona, Barcelona 08005, ES Get directions The ADP (Actual Deferral Percentage) and ACP (Actual Contribution Percentage) tests are nondiscrimination tests that traditional (non-safe harbor) 401(k) plans must pass annually meet IRS qualification requirements. Approximately 30% of small business 401(k) plans subject to ADP/ACP testing fail one or both of the tests. When a test fails, business owners often bear the brunt of the consequences. Here's what you need to know about the ADP and ACP nondiscrimination tests. What is ADP/ACP Testing? The ADP and ACP tests compare the contributions made to a 401(k) plan by Highly Compensated Employees (HCEs) and Non-Highly Compensated Employees (NHCEs) to ensure they do not disproportionately favor HCEs. 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