



# NPPG

NATIONAL PROFESSIONAL  
PLANNING GROUP, INC.

## **ADP/ACP Testing**

The ADP and ACP tests revolve around contribution comparisons of Highly Compensated Employees and Non-Highly Compensated Employees as part of the annual Non-Discrimination Testing that plans without Safe Harbor provisions are subject to. Below is the IRS definition of what a Highly Compensated Employee (HCE) is for the year 2022 along with descriptions of the ADP and ACP Tests.

**HCE (Highly compensated employee):** A person can be classified as an HCE because of ownership (direct or indirect) of the company or because they earned over the compensation limit from the company during the prior year.

- To be classified as an HCE because of compensation, an employee must have earned more than \$135,000 during 2021 (**the look-back year**).
- To be classified as an HCE due to ownership, an employee must own **more than 5%** of the company during the 2021 or 2022 plan year.
  - The spouse, children, grandparents or parents of a 5% owner are also classified as HCEs
  - There is no minimum income required for a 5% owner or family member to be classified as an HCE. For example, they could earn only \$1,000 and still be classified as an HCE
- HCEs are used in the ADP and ACP tests.

**NHCE (Non-highly compensated employees):** Anyone not classified as an HCE is considered a NHCE.

The ADP test compares the average percentage of pay contributed to the plan by HCE's to the average percentage of pay contributed by NHCE's. If the average percentage contributed by HCE's exceeds the percentage contributed by NHCE's by more than the amount allowed, the test fails.

The ACP test compares the average percentage of pay contributed to the plan in company **matching contributions** for HCE's to the average percentage of pay in company matching contributions for NHCE's. If the percentage contributed for HCE's exceeds the percentage contributed for NHCE's by more than the amount allowed, the test fails.

## **Top Heavy Testing**

A top heavy status occurs when account balances of all Key Employees are greater than 60% as compared to the account balances of all employees. The account balance used is the ending balance of as of the end of the prior plan year that is being tested. For a calendar year plan ending 12/31/2022, the balances as of 12/31/2021 will be used to examine whether the Key Employee balances surpass 60% of the total account balances of the plan. Start up plans use the balances as of the end of the first plan year. The IRS definition of a Key Employee is below:

### **Key Employee Determination:**

- More than 5% owner and any attributed family members

- 1% owner earning \$150,000
- Officer earning \$185,000 (2021 compensation limit)

**Note:** Family attribution applies to Key Employees. Ownership is attributed to an owner's spouse, children, grandparents, and parents.

**404 Deductibility Test**

In general, the deduction limit is 25 percent of eligible participants' compensation in the case of profit sharing, profit sharing 401(k) plans, money purchase plans, or target benefit pension plans. A single 25 percent limit applies to all plans maintained by an employer.

**Code section 415(c) limit or annual addition test**

For any given plan year, each participant may not receive allocations of more than 100 percent of the participant's eligible compensation or \$61,000 for 2022, whichever is less, under all of the defined contribution plans of the same employer.

**Code section 414(s) limit or compensation ratio test**

In recognition of the above, the retirement plan rules include a test designed to make sure a given plan does not carve out certain forms of compensation in such a way that disproportionately benefits the highly compensated employees or HCEs.

**410(b) Coverage Testing**

This is a "counting" form of testing, where you are comparing the ratio of the number of HCE's who benefit (allowed to be in the plan, even if they do not defer) under the plan to the total number of statutorily eligible HCEs, to a similar ratio for everyone else also known as Non-highly Compensated Employees.