

ADP/ACP Testing

The IRC requires that 401(k) plans conduct annual nondiscrimination tests to demonstrate that deferrals, matching contributions and after-tax contributions made for HCEs do not exceed those made for Non-Highly Compensated Employees (NHCEs) by more than a specified amount.

The Actual Deferral Percentage (ADP) test compares the salary-deferral contribution percentages made by the HCEs and the NHCEs. The Actual Contribution Percentage (ACP) test compares the total of any matching and after-tax contribution percentages of the HCEs and NCHCEs. When either or both of these tests are not satisfied, prescribed corrective actions must be taken to avoid losing the plan's tax-qualified status.

In general, there are two ways to satisfy the ADP test:

- Applying the 1.25-times rule: On average, HCEs can defer up to 1.25 times the average of the percentage of compensation deferred by the NHCEs.
- Under the two-plus or two-times rules: HCEs can defer up to double the average of the percentage of compensation deferred by the NHCEs, but not more than 2% above the average NHCE percentage.

The ACP test, which works in similar fashion, measures the combination of after-tax matching contributions made for HCEs and NHCEs.

A plan can use either rule to satisfy the ADP or ACP tests. The table below illustrates how these rules work.

Actual NHCE Average Percentage	Two-Plus/Two-Times Rule Results	125% Rule Results	Maximum HCE % (Greater of Two Rules Results)
1.00%	2.00%	1.25%	2.00%
2.00%	4.00%	2.50%	4.00%
3.00%	5.00%	3.75%	5.00%
4.00%	6.00%	5.00%	6.00%
5.00%	7.00%	6.25%	7.00%
6.00%	8.00%	7.50%	8.00%
7.00%	9.00%	8.75%	9.00%
8.00%	10.00%	10.00%	10.00%
9.00%	11.00%	11.25%	11.25%
10.00%	12.00%	12.50%	12.50%

As you see from the table above, at NHCE contribution levels averaging less than 8%, the two-plus or two-times rule provides the better result. At an 8% NHCE contribution level, either rule results in a maximum 10% contribution rate for the HCEs. Finally, at NHCE contribution levels above 8%, the 1.25 times rule provides the better result.

The year-end ADP/ACP testing performed for your plan uses the plan-year contributions made for your participants and maintained on our recordkeeping system and the plan year-end compliance data you provide. Our testing system limits participant compensation in accordance with the applicable IRC limits.