

A cross-tested 401(k) Safe Harbor Profit Sharing Plan is a defined contribution plan that has three (or more) types of contributions. Each type of contribution is defined by the plan document, generally as a percentage of compensation (hence the name “defined contribution”). The possible types of contributions associated with this type of plan are as follows: salary deferrals, safe harbor employer contributions, matching employer contributions, and profit sharing contributions. Not every plan will have all types of contributions. There are both individual contribution limits and overall employer contribution limits. A [summary](#) of limits that apply to retirement plans can be found in the resources section of our website.

Salary deferrals are amounts that the participant would have received as salary, but instead elected to defer into the plan. These amounts are subject to FICA and FUTA. Regular salary deferrals are not subject to federal or state income taxes, but Roth 401(k) deferrals are subject to federal and state income tax. Assuming certain distribution rules are met, the Roth 401(k) deferrals and the earnings credited to them will be tax free upon distribution. Salary deferrals do not count toward the overall employer contribution limit, but do count toward the individual contribution limit. In addition, there is a special limit on the amount of salary deferrals a participant may have in a calendar year. The total of regular and Roth salary deferrals cannot exceed \$18,000 for a participant who is under age 50, or \$24,000 for a participant who is at least age 50 by the end of the 2017 year. The extra \$6,000 of deferrals for those age 50 or older are called “Catch-up Deferrals”. These catch-up deferrals are excluded from all other testing.

A profit sharing plan can also provide employer matching contributions that are not safe harbor contributions. The employer matching contributions are based on the amount of deferrals. The formula may be defined or discretionary. Only those participants who defer will receive a matching contribution. While the safe harbor matching contributions discussed below are 100% vested, the regular matching contributions are subject to vesting and may have “accrual requirements”. That is, a participant may be required to be employed as of the last day of the plan year and have worked at least 1,000 hours during the plan year in order to receive a matching contribution.

The salary deferrals and the employer matching contributions have to pass special nondiscrimination tests. The safe harbor employer (either profit sharing or matching) contribution gives you an automatic pass on the salary deferral (ADP) test. The safe harbor match would provide an automatic pass for both the ADP and ACP (matching) tests.

The safe harbor profit sharing contribution is a 3% of compensation contribution for each employee who is eligible to defer, whether or not they choose to defer. This contribution will always be 100% vested. The safe harbor matching contribution is an employer contribution that is based on the amount of deferrals a participant makes: the matching contribution will be 100% of the amount deferred, up to 3% of compensation, plus 50% of additional compensation deferred from 3% to 5% of compensation. Alternatively, the safe harbor matching contribution can be 100% of the amount deferred up to 4% of compensation. Again, this matching contribution will be 100% vested, and will go to any participant who makes salary deferrals.

The profit sharing contribution is an employer contribution that is generally a percentage of compensation. This contribution is generally discretionary (that means each year, at the end of the year, the employer may decide if, and how much, of a contribution will be made). Accrual requirements (last day employment and 1,000 hours worked) may apply. With a cross-tested profit sharing allocation, each person can often be assigned his or her own percentage.

However, the plan must pass certain nondiscrimination requirements to use this separate percentage contribution. These are the “cross-testing” requirements. If the owners are the oldest employees in the group, and the majority of the non-owner employees are younger, these tests are easily passed. However, if the demographics of an employee group change, the owner may not be able to take full advantage of this type of allocation. For example, if younger employees are replaced with employees who are as old as the owners, the plan may have to provide a much higher percentage of compensation for the non-owners – almost the same percentage as the owner.

As mentioned earlier, there is an overall employer contribution limit, and an individual limit. The total maximum contributions that can be contributed to a participant’s account for a plan year is \$54,000 (plus \$6,000 in catch-up deferrals, if participant is at least age 50), but not to exceed 100% of his or her compensation. For a sole-proprietor, compensation is Net Earned Income, less ½ the self-employment tax, less the participant’s allocation of the **employer** contribution. For this limit, the salary deferrals are counted as contributions.