General Overview
401(k) PROFIT SHARING PLAN
(For plan years beginning in 2026)

A profit sharing 401(k) plan allows contributions through three different methods: employer profit sharing, matching and employee 401(k) salary deferrals.

Profit Sharing
Contrary to what the name may imply contributions to a profit sharing plan are not based on the profitability of the company. Contributions can be allocated based on the amount of each participant's compensation, job class, and/or age. The employer may vary the contributions year to year, ranging from 0 to 25% of eligible compensation, considering no more than $360,000 (2026 index) individually as compensation. The deadline for company contributions is the company's year-end tax return deadline including extensions.

For eligibility, the employer may be more lenient, but not stricter than excluding any employee: under age 21, less than 1 year of service (may be 2 years if 100% vested), under 1,000 hours per year and union employees. Beginning 2025, no employer contribution required but must include 401(k) eligibility for Long Term Part Time Employees (LTPTEs) who are age 21, with 2 years consecutive service and at least 500 hours each year. There may also be a class exclusion of 30% of the eligible non-highly compensated employees. Generally the only class excluded is employees not employed on the last day of the plan year. Once an employee meets the eligibility requirements they will typically enter the plan the first day of the plan year or seventh month (Jan 1 or July 1).

Employer contributions may come under a vesting schedule. Vesting is the employees' right to the employers' contribution. The most common schedule is 20% per year up to six years and goes 0-20-40-60-80-100%. Vesting may start at date of hire or for new plans, everyone may start at 0% vesting. The forfeitures under vesting may be reallocated to participants as a percent of compensation or used to offset employer contributions.

401(k) / ADP Test
Employees may contribute 100% of compensation up to $24,500 (2026 index). All employee contributions will be 100% vested. There are no Federal or State income taxes (for most states) on 401(k) contributions. The Actual Deferral Percentage (ADP) test must be passed where the average of the non-highly compensated employees is calculated and the highly compensated employees may contribute a slightly higher average. Either the current or prior years' non-highly compensated average should be elected at plan set up. In 2026, highly compensated is defined as: over 5% owner, compensation over $160,000 in 2026 (may limit to top 20%), or a spouse or linear relation.

Individuals age 50 or older may contribute an additional catch-up contribution of $8,000 in 2026 ($11,250 if age 60-63), which is not subject to any tests (ADP) or limits. These contributions must be Roth if FICA wages exceeded $150,000 in 2025.

Employers may also allow for Roth 401(k) contributions. These contributions are after-tax and therefore not taxed at retirement. Employees are not limited by the IRA compensation limits. Roth and regular 401(k) contributions are combined for testing and limited to $24,500 ($32,500 if age 50 or $35,750 if age 60-63). Separate accounting is required for the Roth 401(k).

Effective 2025, auto-enroll is required for some employers. Typically employees auto-enrolled at 3-10% of compensation unless they opt out. Employers may also elect special safe-harbor provisions. See our Auto-Enroll Overview for details.

© Nicholas Pension Consultants

Match
The employer may offer a match, to increase participation, which can come under a vesting schedule. For example, 25¢ on the $1 up to 4% of pay. The match may be discretionary, as long as the employer allows the employees to change their 401(k) election if the match is changed.

Top-Heavy Test
If your plan is top-heavy (the total of the accounts of all key employees exceeds 60% of the total of the accounts of all employees) you are required to make a minimum contribution to non-key employees equal to the lesser of 3% of compensation or the highest contribution percentage rate for a key employee. You may also contribute the same percent for the key employees. This contribution will come under the vesting schedule. If the plan is top-heavy a contribution may be avoided if none of the key employees make a 401(k) deferral in that year.

For 2026, key employee is defined as: over 5% owner, a > 1% owner with compensation at or above $150,000, an officer with compensation at or above $235,000, or a spouse or linear relation.

Safe Harbor Options
An employer may choose to make a 100% vested contribution (2 year cliff if QACA) to the employees to pass the ADP and top-heavy tests. This must include eligible employees who terminate before the end of the year. New plans must be in place for at least 90 days. These options are:

1) 3% non-elective contribution to all eligible non-highly compensated employees (may also include highly compensated). 3% may do "double duty" counting as a basis for new comparability plans based on job class. Maybe Notice due 30 days prior to plan year beginning and final notice due 30 days prior to plan year-end.
2) Match non-highly compensated employees $1 for $1 up to 3%, plus 50¢ on the $1.00 from 3% to 5% (may increase match to $1 for $1 up to 6% of pay and include highly compensated). Final notice due 30 days prior to plan year beginning, except for new plans.
3) Auto-Enroll QACA allows 2 year cliff vesting with either a 3% non-elective or matching contributions (matching may be $1 for $1 up to 3.5%). See our Auto-Enroll Overview for details.

Limits
No more than $360,000 (2026 index) may be considered as a basis of compensation. The most an individual may receive from the three sources (profit sharing, match and 401(k)) is 100% of compensation up to $72,000 ($80,000 if age 50 / $83,250 if age 60-63).

The plan is still a profit sharing plan that has matching and 401(k) provisions within. Therefore, the employer match and profit sharing (401(k) excluded) plan contributions are limited to 25% of eligible compensation. Since this is an average of all employer contributions (401(k) excluded) some individuals may receive 100% while the total employer contribution is still under the 25% limit.

Investments
The plans are self-trusteed so the employer can choose any legal non-foreign investment. Typically, the employer will control the profit sharing contribution as it comes under the vesting schedule and therefore may not yet be owned by the employee.

The employees usually control their own 401(k) contribution. Each employee can have their own segregated account where they can obtain their balance at any time as well as trade the account within a menu of funds. Employees should be given the choice of at least four investments, ranging from conservative to aggressive.

For questions or to meet with a consultant, please call NICHOLAS PENSION CONSULTANTS.