

2021 Cost of living adjustments

Qualified Plans Consulting Group

The IRS released the 2021 limits/thresholds on October 26, 2020. Several limits, including for salary deferral purposes, remain unchanged from the 2020 limits. The annual addition and maximum compensation limits experienced a slight increase. The compensation thresholds for making a deductible IRA contribution when covered by a retirement plan also increased slightly.

In addition, the compensation thresholds for the saver's credit have increased slightly. *Note: married couples filing jointly can make up to \$66,000 adjusted gross income (income after subtracting deferrals and certain other salary reductions and certain deductions) and still be eligible for the saver's tax credit.*

The following table highlights the thresholds for qualified retirement plans. Exhibit A provides a more complete explanation of each of these limits as well as the SIMPLE IRA/SIMPLE 401(k) and IRA contribution limits.

Deferral limits and catch-up limits are subject to cost of living increases each year but only in increments of \$500 (i.e., the cumulative COLA changes must result in an increase of \$500).

The application level refers to how the limit is applied. For example, deferral limits apply at an employee level, meaning an employee's total deferrals are limited even if he/she made deferrals to plans of other employers, whether or not related. For an HCE under age 50 earning \$290,000 wishing to make the maximum deferral of \$19,500, this translates to an equivalent election of 6.72%.

Caution: The 415 limits apply for limitation years ending in 2021 (e.g., a July 1 limitation year will have 2021 limits (\$58,000 for defined contribution plan) apply for July 1, 2020 to June 30, 2021 limitation year, while a calendar year limitation year will have the 2021 limit apply for the 2021 calendar/ limitation year).

Limit/Threshold	Application level	2021*	2020*	2019*
Calendar-year maximum salary deferral for 401(k) plans (limit applies to the sum of traditional and Roth deferrals).	Employee	\$19,500	\$19,500	\$19,000
Catch-up deferral contributions (limit applies to the sum of traditional and Roth deferrals).	Employee	\$6,500	\$6,500	\$6,000
Defined contribution annual addition limit	Employee of related employers (i.e., separate limits for unrelated employers)	Lesser of \$58,000 or 100% compensation	Lesser of \$57,000 or 100% compensation	Lesser of \$56,000 or 100% compensation
Maximum compensation limit (qualified plans and SEPs)	Plan	\$290,000	\$285,000	\$280,000
Highly Compensated Employee (HCE)** determination	Employer			
<ul style="list-style-type: none"> Employee earning more than 		\$130,000**	\$130,000**	\$125,000**
<ul style="list-style-type: none"> Employee earning more than and part of the top-paid 20% (if elected in the plan(s)) 		Same as above	Same as above	Same as above

Limit/Threshold	Application level	2021*	2019*	2018*
Key employee – officer earning more than	Employer	\$185,000	\$185,000	\$180,000
404 tax deduction limit defined contribution profit sharing and 401(k) plans (deferrals are deductible over and above these limits): higher deductible limits apply to DC/DB plan combinations	Employer	Employer contributions 25% of total compensation- Deferrals separately deductible	Employer contributions 25% of total compensation- Deferrals separately deductible	Employer contributions 25% of total compensation- Deferrals separately deductible
Defined benefit maximum annual benefit at retirement age for limitation years ending with year specified	Employer	\$230,000	\$230,000	\$225,000
Social Security Taxable Wage Base	Employee (can obtain refund for employee working for separate employers whose comp is over the wage base)	\$142,800	\$137,700	\$132,900

Saver's Tax Credit

Depending on Adjusted Gross Income (AGI), taxpayers who make retirement contributions such as deferrals and IRA contributions may be eligible for a Federal Income tax credit of *up to \$2,000 per eligible taxpayer, \$4,000 if filing jointly (cannot reduce taxable income to less than zero)*.

Table of Employee Tax Credits for 2021 (based on AGI)

Joint filer	Head of household	All other filers	Tax credit
\$0-\$39,500	\$0-\$29,625	\$0-\$19,750	50%
\$39,501-\$43,000	\$29,626-\$32,250	\$19,751-\$21,500	20%
\$43,001-\$66,000	\$32,251-\$49,500	\$21,501-\$33,000	10%
Over \$66,000	Over \$49,500	Over \$33,000	0 %

*The salary deferral and catch-up limits are effective January 1, 2021. The 415 limits for 2021 are effective with the limitation year, which **ends in** 2021. For example, a plan with a July 1 plan year will use the 2021 415 limit for the July 1, 2020 through June 30, 2021 plan year. Similarly, the key officer compensation threshold for 2021 is effective for the plan year, which **ends in** 2021. All others are effective for the plan year, which **begins in** the year specified.

**Since the determination of HCEs due to compensation is generally based on compensation earned in the prior year, the limits shown apply to the following year. For example, although the HCE threshold is \$130,000 for 2021, this threshold first impacts HCE determinations in the 2022 year.

Exhibit A

Salary Deferral Maximum

This is the combined maximum amount an employee can contribute in a calendar year on a pre-tax basis to 401(k)/403(b) plans under which the employee participated, even if with different employers. A separate but equal limit applies to 457(b) plans. Limits under a SIMPLE 401(k) or SIMPLE IRA are \$13,500. To the extent an employee deferred to both a SIMPLE and a 401(k) or 403(b) in the same year (e.g. due to change of employers), deferrals are aggregated for purposes of the 401(k), 403(b), and SIMPLE limits. IRA (traditional (may or may not be deductible) or Roth) contribution limit for 2021 is \$6,000.

Catch-up Contribution

These are additional deferrals an individual can make who is at least age 50 by the end of the calendar year. The limit is separately applied to governmental 457(b) plans. The catch-up contribution limit under a SIMPLE 401(k) or SIMPLE IRA is \$3,000 for 2021. An eligible individual may also make catch-up IRA contributions of \$1,000 for 2021 (may or may not be deductible).

Highly Compensated Employee

A key component in various requirements for qualified plans is the determination of who is a highly compensated employee. A highly compensated employee is an individual who is:

- A 5% owner (an individual will be considered a 5% owner if he/she or his/her spouse, children, grandchildren, or parents own (individually or in the aggregate) more than 5% of the business) in the current or prior plan year. Other constructive ownership applies as well (e.g., there may be indirect ownership due to options to purchase shares/membership units whether or not exercised, and certain interests held by trusts, corporations, partnerships or estates).
- An individual who earned more than the applicable compensation threshold in the prior year.
- An individual who is in the top-paid 20% and earned more than the applicable threshold for the prior year. If the top-paid 20% election is desired, the election must be made by all related employers and apply to all plans of the employer and related employers. In addition, it must be applied on an Employer/related employer wide basis, not to each respective Employer. Note an individual who is a 5% owner will be an HCE even if not in the top paid 20%.

Note: ADP/ACP current/prior year testing methodology does not impact determination periods above.

Defined Contribution Annual Additions Limit

This is the maximum amount of annual additions (i.e., regular salary deferrals (but not catch-up contributions), employer contributions, employee contributions, and reallocation of forfeitures to participants) that can be contributed in a limitation year and is equal to the lesser of 100% of total compensation or the applicable dollar limit. Even if not a controlled group, 415 limits must be combined where the parent organization in a parent subsidiary controlled group owns more than 50% of a company.

Compensation Limit

This is the maximum amount of compensation that can be used in calculating benefits/contributions and deductible limits under qualified plans and SEPs.

Defined Benefit Maximum Annual Benefit

This is the maximum benefit an individual could receive if he/she retired at his/her social security retirement age, which ranges from age 65 to 67. This limit is reduced for individuals retiring prior to age 62. This limit is also reduced if the individual has less than ten years of participation in the plan.

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