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401(k) Plan Matching Contributions: To True Up or Not True Up?

by Lisa S. Boehm on December 5, 2022

As a matter of plan design, for purposes of matching contributions some 401(k) plans provide that a participant's compensation for the entire plan year is taken into account (regardless of whether the participant makes elective deferrals with respect to each payroll period during the year), while other 401(k) plans take into account a participant's compensation only with respect to payroll periods for which the participant makes elective deferrals. The former design is commonly referred to as a "true up" feature. This post illustrates, through examples, each design, addresses why a plan sponsor might choose one design over the other, and provides some additional thoughts and a reminder for safe harbor design plans.

The examples that follow assume a calendar year plan year, 52 pay periods during the year, compensation paid ratably during the year, a matching contributions formula of $1.00 for each dollar of elective deferrals made by a participant up to 5% of the participant's compensation, and that matching contributions are made to the 401(k) plan on a weekly basis, at the same time as the elective contributions to which they relate.

<u>True Up Example</u>:

Employee A's annual compensation is $52,000, and she makes a deferral election equal to 10% of her compensation. After 26 pay periods, Employee A voluntary stops her deferral election. Through 26 pay periods, here is the result:

Annual Compensation	Elective Contributions per pay period	Matching Contributions per pay period	Total Elective Contributions through 26 pay periods	Total Matching Contributions through 26 pay periods
$52,000	$100	$50	$2,600	$1,300

With a true up feature, at the end of the year the plan administrator performs a calculation to ensure that Employee A receives the maximum amount of matching contributions to which she is entitled for the year based on her compensation for the entire year. Taking into account Employee A's compensation for the entire year, Employee A made elective deferrals equal to 5% of her compensation ($2,600 ÷ $52,000 = 5%) and is, therefore, entitled to an additional $1,300 in matching contributions. Employee A's total matching contributions amount for the year is $2,600.

Without a true up feature, Employee A's total matching contributions for the year would be $1,300.

No True Up Example:

Freddie Frontloader, Steady Eddie, and Bobby Backloader each have annual compensation of $78,000, and each wishes to defer $3,900 for the year. Freddie Frontloader makes elective contributions at a 10% rate each pay period beginning with the first pay period of the year, Steady Eddie makes elective contributions at a 5% rate each pay period beginning with the first pay period of the year, and Bobby Backloader waits until there are only 10 pay periods left in the year and then makes elective contributions at a 26% rate each pay period. All three voluntarily stop their deferral elections when they reach $3,900. The result:

Elective Contributions Rate	Annual Compensation	Elective Contributions per pay period	Matching Contributions per pay period	Pay Periods to reach $3,900	Total Elective Contributions	Total Matching Contributions
Freddie Frontloader: 10%	$78,000	$150	$75	26	$3,900	$1,950
Steady Eddie: 5%	$78,000	$75	$75	52	$3,900	$3,900
Bobby Backloader: 26%	$78,000	$390	$75	10	$3,900	$750

While all three participants had the same annual compensation and deferred the same dollar amount into the 401(k) plan, only Steady Eddie maximized the amount of matching contributions, because Steady Eddie made elective contributions throughout the entire year (at a rate equal to at least 5% of compensation each pay period).

As a matter of compensation philosophy, it is difficult to justify why these three participants should end up with different matching contributions amounts for the year simply because of their choice regarding when they made elective contributions during the year, and this is why some employers include a matching contributions true up feature in their 401(k) plan. Employers that do not include this feature in their 401(k) plan often cite increased administration (and increased risk of administrative error) and, to a lesser extent, potential cost savings as reasons for not implementing a true up feature.

For employers with 401(k) plans that do not include a matching contributions true up feature, we recommend that their participant disclosure materials (*e.g.*, SPD and notice of 401(k) safe harbor design) (1) include an example similar to the above No True Up Example to illustrate how the 401(k) plan's matching contributions formula works, and (2) emphasize (*e.g.*, with bolded text) that it is important for participants to understand that they can maximize the amount of their matching contributions for a plan year only by spreading their elective contributions over the entire year at a percentage of their compensation *each pay period* that is at least equal to the percentage under the plan's matching contributions formula that provides the greatest amount of matching contributions (*e.g.*, 5% in the above examples). This recommendation is especially pertinent where an employer amends its 401(k) plan to eliminate the matching contributions true up feature for subsequent plan years. In addition, as a reminder for employers with a 401(k) safe harbor design plan that does not include a matching contributions true up feature, matching contributions with respect to elective contributions made during a plan year quarter must be remitted to the plan no later than the last day of the following plan year quarter.

Please contact a member of our Employee Benefits & Executive Compensation Group if you have questions regarding a matching contributions true up feature or other questions relating to your 401(k) plan's matching contributions formula.

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