

# For 2021, 401(k) Contribution Limit Unchanged for Employees, Up for Employers

Reaching the 401(k) contribution ceiling can be a long-term savings goal

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**E**mployee 401(k) contributions for plan year 2021 will once again top off at \$19,500 with an additional \$6,500 catch-up contribution allowed for those turning age 50 or older. But maximum contributions from all sources (employer and employee combined) will rise by \$1,000.

Few defined contribution and defined benefit plan limits will be adjusted upward, the IRS announced (<https://www.irs.gov/newsroom/income-ranges-for-determining-ira-eligibility-change-for-2021>) on Oct. 26, when it issued Notice 2020-79 (<https://www.irs.gov/pub/irs-drop/n-20-79.pdf>).

For employee contributions—the elective deferral limit—the news is "no changes" for 2021, whereas last year saw a \$500 jump in the overall employee contribution limit for 2020 plus a \$500 rise in the catch-up limit.

Defined Contribution Plan Limits	2021	2020	Change
Maximum employee elective deferral*	<b>\$19,500</b>	\$19,500	unchanged
Employee catch-up contribution (if age 50 or older by year-end)**	<b>\$6,500</b>	\$6,500	unchanged
Maximum employee elective deferral plus catch-up contribution (if age 50 or older by year end)	<b>\$26,000</b>	\$26,000	unchanged
Defined contribution maximum limit, all sources (employee + employer)***	<b>\$58,000</b>	\$57,000	+\$1,000
Defined contribution maximum limit (if age 50 or older by year end); maximum contribution all sources plus catch-up	<b>\$64,500</b>	\$63,500	+\$1,000
Employee compensation limit for calculating contributions	<b>\$290,000</b>	\$285,000	+5,000
Key employees' compensation threshold for nondiscrimination testing	<b>\$185,000</b>	\$185,000	unchanged
Highly compensated employee (HCE) threshold for nondiscrimination testing	<b>\$130,000</b>	\$130,000	unchanged

\*The \$19,500 elective deferral limit is also known as the 402(g) limit, after the relevant tax code section.

\*\*The \$6,500 catch-up contribution limit for participants age 50 or older applies from the start of the year to those turning 50 at any time during the year.

\*\*\*Total contributions from all sources may not exceed 100% of a participant's compensation.

Source: IRS Notice 2020-79.

Annual contribution limits for defined contribution retirement plans are adjusted each year to include the effects of inflation as measured by the consumer price index for urban wage earners and clerical workers, or CPI-W, explained Harry Sit, CEBS, who edits The Finance Buff blog. Adjustments, when warranted, are made in \$500 increments for employee contributions and in \$1,000 increments for the overall limit on plan contributions from all sources. However, "if inflation is not sufficient to trigger these increments, the limit will stay unchanged for the new year," he said.

[*SHRM members-only Toolkit: Designing and Administering Defined Contribution Retirement Plans* ([www.shrm.org/resourcesandtools/tools-and-samples/toolkits/pages/designingandadministeringdefinedcontributionretirementplans.aspx](http://www.shrm.org/resourcesandtools/tools-and-samples/toolkits/pages/designingandadministeringdefinedcontributionretirementplans.aspx))]

#### **Annual Limit as a Contribution Goal**

Although remaining unchanged for 2021, HR professionals should still convey to employees their plan contribution limits for next year. Not all plan participants will be able to fund their 401(k) accounts up to the maximum, of course, but the contribution cap is a goal they should keep in mind and may encourage those who can defer extra dollars for retirement savings to do so.

According to Fidelity Investments, employees' average 401(k) contribution rate remained steady at 8.9 percent of their pay during the first quarter of 2020, (<https://newsroom.fidelity.com/press-releases/news-details/2020/Fidelity-Q1-2020-Retirement-Analysis-Retirement-Savers-Stayed-the-Course-Despite-Economic-Crisis/default.aspx>) despite significant market volatility due to the pandemic and economic downturn.

With the annual increase in the employee contribution limit, a good message for plan participants is that "increasing your contribution rate, even by 1 percent, can make a big difference in your long-term retirement savings," said Kevin Barry, president of workplace investing at Fidelity. "What may seem like a small amount today can have a significant impact on your account balance in 10 or 20 years."

Those who have not been contributing enough per paycheck to reach the annual cap and who can afford to do so can increase their contributions before the end of the year so that they reach the full annual limit.

Conversely, participants may want to ensure that they don't hit the annual limit prior to year-end, which could mean losing out on employer matching contributions tied to per-paycheck deferrals ([www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/consider-true-up-payments-for-employer-matching-contributions.aspx](http://www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/consider-true-up-payments-for-employer-matching-contributions.aspx)), unless the plan sponsor has agreed to "make whole" or "true up" participants who max out their annual contributions prior to their final paycheck.

#### **Defined Benefit Plan Limits**

Sponsors of defined benefit pension plans should note that the IRS announced the following cost-of-living adjustments under tax code Section 415, also taking effect on Jan. 1:

- **Annual benefit limit.** The maximum annual benefit that may be provided through a defined benefit plan remained unchanged at **\$230,000**.
- **Separation from service.** For a participant who separated from service before Jan. 1, 2021, the annual benefit limit for defined benefit plans is computed by multiplying the participant's compensation limit, as adjusted through 2020, by **1.0122**. This is a slight decrease from the previous year, when the participant's compensation limit, as adjusted through 2019, was multiplied by 1.0176.

Separately, the federal Pension Benefit Guaranty Corp., which insures private-sector defined benefit pension plans, posted 2021 premium rates (<https://www.pbgc.gov/prac/prem/premium-rates>) for single-employer and multiemployer pension plans.

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