PREMIER PLAN CONSULTANTS

WHAT IS 401(K) PLAN DESIGN?

Employer Overview

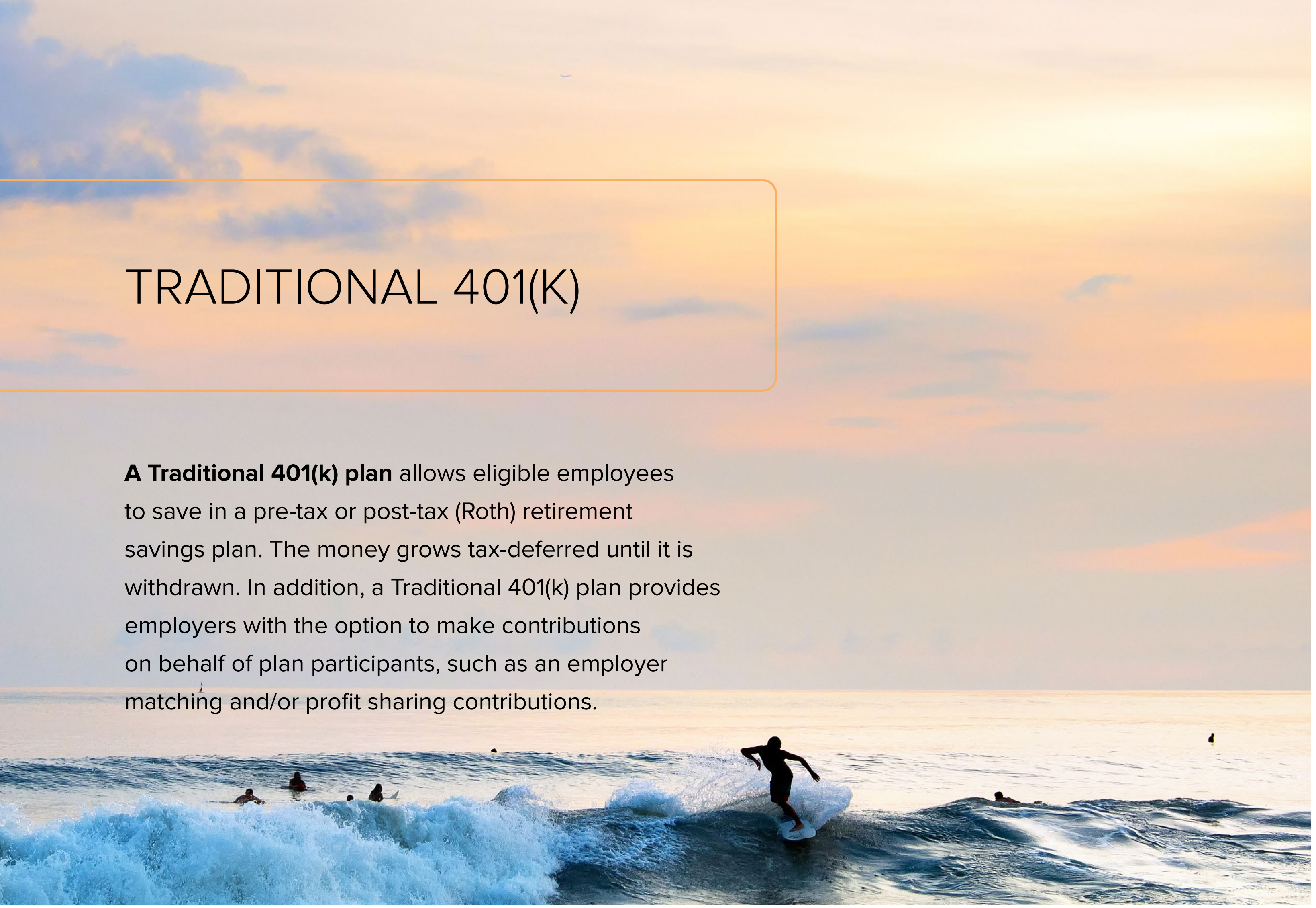
A 401(k) is a type of workplace savings plan that allows employers and eligible employees to save and invest for retirement through payroll deductions. Setting up and sponsoring a retirement plan is a valuable employee benefit and one that can be used to recruit, retain and reward your employees.

It is also a powerful savings plan for employers to optimize tax strategies, while saving for their own retirement future.

There are **two primary 401(k) plan design types** and each one is unique with its own set of administrative rules.

TRADITIONAL 401(k)

SAFE HARBOR 401(k)



TRADITIONAL 401(K)

A Traditional 401(k) plan allows eligible employees to save in a pre-tax or post-tax (Roth) retirement savings plan. The money grows tax-deferred until it is withdrawn. In addition, a Traditional 401(k) plan provides employers with the option to make contributions on behalf of plan participants, such as an employer matching and/or profit sharing contributions.

What are **Testing Requirements**?

It is important to understand that Traditional 401(k) plans are subject to non-discrimination testing on both annual contributions (ADP Testing) and cumulative assets (Top Heavy Testing). These tests are administered to ensure that plans are set up for the benefit of all employees, not just owners and Highly Compensated Employees (HCEs).

Highly Compensated Employees (HCEs)

More than 5% ownership

Direct family members of 5% or more owners (e.g. spouse, children or parent)

Employees that earn more than annually specified limit

Non-Highly Compensated Employees (NHCEs)

All other employees that do not meet the HCE definition

What is **ADP/ACP testing**?

Traditional 401(k) plans are required to meet certain non-discrimination requirements. To ensure the plan satisfies the non-discrimination requirements, the employer must perform an Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) test on an annual basis. This testing procedure compares the average employee deferral rate (ADP) and the average company matching rate (ACP) of HCEs with Non-Highly Compensated Employees (NHCEs). This is to ensure there is no discrimination in favor of HCEs.

HCEs include the following: any owner with more than 5% interest in the business; the spouse, children or parents of a greater than 5% owner; and any employee who receives more than the annually specified compensation limit.

For the ADP test, pre-tax and Roth deferrals are averaged by dividing each eligible plan participant's deferral amount by their annual compensation. Then, the HCEs and NHCEs groups are determined by dividing the sum of the deferral percentages by the total number of eligible employees in the groups. In most cases, to pass the ADP test, the HCEs may not exceed annual deferrals of the NHCEs by more than 2%.

EXAMPLE: Caden and Carlie are 50/50 owners. They have 10 employees. Their employees save an average of 4%. With a Traditional 401(k) plan, Caden and Carlie are limited with how much they can contribute. Their savings percentage is linked to their average employee deferral rate. They are allowed to save 2% more than the employee average (4% + 2%). With a Traditional 401(k) plan, Caden and Carlie can save a combined average of 6%.

Traditional 401(k)

Employee deferrals are subject to testing requirements

Highly Compensated Employees (HCEs) can usually defer 2% more than the average of Non-Highly Compensated Employees (NHCEs)

HCEs can be limited in their participation if NHCEs do not participate at a substantial level

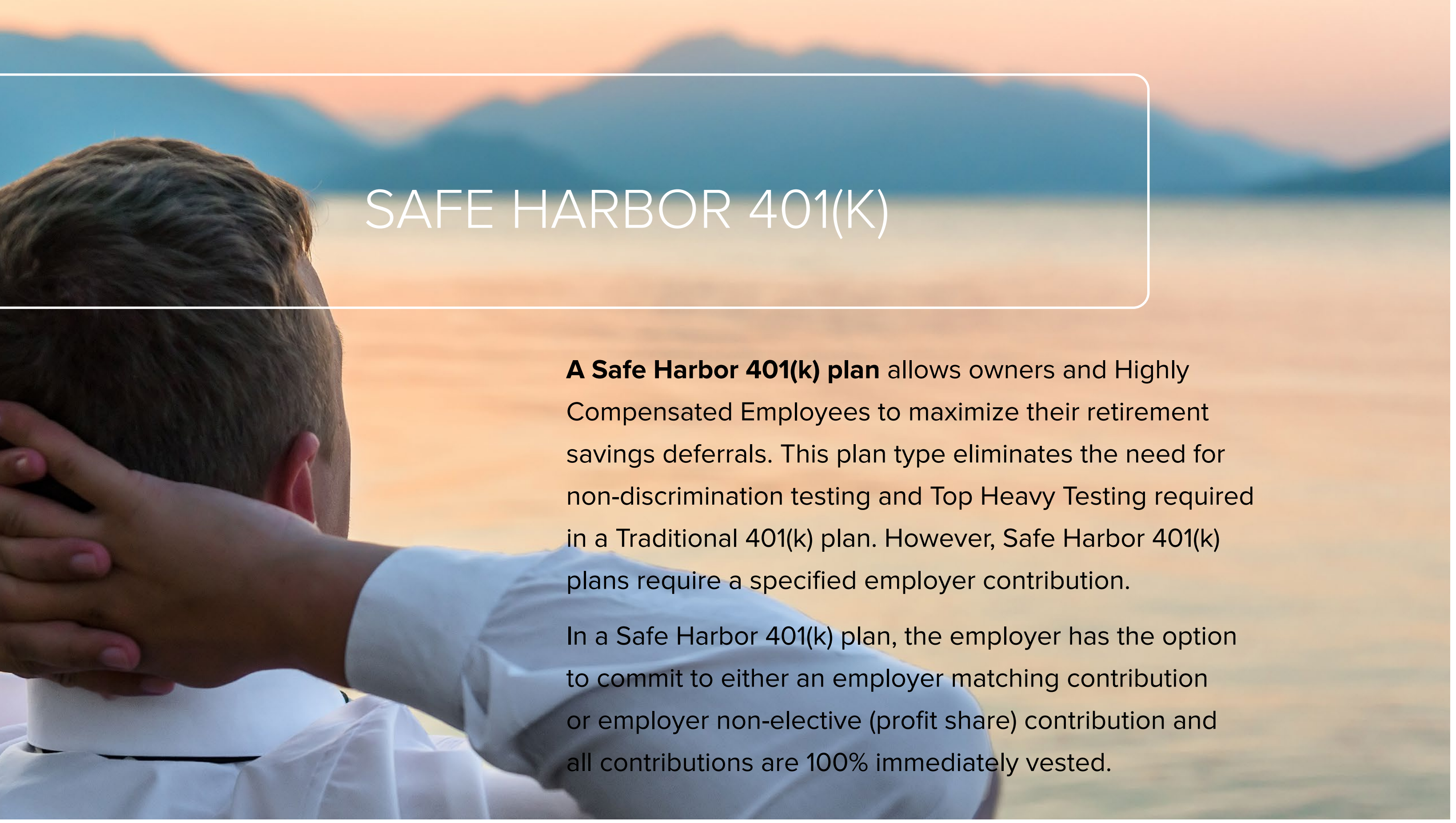
Key Employee account balances should be less than 60% of the total plans account value

What is **TOP HEAVY testing**?

In addition to the required ADP/ACP non-discrimination testing, Traditional and Roth 401(k) plans are also subject to Top Heavy Testing.

A plan is Top Heavy for a plan year if at the end of the preceding year the total value of account balances of Key Employees was more than 60% of the total value of the plan. If the plan is determined to be Top Heavy and is funded by a Key Employee, then the employer is required to make a minimum contribution of 3% to all non-key employees who are employed on the last day of the plan year.

A **Key Employee** is anyone who at any time during the plan year was: an employee who owns more than 5% of the business; an employee who owns more than 1% of the business and making over $150,000; and/or an officer making over the annual IRS limit.



SAFE HARBOR 401(K)

A Safe Harbor 401(k) plan allows owners and Highly Compensated Employees to maximize their retirement savings deferrals. This plan type eliminates the need for non-discrimination testing and Top Heavy Testing required in a Traditional 401(k) plan. However, Safe Harbor 401(k) plans require a specified employer contribution.

In a Safe Harbor 401(k) plan, the employer has the option to commit to either an employer matching contribution or employer non-elective (profit share) contribution and all contributions are 100% immediately vested.

What is a **SAFE HARBOR 3% NON-ELECTIVE**?

The employer must make a 3% contribution to all eligible employees regardless of whether or not the employees are participating in the plan. This type of contribution can also be done with a "flexible" notice letting the employer decide each year whether or not they will make the contribution.

What is a **SAFE HARBOR MATCH**?

The basic Safe Harbor match formula is 100% of deferrals up to 3% of compensation and 50% of deferrals on the next 2% of compensation deferred. The maximum match is 4% of pay for anyone who defers 5% or more of their compensation. Employers may also elect to offer an Enhanced Safe Harbor Match up to 100% of deferrals not to exceed 6% of compensation deferred.

EXAMPLE: Caden and Carlie are 50/50 owners. They have 10 employees. To eliminate non-discrimination testing requirements, they add a Safe Harbor match provision to their workplace retirement plan.

SAFE HARBOR MATCH	EMPLOYEE 1	EMPLOYEE 2	EMPLOYEE 3
Caden and Carlie have 10 employees. However, only 6 employees are participating in the retirement plan. Caden and Carlie will match $1.00 for $1.00 of each employee's contributions up to 3%. Then they will match $0.50 for $1.00 up to 5%. Here are three Safe Harbor match examples:	DEFERRAL RATE 1% / SAFE HARBOR MATCH 1% (Dollar for dollar match up to 3%, so if the employee is deferring 1%, they will receive a 1% match.)	DEFERRAL RATE 5% / SAFE HARBOR MATCH 4% (This employee is deferring 5%; therefore, they receive the 3% dollar for dollar match, then the $0.50 per $1.00 match up to 5% for a total match of 4%.)	DEFERRAL RATE 10% / SAFE HARBOR MATCH 4% (For this super saver, they will receive a Safe Harbor match of 4%. Dollar for dollar up to 3% then the $0.50 per $1.00 match up to 5% for a total match of 4%.)

EMPLOYER MATCHING AND PROFIT SHARING

Employer Matching and Profit Sharing provides employers both design flexibility and discretion with respect to contributions. Employers are allowed to make additional Matching and Profit Sharing contributions to both Traditional and Safe Harbor 401(k) plans. Employer contributions are discretionary and can be allocated in a number of ways. Maximum employer deductions are limited to 25% of eligible compensation or the annual maximum contribution limit, whichever is less. There are a variety of ways these contributions can be made to a plan.

Why consider an **EMPLOYER MATCH**?

Matching is a great way to encourage employees to participate in the company's retirement plan. Employer matching contributions can be made as either a discretionary or a fixed match formula. A discretionary match gives the employer the most flexibility regarding annual cost. A common match formula is $0.50 on the $1.00 up to 4%-6% of deferred employee compensation. Most companies design their match based on the company's budget for employer contributions.

What is **PROFIT SHARING**?

Employer Profit Sharing can be included in the design of the plan and Profit Sharing will be 100% at the discretion of the employer each year. The employer contribution can range between 0% to 25% of compensation for eligible employees. The maximum amount allowed is 25% of total eligible payroll and cannot exceed the annual IRS limit.

The following are the three most common methods for allocating Profit Sharing.

1. **PRO RATA ALLOCATION**

   This allocation method is the simplest formula allowable and allocates the employer contributions to all eligible participants on a proportionate basis. All employees will receive the same percentage of their total compensation.

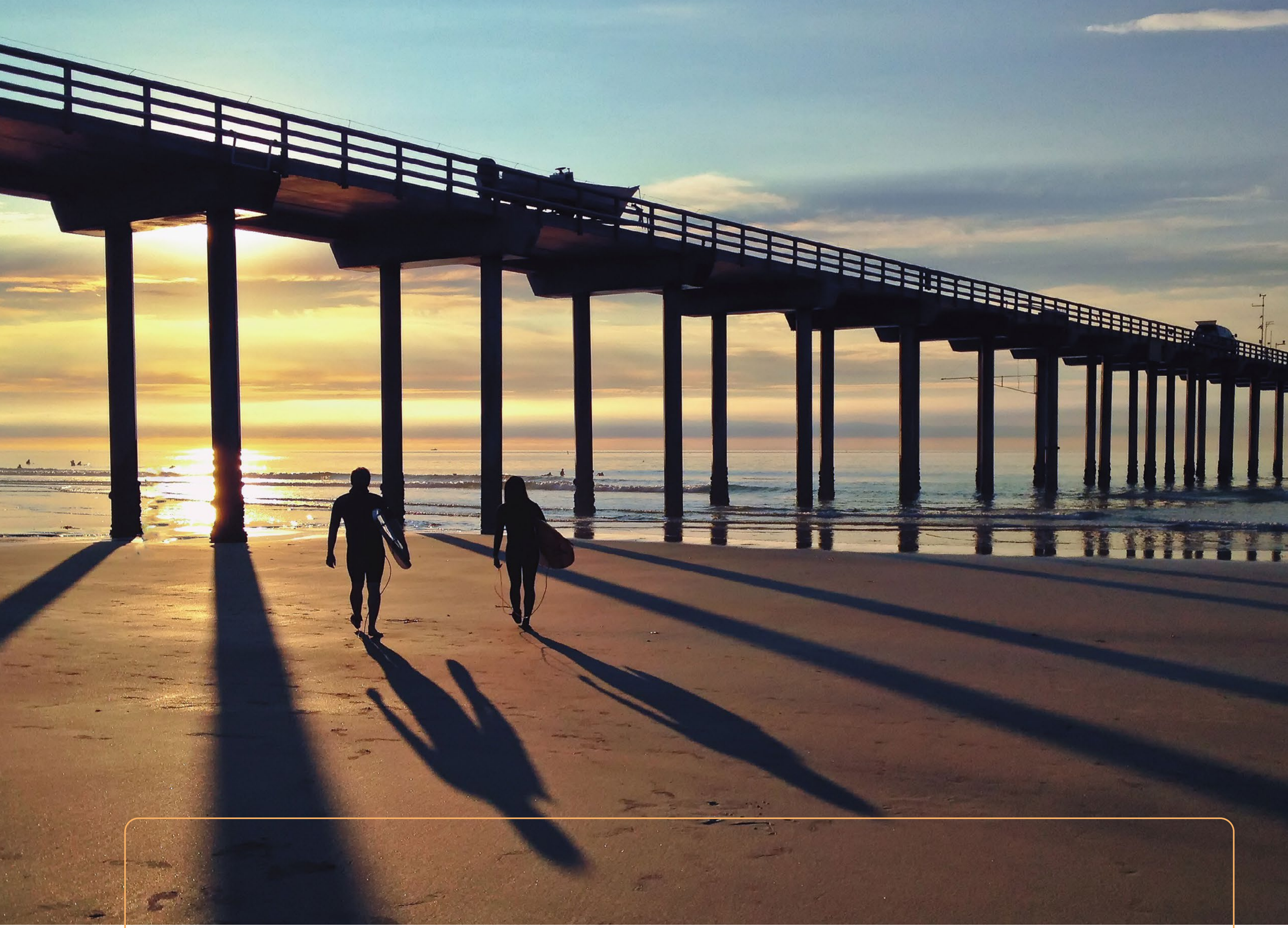
2. **INTEGRATED ALLOCATION**

   This allocation method is a process of correlating the benefits or contributions provided by the company plan with Social Security benefits. This considers the amount an employee earns relative to the Social Security Taxable Wage Base and for some employees will result in a slightly larger allowable contribution level. This type of Profit Sharing allocation is typically best for employers trying to maximize benefits for the highest paid employees.

3. **NEW COMPARABILITY ALLOCATION**

   This allocation method provides the employer with the greatest flexibility. The employer can establish classes or "tiers" of employees and can fund different contribution rates or amounts to each tier. Although this provides the greatest level of flexibility, it does require additional non-discrimination testing each year. The "tiers" need to be established in a non-discriminatory manner, but it is important to note that the allocation is generally tested based on the ages of employees in each "tier".

   This type of allocation is most advantageous for employers and owners/key employees that are closer to normal retirement age and there is a defined age difference between the owners/key employees and other employees.



There are a variety of ways to design a 401(k) plan to meet your company's specific needs. We are intimately familiar with the retirement plan options available today. We begin our process with a conversation to understand your specific goals and then present custom plan illustrations to demonstrate the different options available. As we work side-by-side with our clients, they have found this information valuable and easy to understand. For questions about your plan design options, we are happy to discuss how we may design a company sponsored plan that meets your specific retirement plan goals.

To get started, let us help.

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