



SAFE HARBOR PLAN DESIGNS

DO YOUR COMPANY OWNERS AND TOP EXECUTIVES RECEIVE REFUNDS OF THEIR CONTRIBUTIONS EACH YEAR OR ARE THEY ADVISED THAT THEY MUST LIMIT THEIR CONTRIBUTIONS? FOR MANY COMPANIES, THE EMPLOYEES WHO ARE MOST INTERESTED IN CONTRIBUTING TO THE 401(K) PLAN CAN'T. A SAFE HARBOR PLAN DESIGN MAY BE THE ANSWER FOR YOUR COMPANY'S 401(K).

The pension laws were designed to ensure that rank-and-file employees are able to realize the tax benefits of their company's retirement plan. However, these same laws also often restrict the ability of the company's key personnel, top managers, and company owners to participate in the plan. Although the tax laws allow participants to contribute as much as \$15,500 each year, Highly Compensated Employees (HCEs) can often contribute only a fraction of that amount, often receiving taxable refunds of their "excess contributions."

Contributions from Highly Compensated Employees and owners are restricted because annual compliance tests require that the contributions made and matching funds received by HCEs are conditioned on the contributions made and the matching funds received by Non-Highly Compensated Employees (NHCEs). This means that if your NHCEs do not participate or do not participate in sufficient numbers, your HCEs will find that they cannot participate either. Many companies find that, despite their best efforts to increase participation among their rank and file employees, they cannot increase participation enough to allow their top personnel to contribute as much as they would like.

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A Common Problem

Consider a company with a 50% participation rate among their NHCEs, which for many companies is quite good. The NHCEs who are participating are contributing between 1% and 3% of their salary -- typical rates for their salary level. However, as shown in Table 1, when considered in the aggregate, the average deferral rate for the NHCE group is only 1%. What does this mean for this company's HCEs? The applicable compliance tests allow HCEs to contribute on average two times the NHCE average deferral rate **or** two plus the NHCE average deferral rate, whichever is less. Since the NHCE average rate is 1%, the HCEs can only contribute 2% of their compensation. For these HCEs, 2% is far less than the legal limit of \$15,500 and, with contributions of only \$3,000 to \$4,000 each year, does little to help these executives prepare for their retirement. To make matters worse, because the HCEs can only contribute 2%, they are unable to take full advantage of the company's match, which matches \$0.50 for each \$1 contributed up to 6% of compensation.

Table 1: A Common Problem

EMPLOYEE TYPE	SALARY	DEFERRAL %	DEFERRAL \$	MATCH \$	TOTAL
NHCE	\$45,000	0.0%	\$0	\$0	\$0
NHCE	\$30,000	0.0%	\$0	\$0	\$0
NHCE	\$20,000	1.0%	\$200	\$100	\$300
NHCE	\$40,000	0.0%	\$0	\$0	\$0
NHCE	\$40,000	3.0%	\$1,200	\$600	\$1,800
NHCE	\$35,000	2.0%	\$700	\$350	\$1,050
HCE	\$150,000	2.0%	\$3,000	\$1,500	\$4,500
HCE	\$200,000	2.0%	\$4,000	\$2,000	\$6,000

* Reflects a matching contribution of \$0.50 per \$1 up to 6% of compensation.

WHAT CAN YOU DO TO ENSURE THAT YOUR 401(K) IS A BENEFIT ENJOYED BY ALL OF YOUR EMPLOYEES? SAFE HARBOR PLAN DESIGNS ARE THE SOLUTION.

When you adopt safe harbor provisions for your plan, full participation by your top personnel is **guaranteed** because the contribution rate for your HCEs is no longer conditioned on the contribution rate of your NHCEs. Regardless of participation levels by your rank and file employees, your HCEs can contribute up to the legal annual contribution limit and can receive and retain all of the matching contributions they earn. Either a Safe Harbor Match design or a Safe Harbor Non-Elective design will ensure that all of your employees are able to prepare effectively for their retirement.

Safe Harbor Match

By making an employer matching contribution of \$1 for each \$1 contributed up to 4% of compensation (or a contribution of \$1 for \$1 for the first 3% of compensation and then \$0.50 for each \$1 for the next 2% of compensation), your HCEs can defer up to the legal limit regardless of the participation rate of your NHCEs. As Table 2 demonstrates, with a safe harbor matching plan, your 401(k) becomes a real benefit to all of your employees. Not only can your HCEs contribute up to the legal limit each year, but your matching dollars are effectively targeted to key personnel, helping you to attract and retain the employees that are often the hardest to replace.

Table 2: Safe Harbor Match

EMPLOYEE TYPE	SALARY	DEFERRAL %	DEFERRAL \$	MATCH \$	TOTAL
NHCE	\$45,000	0.0%	\$0	\$0	\$0
NHCE	\$30,000	0.0%	\$0	\$0	\$0
NHCE	\$20,000	1.0%	\$200	\$200	\$400
NHCE	\$40,000	0.0%	\$0	\$0	\$0
NHCE	\$40,000	3.0%	\$1,200	\$1,200	\$2,400
NHCE	\$35,000	2.0%	\$700	\$700	\$1,400
HCE	\$150,000	10.33%	\$15,500	\$6,000	\$21,500
HCE	\$200,000	7.75%	\$15,500	\$8,000	\$23,500

* Reflects safe harbor matching contribution of \$1 per \$1 up to 4% of compensation.

To qualify for safe harbor status, along with the matching contribution, an annual Safe Harbor Notice must be provided to all eligible participants. The matching contribution must also be immediately 100% vested. If you are concerned that this may be too expensive for your company, don't forget that the matching contribution can be subject to a one Year of Service eligibility requirement, enabling you to reduce your employer costs and target the matching contribution to your longer-term employees. Even better, a generous matching contribution significantly increases the value of your 401(k) to your employees, helping you to attract the quality workforce you need and to avoid costly turn-over. Since employer contributions are not subject to payroll taxes, your matching contributions can also be a cost-effective means of providing additional compensation to your employees.

Interested?

If you have an existing plan, you can switch to safe harbor at the beginning of your next Plan Year. Since Safe Harbor Notices must be provided to your eligible participants at least 30 days prior to the beginning of the Plan Year, be sure to contact Capital Retirement Plan Services **TODAY** so that the necessary amendments and Notices can be prepared.



Safe Harbor Non-Elective

Like the safe harbor matching plan, the safe harbor non-elective plan *guarantees* your HCEs the ability to participate. In this plan design, a 3% non-elective contribution is made to all eligible employees regardless of whether they contribute into the plan. To qualify as a safe harbor contribution, a Safe Harbor Notice must be provided annually and the contribution must be immediately 100% vested. The safe harbor non-elective contribution can be subject to a One Year of Service eligibility requirement to reduce employer costs and target the employer contributions to longer term employees.

As Table 3 shows, this plan design ensures that your HCEs can contribute regardless of the participation and deferral rates of your NHCEs. Because this is a non-elective contribution, rather than a matching contribution, all eligible employees receive 3% of their eligible compensation as an employer contribution. If you intend to make a profit sharing contribution, especially if it is a cross-tested profit sharing contribution, a safe harbor non-elective plan design has the added advantage of helping you pass the non-discrimination tests applicable to such contributions.

Table 3: Safe Harbor Non-Elective

EMPLOYEE TYPE	SALARY	DEFERRAL %	DEFERRAL \$	NON-ELECTIVE \$	TOTAL
NHCE	\$45,000	0.0%	\$0	\$1,350	\$1,350
NHCE	\$30,000	0.0%	\$0	\$900	\$900
NHCE	\$20,000	1.0%	\$200	\$600	\$800
NHCE	\$40,000	0.0%	\$0	\$1,200	\$1,200
NHCE	\$40,000	3.0%	\$1,200	\$1,200	\$2,400
NHCE	\$35,000	2.0%	\$700	\$1,050	\$1,750
HCE	\$150,000	10.33%	\$15,500	\$4,500	\$20,900
HCE	\$200,000	7.75%	\$15,500	\$6,300	\$21,800

A Solution for Top Heavy

If your plan is at risk of being Top Heavy, a safe harbor plan design offers even more benefits. Plans become top heavy if more than 60% of plan assets are held by Key Employees.* If your plan becomes top heavy, your company will need to make a 3% top heavy contribution to all non-Key eligible employees or a contribution equal to the highest deferral percentage of any key employee if less than 3%.

SAFE HARBOR MATCHING PLANS are not subject to the Top Heavy Test so long as no other employer contributions are made into the plan. So even if your plan becomes top heavy, you will not be required to make the 3% top heavy contribution! **SAFE HARBOR NON-ELECTIVE PLANS** are similarly not subject to the Top Heavy Test, but have the added advantage of getting a pass on this test regardless of any other contributions that you might make. If you are at risk of being Top Heavy and will likely need to make a 3% top heavy contribution, far better to make a 3% safe harbor non-elective contribution and buy your HCEs the freedom to contribute to your plan without restriction!

* Key Employees are defined as (1) all employees who own, directly or indirectly, more than 5% of the company, (2) all employees who own, directly or indirectly, more than 1% of the company and whose annual compensation exceeds \$150,000, and (3) an officer of the company whose annual compensation for the year exceeds a prescribed dollar amount.

