



Safe Harbor 401(k) Plans

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Key Terms in Non-Discrimination Testing

Highly Compensated Employee (HCE)

An IRS term used to describe any employee that is a greater than 5% owner, certain family members of a greater than 5% owner (spouse, parent, child, grandchild) or any employee that received compensation in excess of \$105,000 in 2007.

ADP Test

The non-discrimination test applied to employee 401(k) contributions. The test compares actual deferral percentage (ADP) of highly compensated employees to those of Non-HCE. In general, only a 2% point gap is allowed between the average contribution rates of HCE and Non-HCE. ADP Test failure can result in refunds to the HCE.

ACP Test

The non-discrimination test applied to employer matching contributions. The test compares actual contribution percentages (ACP) of highly compensated employees to those of Non-HCE. In general, only a 2% point gap is allowed between the average contribution rate of HCE and Non-HCE. ACP Test failure can result in refunds to the HCE.

Key Employee

A DOL term used to describe any employee that is a greater than 5% owner, a greater than 1% owner with annual compensation in excess of \$150,000 or any officer receiving compensation in excess of \$150,000.

Top Heavy Plan

A qualified plan is considered "Top-Heavy" if the value of the Key Employees' benefits under the plan is greater than 60% of total plan benefits. If a plan is top heavy and a key employee received a benefit under the plan, this will trigger a required top-heavy minimum employer contribution of 3% of plan compensation paid to all non-keys.

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Safe-Harbor 401(k) Plan: The Basics

Introduction

The Small Business Job Protection Act (SBJPA) gave retirement plan sponsors the ability to add safe-harbor provisions to qualified plans. Adoption of safe-harbor provisions allows 401(k) plan sponsors to avoid the actual deferral percentage (ADP) test and the actual contribution percentage (ACP) test for employer contributions. These non-discrimination tests are deemed satisfied if the employer agrees to make certain contributions on behalf of plan participants.

In other words, safe-harbor adoption will allow 401(k) participants (including Highly Compensated Employees) to defer up to the maximum IRS limit without fear of discrimination test failure.

Safe-Harbor Contribution Requirements

Employers may choose from two types of contributions to satisfy safe-harbor provisions and receive ADP/ACP test relief.

Non-Elective Contribution – Employer contributes 3% of pay for each eligible employee, without regard to whether the employee actually chooses to make 401(k) deferrals. This contribution will also satisfy the minimum contribution requirements for top-heavy plans.

Matching Contribution – Employer matches 100% of the first 3% of employee deferrals, plus 50% of the next 2% of employee deferrals. This contribution will also satisfy the minimum contribution requirements for top-heavy plans.

Participants become 100% vested in all safe-harbor contributions as soon as they are made. Safe-Harbor contributions cannot be made subject to a graded or cliff vesting schedule.

Safe-Harbor Notice Requirements

Eligible employees must receive an annual written notice at least 30 days before the beginning of each plan year. Employees that become eligible during the plan year must receive notice before their eligibility date. InWest will prepare the employee notice.

Is Safe-Harbor right for your 401(k) plan?

Several factors should be considered before adopting safe-harbor provisions. The reverse side of this form contains a checklist designed to identify suitable plans for the 401(k) safe-harbor. If you answer yes to one or more of these questions, your plan may be a good candidate for safe-harbor. Please contact InWest Retirement Solutions at 1-800-594-7700 for more details.

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Identifying Suitable Plans for the 401(k) Safe-Harbor

If you answer yes to one or more of the following questions, then a safe-harbor 401(k) should be considered. Please contact InWest Retirement Solutions at 1-800-594-7700 for more details:

- **Does the business owner wish to make greater personal contributions into the retirement plan?**

Under a safe-harbor plan, the owner's personal plan contributions are not limited by staff contribution rates. In addition, safe harbor can be used in conjunction with other plan design features, such as new comparability, to dramatically increase owner contribution rates.

- **Is the plan failing the ADP and/or ACP test in a typical year?**

If the plan is failing its non-discrimination tests, safe-harbor will eliminate this problem.

- **Is satisfaction of the ADP/ACP test highly volatile, due, for example, to the nature of the employee population or changing nature of compensation earned?**

Even if the ADP/ACP tests are satisfied most years, the employer should look at safe-harbor to determine if the associated costs could be worth the comfort of knowing the tests are passed each year.

- **Is the employer willing to vest safe-harbor plan contributions 100% from date made?**

All safe-harbor contributions must be 100% vested when made.

- **Is the plan top-heavy (60% of plan assets owned by key employees)?**

Safe-Harbor contributions can be used to satisfy the top-heavy minimum.

- **Does the employer currently match employee salary deferrals?**

If the employer is already matching salary deferrals, safe-harbor is a smooth transition. The employer may also keep the plan's existing vesting schedule in place for pre-safe-harbor contributions.

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Safe-Harbor 401(k) Plan: What's New

Qualified Automatic Contribution Arrangement (QACA)

The Pension Protection Act of 2006 will make a new version of Safe Harbor available for plan years beginning after 2007. Beginning in 2008, plan sponsors can meet Safe Harbor by including an automatic enrollment feature that satisfies the definition of a Qualified Automatic Contribution Arrangement (QACA). The requirements of a QACA are discussed below.

Automatic Deferral Requirements for a QACA

The automatic enrollment percentage under a QACA must be set between 3% and 10% of compensation. If the initial percentage is set at less than 6%, then the initial percentage must be no less than the following minimum percentage requirements:

- 1) 3% for the period beginning with the first automatic contribution and ending on the last day of plan year following the plan year of the first automatic contribution.
- 2) 4% during the first plan year following the period described in (1)
- 3) 5% during the second plan year following the period described in (1) and
- 4) 6% during any subsequent plan year

For example, if an employee is auto enrolled on 1/1/2008 then his minimum percentage can be set at 3% until 12/31/2009. It must then be increased to at least 4% for 2010, at least 5% for 2011 and at least 6% for 2012 and subsequent years.

Due to the administrative complexities of increasing plan deferral contributions as described above, we suggest that employers consider setting an initial automatic enrollment percentage at 6% or more.

Basic Matching Formula Requirements for a QACA

Under a QACA, the Employer matches 100% of the first 1% of compensation that is deferred by the employee plus 50% of the next 5% deferred by the employee. Thus, the maximum required match is 3.5% of compensation. This compares to maximum non-QACA safe harbor match of 4% of compensation.

Vesting Requirements for a QACA

Employer matching contributions under a QACA safe harbor must be 100% vested for any employee who has completed at least 2 years of service. This compares to 100% immediate vesting of employer contributions under a non-QACA safe harbor plan.

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Safe-Harbor 401(k) Plan Illustration

Employee	Plan Comp	Traditional 401(k)				Safe-Harbor 401(k) Matching Option				Safe-Harbor 401(k) Non-Elective Option			
		EE Deferral	ADP	ER Match	ACP	EE Deferral	ADP	ER Match	ACP	EE Deferral	ADP	ER Cont	ACP
President	225,000	15,500	6.89%	6,750	3.00%	15,500	6.89%	9,000	4.00%	15,500	6.89%	6,750	3.00%
VP	120,000	15,500	12.92%	3,600	3.00%	15,500	12.92%	4,800	4.00%	15,500	12.92%	3,600	3.00%
HCE Totals	345,000	31,000	9.90%	10,350	3.00%	31,000	9.90%	13,800	4.00%	31,000	9.90%	10,350	3.00%
Staff	70,000	7,000	10.00%	2,100	3.00%	7,000	10.00%	2,800	4.00%	7,000	10.00%	2,100	3.00%
Staff	60,000	4,800	8.00%	1,800	3.00%	4,800	8.00%	2,400	4.00%	4,800	8.00%	1,800	3.00%
Staff	60,000	3,000	5.00%	1,800	3.00%	3,000	5.00%	2,400	4.00%	3,000	5.00%	1,800	3.00%
Staff	50,000	2,000	4.00%	1,500	3.00%	2,000	4.00%	1,750	3.50%	2,000	4.00%	1,500	3.00%
Staff	40,000	1,200	3.00%	1,200	3.00%	1,200	3.00%	1,200	3.00%	1,200	3.00%	1,200	3.00%
Staff	40,000	-	0.00%	-	0.00%	-	0.00%	-	0.00%	-	0.00%	1,200	3.00%
Staff	30,000	900	3.00%	900	3.00%	900	3.00%	900	3.00%	900	3.00%	900	3.00%
Staff	30,000	-	0.00%	-	0.00%	-	0.00%	-	0.00%	-	0.00%	900	3.00%
Staff	20,000	400	2.00%	400	2.00%	400	2.00%	400	2.00%	400	2.00%	600	3.00%
Staff	20,000	-	0.00%	-	0.00%	-	0.00%	-	0.00%	-	0.00%	600	3.00%
Non-HCE Totals	420,000	19,300	3.50%	9,700	2.00%	19,300	3.50%	11,850	2.35%	19,300	3.50%	12,600	3.00%
Company Totals	765,000	50,300		20,050		50,300		25,650		50,300		22,950	

ADP Test Failure
HCE Corrective Refunds = \$12,025

ADP and ACP Passes

ADP and ACP Passes

Notes:

Highly compensated employee (HCE) defined as greater than 5% owners, certain family members of greater than 5% owners and/or employees earning over \$105,000 in 2007.

ADP Test fails with Traditional 401(k) because HCE average deferral rate of 9.90% exceeds 5.50% (Non-HCE average deferral rate 3.50% plus 2.00%).

An HCE corrective refund of \$12,025 will lower the HCE average deferral rate to 5.50% and the ADP Test is deemed to have passed.



InWest Retirement Solutions partners with employers and financial advisors to design, communicate and administer retirement savings plans. We pursue innovative solutions that help our clients promote corporate objectives, control costs and give employees needed retirement income security.

OUR SERVICES

Plan Design

We recognize that every employer's objective and financial capabilities are different. We offer customized plan design services to meet the unique needs of each employer. Whether the goal is maximizing benefits for owners and key employees or employee recruitment and retention, our plan architects can build a plan to meet your needs.

Plan Installation

Our clients receive turnkey plan installation services; including plan documents prepared by experienced ERISA consultants and hands-on coordination of existing plan conversions. Our dedicated plan installation team guides you every step of the way.

Plan Communication

The effective communication of your plan is key to its success. Our communication specialists create campaigns that explain benefits in simple terms and spark enthusiasm for the plan. InWest is recognized for our customized communication efforts that both empower and educate plan participants.

Plan Administration

Responsiveness. Accuracy. Full Service. These are some of the core qualities that define us as a company and make InWest a leader in retirement plan administration. Our experience team frees you from the tedium of day-to-day plan administration.

WE SPECIALIZE IN

Retirement Plans

Traditional 401(k) Plans
Safe-Harbor 401(k) Plans
New Comparability Profit Sharing Plans
457/403(b) Plans
Owner-Only Retirement Plans
Defined Benefit Plans
New Comparability Cash Balance Plans
Defined Contribution/Defined Benefit Combo Plans

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