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QUALIFIED PLAN CONSULTANTS

Plan Sponsor 401(k) Retirement Plan Analysis

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Controlled Groups & Affiliated Service Groups

Is your group a Controlled Group or an Affiliated Service Group?

For purposes of the 401 (k) plan, employees are considered employees of the client employer, i.e. your company. Each adopting company is individually tested for compliance purposes. When a group of companies has sufficient ownership, they form a *controlled group.* The employees of these companies are treated as if they were employed by a single employer, unless they are able to pass section 410(b) coverage separately.

A controlled group exists if five or fewer individuals have 80% or more common ownership, or if a corporation has controlling interest of at least 80% of a subsidiary. Affiliated service groups may not require a common ownership to be treated as a controlled group. A legal opinion should be sought by the client to determine if a controlled group or affiliated service group exists for plan testing purposes.

Plan Design Alternatives

	SIMPLE-IRA	Safe harbor 401(k)	Cross-tested	Cash Balance
Key Advantages	Salary reduction plan with little administrative paperwork.	No nondiscrimination testing required.	Can target specific group of participants for greater employer contributions	Can target specific group of participants for greater employer contributions
Employers Who Can Provide This Option	Any employer with 100 or fewer employees that does not currently maintain another retirement plan.	Any employer with one or more employees.	Any employer with one or more employees.	Any employer with one or more employees.
Employer's Responsibilities	Set up plan, for example, by completing IRS Form 5304-SIMPLE or IRS Form 5305-SIMPLE. No annual filing requirement for employer. Bank or financial institution does most of the paperwork.	There is no model form to establish a plan. Advice from a financial institution or employee benefit advisor would be necessary. Annual filing of Form 5500 is required.	There is no model form to establish a plan. Advice from a financial institution or employee benefit advisor would be necessary. This is a complex design, and therefore requires a greater level of expertise. Annual filing of Form 5500 is required.	There is no model form to establish a plan. Advice from a financial institution or employee benefit advisor would be necessary. This is a complex design, and therefore requires a greater level of expertise. Annual filing of Form 5500 is required.
Funding Responsibility	Employee salary reduction contributions and employer contributions.	Employee salary reduction contributions and (any required) employer contributions.	Annual employer contribution is discretionary.	Annual employer contribution is required.
Maximum Annual Contribution (Per Participant)	***Employee:*** Up to \$11,500 (for 2011). Additional contributions can be made by participants age 50 or over. ***Employer:*** Either match employee contributions 100% of first 3% of compensation (can be reduced to as low as 1% in any 2 out of 5 yrs.) or contribute 2% of each eligible employee's compensation.[2]	***Employee:*** \$16,500 in 2011. Additional contributions can be made by participants age 50 or over. ***Employer/Employee Combined:*** Contributions per participant up to the lesser of 100% of compensation or \$49,000 in 2011.[1] Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	Contributions per participant up to the lesser of 100% of compensation or \$49,000 in 2011.[1] **Employer** can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	Contributions are determined by a formula specified in the plan document. Limits for 2011 can exceed \$49,000 depending on your age and level of compensation.
Minimum Employee Coverage Requirements	Must be offered to all employees who have earned at least \$5,000 in any prior 2 years, and are reasonably expected to earn at least \$5,000 in the current year.	Generally, must be offered to all employees at least age 21 years of age who worked at least 1,000 hours in a previous year.	Generally, must be offered to all employees at least age 21 years of age who worked at least 1,000 hours in a previous year.	Generally, must be offered to all employees at least age 21 years of age who worked at least 1,000 hours in a previous year.
Withdrawals & Payments	Withdrawals at any time. If employee is under age 59 ½, may be subject to a 25% penalty if taken within the first 2 years of participation and a possible 10% penalty if taken afterwards.	Salary deferrals cannot be withdrawn until a specified event, such as reaching age 59 ½, death, severance from employment, or in other limited circumstances. May permit hardship withdrawals. Withdrawals may be subject to a possible 10% early withdrawal	Withdrawals can be made after contributions have remained in the plan for at least two years, the participant has attained a certain age, or other specified occurrence as set forth in the plan. Withdrawals may be subject to a possible 10% early withdrawal	Withdrawals can be made no earlier than the date the participant has reached age 62.
Loans permitted	No.	Yes, with restrictions.	Yes, with restrictions.	Yes, with restrictions.
Vesting	Employer and employee contributions are vested 100% immediately.	Employee salary deferrals and required employer contributions (safe harbor) are immediately 100% vested. Additional employer contributions may vest over time according to plan terms with a maximum of a 6 year graded or 3 year cliff schedule.	May vest over time according to plan terms with a maximum of a 6 year graded or 3 year cliff schedule.	May vest over time according to plan terms with a maximum of a 3 year cliff schedule.
Contributor's Options	Employee can decide how much to contribute. Employer must make matching contributions or contribute 2% of each employee's salary up to the set maximum.	Employee can elect how much to contribute pursuant to a salary reduction agreement. The employer must either make specified matching contributions or a 3% contribution to all participants.[3]	The amount of the contribution is discretionary on the part of the employer. The allocation of the contribution is set by plan terms.	The amount of the contribution is required on the part of the employer. The allocation of the contribution is set by plan terms.

[1] Maximum compensation on which 2011 can be based is \$245,000. [2] Maximum compensation on which 2011 employer 2% non-elective contributions can be based is \$245,000. [3] Match must be 100% of deferral up to 3% of compensation, plus 50% of deferral from 3% to 5% of compensation.

401(k) Testing Requirements

ADP & ACP Testing

Special nondiscrimination rules apply to 401(k) plans that do not utilize the Safe Harbor provisions, to ensure that deferrals made by HCEs are not disproportionate to deferrals made by rank-and-file employees. Usually a company's HCEs can defer two percentage points more than the ADP of the non-HCEs.

The maximum amount of compensation that can be used as the basis for HCE deferral rates is $245,000 for 2011. Compensation is pro-rated throughout the plan year for the purpose of elective deferrals. Therefore when a plan is adopted mid-year, only compensation earned after the adoption date or eligibility date can be considered.

In order to obtain unique tax-favored advantages of a qualified plan, the amount of contributions under your 401(k) plan must not discriminate in favor of highly compensated employees (HCEs). Employees are divided into two groups:

HCE – *Highly compensated employee*

- >5% owner
- Earned over $110,000 during the previous calendar year (2010), with the current employer

NHCE – *Non-highly Compensated Employee*

- Any eligible employee who is not part of the HCE group.

ADP & ACP Testing

Based on the average percentage of income deferred by your NHCEs during the plan year, the following chart shows the maximum average percentage of deferred income available to your HCEs.

If your company is establishing a 401(k) plan for the first time, the maximum average percentage of income that can be deferred by the HCEs during the initial plan year is 5%.

ADP for NHCE	ADP for HCE	Rule Used
1%	2%	Times 2
2%	4%	Plus 2
3%	5%	Plus 2
4%	6%	Plus 2
5%	7%	Plus 2
6%	8%	Plus 2
7%	9%	Plus 2
8%+	10%+	Times 1.25

Top Heavy Test

A 401(k) Plan is Top Heavy if 60% of the plan assets are held by key employees on the last day of the preceding plan year. If a 401(k) plan is top-heavy, the client employer is generally required to make a 3% non-elective contribution to all eligible non-key employees, whether or not the employees elected to participate. If a plan is top heavy at the end of the first year of the plan, then the 3% is required for the initial year and the following year.

Key Employee

- Employees who own more than 5% of the business, their spouses and lineal relatives;
- Shareholder owning more than 1% of company stock and earns over $160,000 in the current year; or
- Corporate officers who earn over $160,000

401(k) Safe Harbor Plan Design

You can select a Safe Harbor Plan design and eliminate the nondiscrimination testing requirements that apply to 401(k) deferrals and matching contributions (ADP & ACP tests).

This means the owners and highly compensated employees (HCEs) can defer up to 100% of eligible compensation or $16,500 for 2011*, whichever is less.

- Companies that elect a Safe Harbor Plan Design are also deemed to pass the Top Heavy Test.
- Your company should consider a Safe Harbor Plan design if you currently have a 401(k) Plan that is Top Heavy or is you anticipate a low level of participation from your non-highly compensated employees (NHCEs)

*Indexed: 2008 - $15,500; 2009 - $16,500; 2010 - $16,500

Safe Harbor Funding Options

Two Types of Employer Contribution Methods

1. Safe Harbor Matching Contribution:
   - 100% match on the first 3% of participant deferrals; then a 50% match on the next 2% of pay deferred
   - Contribution is immediately 100% vested
   - Matching contribution is paid each pay period or annually

2. Safe Harbor Nonelective Contributions:
   - 3% of compensation to all eligible employees
   - Contribution is immediately 100% vested
   - Employer contribution is paid after the end of the plan year

Note: You must make your Safe Harbor election prior to the start of the plan year. Notification requirements provide that employees be given written notice of the 401(k) Safe Harbor election at least 30 days prior to the beginning of the plan year.

Cross-Tested Plan Design

◆ *What is a New Comparability profit sharing plan?* A New Comparability profit sharing formula is a plan design that may result in greater funding flexibility among the plan participants.

◆ *What are the advantages of a New Comparability profit sharing plan over a traditional defined benefit plan?*

A New Comparability profit sharing plan:

- Allows different allocations among different groups of plan participants;
- May allow groups to be determined by salary, service, position, or even a combination of these categories;
- May allow the owner to receive a much larger allocation, as a percentage of pay, than other plan participants; and
- May allow an owner to select those participants he would like to reward with larger allocations.

◆ *What requirements must be met to qualify as a nondiscriminatory New Comparability plan?*

1) The design is referred to as a "cross-tested" type of profit sharing plan. The nondiscrimination testing is done by reviewing the projected benefits at retirement as opposed to the traditional plan approach of reviewing the contributions allocated to a participants account each year. In this type of design, the plan is not required to allocate the same percentage of pay to all participants.
2) The projected benefits of the highly compensated employees are averaged and compared to the average projected benefits of all other employees. If the comparison of benefits fall within a particular range, the plan will pass the mathematical testing stipulated in the regulations to qualify as a nondiscriminatory plan.
3) The flexibility allowed will be most pronounced if the key employees are, on average, older than most of the other employees.

Cash Balance Plan Design

What is a Cash Balance Plan? A Cash Balance Plan is a type of hybrid defined benefit plan that operates in ways similar to a Profit Sharing plan. A participant's account grows annually in two ways: first, a contribution and second, an interest credit. This interest credit is guaranteed and is not dependent on the plan's investment performance. Some of the key features are outlined below.

- Individual Accounts. Participants have their own individual accounts. All participant accounts are maintained by the plan actuary who generates an annual "Participant Statement."
- Annual employer contribution. The account is credited annually with an employer contribution which is determined by a formula specified in the Plan Document. The amount is typically a percentage of salary, although it may also be a flat dollar amount.
- Interest credit. Because it is a defined benefit, the interest credit is guaranteed and is not dependent on the plan's investment performance. The guaranteed rate can be tied to an outside index, such as the 30-year treasury rate, which can fluctuate from year-to-year. In recent years, the 30-year rate has been close to 5%. All accounts are invested collectively by the Plan Trustee in one pooled account.
- Accounts are portable. When an employee leaves an employer, the vested portion of the account can be taken as a lump sum or rolled to an IRA.

Who is an Ideal Candidate for a Cash Balance Plan?

- Those who want to contribute more than $49,000 to a qualified plan.
- Those who need to catch-up on their retirement savings.
- Those who want a more significant current-year tax deduction and tax-deferral.

Definitions

- **401(k) plan:** A defined contribution plan offered by a corporation to its employees, which allows employees to set aside tax-deferred income for retirement purposes, and in some cases employers will match the employees contribution. The name 401(k) comes from the IRS section describing the program.

- **415 Limit:** The Maximum Annual Contribution that can be made to each participants account. The limit is actually expressed as the lesser of the dollar limit, $49,000 for 2011, or 100% of the participants compensation. All employee (elective deferral), employer (match or profit sharing) and forfeiture money is counted toward the 415 limit. However “catch-up” contributions are not.

- **Catch-up contributions:** In 2001 congress passed EGTRRA, Economic Growth & Tax Relief Reconciliation Act. This Act allows anyone age 50 or older to make “catch-up” contributions. The limit for 2011 is $5,500. The “catch-up” contribution is in addition to the elective deferral limit, which is $16,500 for 2011. Catch-up contributions are excluded from ADP testing.

- **Elective Deferral:** Contributions made by an employee on a pre-tax basis to a 401(k) plan or other qualified plan under IRC § 402(g)(1). The 2011 deferral limit is $16,500 for those under age 50.

- **HCE:** Highly compensated employee. More than a 5% owner, and/or earned over $110,000 during the previous calendar year (2010).

- **NHCE:** Non-Highly compensated employee. Any eligible employee who is not part of the HCE group.

Definitions (cont.)

- **Safe Harbor 3%:** Safe Harbor provision with a 3% employer contribution to each eligible participant regardless if they contribute to the plan.

- **Safe Harbor Match:** Safe Harbor provision with employer matching contributions of 100% on the first 3% and 50% on the next 2% of pay deferred.

- **Cross-Tested 401(k) Profit Sharing Plan:** This design may allow for the largest possible share of the firm's contribution to be allocated to the owner and/or key employees. There is flexibility in the contribution level since it is a profit sharing plan and the contribution each year is discretionary. The plan works best when the business owner is older and significantly higher paid than most of the other employees.


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