

## Safe Harbor 401(k) Plans

Traditional 401(k) plans require annual testing to determine if highly compensated employees and owners are contributing too much in comparison to other employees. Correcting a failed test requires either an additional employer contribution or a refund to owners and highly compensated employees.

By adopting a Safe Harbor 401(k) Plan, or amending your current 401(k) Plan to a Safe Harbor Plan, you eliminate annual ADP and ACP tests. This gives you and your highly compensated employees the opportunity to take full advantage of the \$16,500 salary deferral limit, regardless of whether your other employees choose to contribute. You'll never have to worry about taxable refunds at the end of the year!

A Safe Harbor 401(k) Plan must meet certain requirements in order to avoid the annual discrimination testing. These requirements are:

1. The employer must provide employees with written notice every year of the safe harbor status of the plan.
2. The employer must make mandatory 100% vested contributions every year. The safe harbor contribution can be either of the following:
  - A matching contribution of 100% on the first 3% of compensation deferred and a 50% match on deferrals between 3% and 5%, or an enhanced match of 100% of deferrals up to 4 , 5 or 6% of pay.
  - A contribution of 3% of the compensation for each eligible employee regardless of whether the employee contributes to the plan.

### **Safe Harbor 401(k) Plans offer distinct advantages over the SIMPLE IRA plan:**

| Safe Harbor 401(k) Plans compared to SIMPLE IRA Plans (2011) |             |                        |
|--|-------------|------------------------|
| Provision  | Safe Harbor | SIMPLE IRA             |
| Maximum Deferral   | \$16,500    | \$11,500               |
| Catch-up Contribution  | \$5,500     | \$2,500                |
| Total Deferral with Catch-up                                 | \$22,000    | \$14,000               |
| Required Company Contributions                               | YES         | YES                    |
| Participant Loans  | YES         | NO                     |
| Maximum Company Size   | No Maximum  | 100 or fewer employees |

## General Rules for Safe Harbor Plans

- All safe-harbor contributions are 100% vested.
- There may be no allocation requirements imposed on safe-harbor contributions, such as a 1,000-hour service requirement or a last day employment rule.
- Safe-harbor contributions are not available for in-service withdrawal prior to age 59½.
- Safe-harbor contributions may not be used to satisfy permitted disparity (social security integration) allocation formulas.
- Safe-harbor contributions may be used towards satisfying the top-heavy plan minimum contribution requirement.
- All eligible participants must receive a written notice describing the applicable safe-harbor provisions between 30 and 90 days before the beginning of the plan year. This notice must be provided for each year the plan will be utilizing safe-harbor provisions.
- Flexibility to switch between options from year to year as long as the employee notice is given as required and the plan document is amended.
- With the non-elective option, you have the flexibility to state that you are considering, though not committing to, making this type of company contribution and that you will notify them if you decide to do so.

### Consider the following example of a straight forward Safe Harbor 401(k) Plan

| Employee       | Salary           | Deferrals        | 3% Employer Contribution | Total           |
|----------------|------------------|------------------|--------------------------|-----------------|
| <b>Owner A</b> | <b>\$245,000</b> | <b>\$22,000*</b> | <b>\$7,350</b>           | <b>\$29,350</b> |
| <b>Owner B</b> | <b>\$150,000</b> | <b>\$22,000*</b> | <b>\$4,500</b>           | <b>\$26,450</b> |
| Employee 1     | \$50,000         | Voluntary        | \$1,500                  | \$1,500         |
| Employee 2     | \$40,000         | Voluntary        | \$1,200                  | \$1,200         |
| Employee 3     | \$30,000         | Voluntary        | \$900                    | \$900           |
| <b>Total</b>   |                  | <b>\$44,000</b>  | <b>\$15,450</b>          | <b>\$59,400</b> |

*\*Includes \$5,500 Catch-up contribution.*

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