

THE BENEFIT BULLETIN

FAST FACTS ABOUT RETIREMENT PLANS

The following article contains general plan facts and is intended for informational purposes only. To ensure that your plan contains specific provisions outlined in this and future articles, please contact your third party administrator or plan ERISA attorney.

Safe Harbor 401(k)

The safe harbor 401(k) plan is one of the most popular plan designs for small employers. The primary use of the safe harbor feature is to avoid failing either of two required tests the plan is subject to each year, the "ADP/ACP test" and the "top heavy test". Failure of these tests often results in required refunds to highly compensated employees (HCE) and/or mandatory employer contributions.

In most cases, adding a safe harbor feature to a 401(k) plan will cause the plan to automatically "pass" the ADP/ACP test as well as the top heavy test. However, in exchange for the automatic pass, the employer must make a safe harbor contribution to the employees in the plan. Nevertheless, the safe harbor feature can greatly benefit the HCE because it may allow them to make the maximum allowable deferral contribution each plan year (\$15,500 for 2007).

There are two types of employer contributions that satisfy the safe harbor conditions: a non-elective contribution or a matching contribution. The distinct difference between the two types of safe harbor contributions is that only employees actually deferring salary into the plan will receive the matching contribution. However, employees do not have to defer salary to be eligible for the non-elective contribution. Both contributions are automatically 100% vested and must be given to each eligible employee regardless of how many hours they worked during the plan year or if they are employed on the last day of the plan year.

The Non-elective Employer Contribution must be equal to at least 3% or more of the eligible employees' compensation. As mentioned, generally, the 3% contribution must be made to all employees eligible to make elective deferrals to the plan, whether or not they are actually deferring salary into the plan.

The Basic Matching Employer Contribution is defined as a matching contribution equal to 100% of the first 3% of compensation deferred, plus 50% on the next 2% of compensation deferred. For example, a participant deferring 5% or more of their compensation will receive an employer matching contribution equal to 4% of their compensation.

There are some additional requirements that must be met in order for a plan to qualify for safe harbor status. The plan document must be amended to include the applicable safe harbor contribution type, and a safe harbor notice must be provided to eligible employees at least 30 days (but not more than 90 days) before the beginning of the plan year in which the safe harbor option is applicable. The election to operate the 401(k) plan as a safe harbor 401(k) must be documented in advance for each plan year.

If you are interested in adding a safe harbor provision to your plan, please contact your third party administrator or plan ERISA attorney.

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