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## **Creative Plan Design Ideas for 2010**

Administrative Retirement Services, Inc. (ARS) believes that plan design is paramount to the success of a retirement plan. In order to properly design a retirement plan, the plan objective must be clearly defined. The most common plan objective we encounter and the one we are going to discuss first is to maximize benefits to the business owner while minimizing contributions to the other participants. This objective can be met by setting up a Cross-Tested Safe Harbor 401(k) Plan. A Cross-Tested Safe Harbor 401(k) Plan is a type of retirement plan which provides the most flexibility in how profit sharing contributions are allocated.

### **Cross-Tested Plans**

Cross-testing is a plan design concept which allows a company to define classes of employees and contribute profit sharing contributions on a percentage basis to each class. Cross-testing works best in a company which has a business owner who is slightly older than the rest of the employees. Annually, the contribution formula must pass an average benefits test. In addition to the average benefits test, the plan must also satisfy a minimum allocation gateway where each non-highly compensated employee (NHCE) in the plan has an allocation rate that is at least one-third of the allocation rate of the highly compensated employee (HCE) with the highest allocation rate, or, each NHCE receives an allocation percentage of at least 5% of the NHCE's compensation.

In a typical cross-tested plan, HCEs receive a higher allocation rate, often 14% to 25% of compensation, while NHCEs, regardless of their age or years of service, receive comparatively lower allocation rates of 5% or less of compensation. For clients who want to utilize cross-testing and safe harbor but want to contribute the minimum amount and receive the maximum available, the owner would receive 9% of compensation and the other eligible employees would receive 3%, which passes the allocation gateway described above.

### **Safe Harbor 401(k) Plans**

Safe Harbor is a concept which has been around since 1999 and allows plans to automatically pass nondiscrimination and top-heavy testing (see ARS July 2004 newsletter "What All 401(k) Sponsors Should Know" for a complete definition of nondiscrimination and top-heavy testing). A Safe Harbor 401(k) Plan requires that the plan sponsor contribute either 3% of compensation to all eligible participants, or match 100% of the first 3% plus 50% of the next 2% of employee compensation deferred. Both contributions are 100% vested immediately.

In order for a company to adopt safe harbor for a calendar year plan, the plan must be amended and notice must be given to the employees at least 30 days prior to the beginning of the plan year, or by December 1 for calendar year plans.

## Creative Plan Design Ideas for 2010. . . Cont'd

The maximum contribution a participant can receive in a 401(k) profit sharing plan for 2010 from all contribution sources such as 401(k), profit sharing, matching and safe harbor is \$49,000, excluding catch-up contributions. See [www.ars401k.com](http://www.ars401k.com) for a complete listing of the 2010 annual plan limits.

In most plan design scenarios the company contribution is reduced if the business owners can contribute the maximum 401(k) amount. For 2010, participants can contribute \$16,500 to a 401(k) plan. If the participant will attain the age of 50 during 2010, they can also contribute \$5,500 as a catch-up contribution. One way to guarantee that the business owner will be able to contribute the maximum 401(k) amount without testing issues is to adopt either Safe Harbor contribution option.

If the business owner utilizes safe harbor and has a spouse on the payroll, the spouse can contribute 100% of their wages up to the annual limits to the plan.

### Examples

In **Option One** we have demonstrated two business owners at different wage levels receiving the maximum 401(k) contribution amount of \$16,500 plus \$5,500 as a catch-up contribution by utilizing the Safe Harbor Non-Elective 3% contribution. The company is also contributing Profit Sharing contributions of 1.42% to the employees and 10.27% to the owners, which are subject to the plan's normal vesting schedule. Under this scenario the business owners receive 72% of the employer contributions.

Some business owners only want to make contributions for those employees who are contributing to their own retirement. The Safe Harbor Matching contribution of 100% of the first 3% plus 50% of the next 2% of employee contributions is a great option for them to use. In **Option Two** we have demonstrated all of the employees contributing 5% of compensation and receiving the Safe Harbor Match. Under this scenario, the business owners can again contribute up to the annual limit of \$16,500 plus \$5,500 as a catch-up contribution for 2010. The matching contributions for the employees are affordable and each business owner contributes the maximum amount allowed. The business owners receive 46% of the matching contributions.

An option to consider for a business with no employees other than the business owner and spouse is a Solo 401(k) Plan. For an owner only business which earns less than \$196,000 per year, a 401(k) plan allows those individuals to contribute more than a traditional profit sharing or SEP. If the owner earned \$100,000 for 2010 and was over 50 years old, under a traditional profit sharing plan the company contribution could be up to \$25,000. If you added a 401(k) feature to the profit sharing plan, the individual can also contribute \$16,500 plus the \$5,500 catch-up contribution for 2010, for a total contribution of \$47,000. Note that there can be no common law full-time employees in the company. Part-time employees who work less than 1,000 hours per year can be excluded from the plan.

For specific plan design ideas, contact Administrative Retirement Services, Inc.

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## Creative Plan Designs for 2010

<u>Name</u>	<u>Age</u>	<b>Option One</b>					<b>Option Two</b>	
		<b>Cross-Tested Safe Harbor 401(k) Plan</b>					<b>Safe Harbor Match</b>	
		<u>Compensation</u>	<u>401(k)</u>	<u>PS</u>	<u>Safe Harbor</u> <u>3%</u>	<u>Total</u>	<u>401(k)</u>	<u>Safe Harbor Match</u>
Owner 1	56	245,000	22,000	25,150	7,350	54,500	22,000	9,800
Owner 2	55	100,000	22,000	10,265	3,000	35,265	22,000	4,000
<b>Total Owners</b>		<b>345,000</b>	<b>44,000</b>	<b>35,415</b>	<b>10,350</b>	<b>89,765</b>	<b>44,000</b>	<b>13,800</b>
Employee 1	48	75,000	0	1,066	2,250	3,316	3,750	3,000
Employee 2	42	40,000	0	569	1,200	1,769	2,000	1,600
Employee 3	47	60,000	0	853	1,800	2,653	3,000	2,400
Employee 4	51	55,000	0	782	1,650	2,432	2,750	2,200
Employee 5	36	30,000	0	427	900	1,327	1,500	1,200
Employee 6	32	25,000	0	355	750	1,105	1,250	1,000
Employee 7	38	35,000	0	498	1,050	1,548	1,750	1,400
Employee 8	35	30,000	0	427	900	1,327	1,500	1,200
Employee 9	33	20,000	0	284	600	884	1,000	800
Employee 10	26	28,000	0	398	840	1,238	1,400	1,120
<b>Total Employees</b>		<b>398,000</b>	<b>0</b>	<b>5,659</b>	<b>11,940</b>	<b>17,599</b>	<b>19,900</b>	<b>15,920</b>
<b>Total Contributions</b>			<b>44,000</b>	<b>41,074</b>	<b>22,290</b>	<b>107,364</b>	<b>63,900</b>	<b>29,720</b>
<b>Percentage to Owners</b>			<b>100%</b>	<b>86%</b>	<b>46%</b>	<b>84%</b>	<b>69%</b>	<b>46%</b>
<b>Percentage to Employees</b>			<b>0%</b>	<b>14%</b>	<b>54%</b>	<b>16%</b>	<b>31%</b>	<b>54%</b>
<b>Percentage of Profit Sharing &amp; Safe Harbor to Owners</b>						<b>72%</b>		
<b>Total Profit Sharing and Safe Harbor</b>						<b>63,364</b>		
<b>Total Profit Sharing and Safe Harbor to Owners</b>						<b>45,765</b>		

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