

Administrative Retirement Services, Inc.
2 S. 545 IL Route 53
Glen Ellyn, IL 60137
Phone (630) 942-0010, Fax (630) 942-0020



The Best Plan Design

The best plan design for plan sponsors that want to make employer contributions to their plan continues to be a Cross-Tested Safe Harbor 401(k) Plan. This plan design provides plan sponsors the most flexibility since both Cross-Testing and Safe Harbor can be easily turned on and off from year to year.

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 employer defined class. Contribution classes can be set up based on job title or job classification.

In a basic cross-tested contribution allocation, the owners would be in one class receiving a contribution of 9% of compensation and all other eligible employees would be in another class receiving a contribution of 3% of compensation. This 3% contribution can be a Safe Harbor contribution.

In a more owner friendly cross tested contribution allocation, the owners may be in one or more classes receiving 15% to 25% of compensation, while nonowners, regardless of their age or years of service, may be in other classes receiving a lower allocation percentage. The contribution allocation must pass an average benefits and gateway testing.

Cross testing works best if the owners are older than the employees.

Compensation for plan purposes is limited to \$245,000 for 2011.

In addition to the cross tested profit sharing contribution the business owner can also contribute the maximum 401(k) contribution to the plan. For 2011 the maximum 401(k) contribution is \$16,500 plus an additional \$5,500 as a catch up contribution if the employee obtains age 50 or over any time during the calendar year.

Safe Harbor is a plan design which allows plans to automatically pass nondiscrimination and top-heavy testing. Safe Harbor allows the business owner and highly compensated employees to contribute the maximum 401(k) amount to the plan.

Cross-testing is a great way to allocate bonuses. Because various classes of employees can be set up, business owners can set up multiple classes and reward employees in various job positions differently.

Profit sharing contributions provide additional savings to the company because they avoid social security and medicare taxes. It is not too late to cross test your plan for 2010 or 2011.

Contact Administrative Retirement Services, Inc. if you have any questions or you would like us to run a demonstration for you using your company data.

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