



401(k) Nondiscrimination Testing May Be Avoided

Many employers have established a pension plan for the benefit of their employees and the majority of these plans have a 401(k) feature which allows employees to contribute a portion of their compensation to the plan on a pre-tax basis. 401(k) plans are required to perform the actual deferral percentage (ADP) test on an annual basis. This test may limit the amount of salary reduction contributions that highly compensated employees (HCEs) may make to the plan. If the plan is not getting sufficient contributions from the non-highly compensated group of employees, contributions by the HCEs could be limited. If matching contributions are made to the plan by the employer, the employer is required to perform the actual contribution percentage (ACP) test as well.

In order to get the maximum benefit for the HCEs, it is important to get high participation from the rest of the employees. These employees need to be aware of how the plan will benefit them. The Company and/or the investment advisor should be setting up meetings with all employees to discuss the benefits of the plan in order to increase participation.

If the plan is still having difficulties passing the tests, the plan can consider automatic enrollments for employees. The Pension Protection Act of 2006 automatic enrollment provision encourages employers to adopt these provisions by providing nondiscrimination safe harbors for elective deferrals and matching contributions but the following must occur:

1. Employees who have not made an affirmative election to participate or not participate in the plan are required to contribute 3% of compensation, increasing by 1% per year up to 6% of pay.
2. The plan must provide notice of the ability to opt out of either contributions or automatic increases.
3. The employer must match 100% of the first 1% of pay contributed by the employee, plus 50% of the next 5% of pay (3.5% match).
4. Vesting for the employer match must be 100% after 2 years of service.
5. This is available for plan years beginning after December 31, 2007.

Plans that have implemented the above requirements will be considered a safe harbor plan and will avoid the nondiscrimination testing. If a participant was automatically enrolled in the plan and within 90 days of joining the plan does not want to participate in the plan, these contributions can be returned to the employee without withdrawal

restrictions or a 10% early withdrawal penalty. These amounts will be included in taxable income in the year the distributions were made.

If you would like additional information on the safe harbor provisions, please contact your GBQ representative at 614.221.1120.