



Catching Up on Contributions

SITUATION: We're a young company with a young work force. But one of our employees will be turning 50 toward the end of 2008. He has indicated that he would like to take advantage of the provision in our 401(k) plan allowing catch-up contributions and start making these extra contributions beginning in January.

QUESTION: Can he do this, even though he won't be age 50 until later in the year?

ANSWER: Yes, an employee whose 50th birthday occurs in a calendar year is treated as reaching age 50 on January 1 of that year and can make catch-up contributions of up to \$5,000 (as adjusted for inflation after 2007), if all other requirements are met.

DISCUSSION: Catch-up contributions allow older employees who may not have contributed enough money toward retirement earlier in their careers to contribute more to their employer's 401(k) plan than permitted under a statutory limit (e.g., the tax law's annual dollar limit on elective deferrals), a plan-imposed limit, or the actual deferral percentage (ADP) limit for the year. To qualify for catch-up contributions, an employee must be age 50 or older by the end of the year *and* must have otherwise made the maximum allowed deferral to the plan.

A plan determines whether elective deferrals are catch-up contributions by comparing the total amount deferred

by an employee during the year to the applicable limits. For example, let's say that a 401(k) plan does not limit annual deferrals except as necessary to comply with the tax law's dollar limit on elective deferrals (\$15,500 for 2007) and the limit on annual additions (the lesser of 100% of compensation or \$45,000 for 2007). An employee who is eligible to make catch-up contributions defers \$17,500 to the plan. The \$2,000 contribution in excess of the \$15,500 dollar limit is treated as a catch-up contribution.

Catch-up contributions that exceed a tax law or plan limit are not taken into account in applying the ADP nondiscrimination test. As a result, even highly compensated employees who are over age 50 can take advantage of their plan's catch-up provision to defer more compensation than they would otherwise be able to.

Note, however, that any contributions an employer makes to match catch-up contributions must still meet the nondiscrimination rules.

2 Employees Are Working Longer

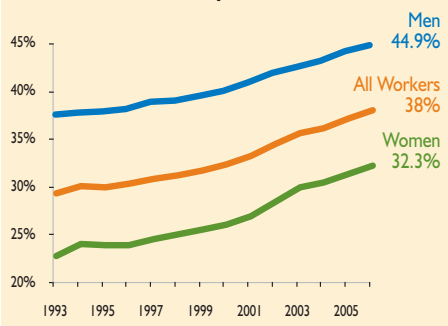
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Work Force Participation Rates (age 55+)



Source: Employee Benefit Research Institute, 2007

Employees Are Working Longer

Americans are staying on the job longer, according to an Employee Benefit Research Institute report compiled from Census Bureau data.* And this trend is expected to continue, which could alleviate some of the concerns employers may have about retaining well-qualified employees in the coming years as baby boomers age.

After reaching a low point in 1993, when only 29.4% of Americans age 55 or older were in the work force, the percentage of people in this age group still employed increased to 38% in 2006. This trend

holds true for both men and women (see graph). The greatest increase in work force participation has occurred among people ages 65 to 69, from 20.3% in 1993 to 29% in 2006.

The study also noted that the higher a worker's education level, the more likely that person is to remain in the work force. In fact, for those age 70 to 74, the percentage with graduate or professional degrees still on the job was almost twice that for people with high school diplomas only.

* Source: "Labor-Force Participation: The Population Age 55 and Older," Craig Copeland, EBRI Notes, June 2007, Vol. 28, No. 6

What's an Employer To Do?

As an employer, you want your employees to appreciate the various benefits you provide them. A satisfied employee generally thinks more highly of his or her employer, works harder, and is more likely to stay with the employer. How can you improve your employees' satisfaction with the benefits you provide?

Show Them the Money

Many employees have no concept of the amount of money employers spend on them to provide a basic benefit package. Bring them up to speed by periodically generating personalized benefit statements showing each employee the cost to you of the benefits the employee receives, including any 401(k) employer matching contributions and profit-sharing retirement contributions.

Promote Retirement Planning

For your retirement plan, in particular:

- **Make sure you cover all the basics.** Review your enrollment education materials to make sure they thoroughly explain how your plan works and convey its benefits in a simple, straightforward manner. Employees can better appreciate your plan if they fully understand it.
- **Take advantage of required quarterly statements.** Defined contribution plan sponsors must provide individual benefit statements quarterly to all employees who participate in a retirement plan that allows participants to direct their own account investments. Since you're distributing the statements already, think about adding information that encourages employees to save and plan for retirement.
- **Customize communications to target specific age groups.** Generally, concerns about having enough money for retirement increase as employees age. Communications that address this increasing concern through targeted education can enhance employee appreciation of your plan.



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Automatic Enrollment — The Rules Have Changed

Automatic enrollment isn't new. Nearly 20% of 401(k) plans have already implemented it, and the number is expected to rise considerably — thanks to two new safe harbors that take effect in 2008.

How do these new safe harbors benefit plan sponsors? The first safe harbor generally relieves employers with “qualified automatic contribution arrangements” of the burdens of conducting annual nondiscrimination testing and complying with the top heavy plan rules. The second, the “default investment” safe harbor, provides relief from fiduciary liability with respect to default investments.

What is a qualified automatic contribution arrangement? A qualified automatic contribution arrangement is an automatic enrollment feature that meets certain requirements. Like any automatic enrollment feature, a qualified automatic contribution arrangement enrolls employees as soon as they become eligible to participate, unless they elect otherwise. The automatic contribution percentage under a qualified automatic contribution arrangement must be at least 3% of pay for the first plan year of participation and increase by 1% each year for three years until it reaches 6%. You can choose a higher rate, but it can't exceed 10%.

Do we have to include all of our employees? No, you don't have to include employees who were eligible to participate in the plan before the qualified automatic contribution arrangement was added and either had deferral elections in place at that time or opted not to participate in the plan.

Are employers required to make contributions? Employers have to make contributions for nonhighly compensated employees. These contributions can be either nonelective contributions or matching contributions. If you choose to make nonelective contributions, they must be at least 3% of compensation and must be made on behalf of all nonhighly compensated employees who are eligible to participate in your plan, whether or not they participate. For matching contributions, you must match 100% of the first 1% of salary deferred by nonhighly compensated employees and 50% of the next 5% deferred.

How do these required contributions compare to the contributions for a regular 401(k) safe harbor match design? The regular safe harbor design can be used to avoid nondiscrimination testing even if you don't use automatic enrollment. With the regular safe harbor design, you either have to make a 3% nonelective contribution on behalf of all nonhighly compensated employees eligible to participate in the plan — the same as under the new qualified arrangement rules — or match 100% of the first 3% of salary deferred by nonhighly compensated employees and 50% of any deferrals between 3% and 5%. So the matching contribution safe harbor available with a qualified automatic contribution arrangement is generally less expensive for employers than the regular safe harbor match.

What is the default investment safe harbor? This safe harbor provides employers that allow employees to direct their own account investments with relief from fiduciary liability for investing an employee's account assets in a default investment when the employee hasn't given any investment directions. To secure protection, your plan must have a default investment that satisfies U.S. Department of Labor (DOL) guidelines and meet other safe harbor conditions. The DOL has proposed regulations that list lifecycle funds, targeted retirement date funds, balanced funds, and professionally managed accounts as possible choices. The DOL could add additional investments when it finalizes the regulations.

Must employees be notified of the qualified automatic contribution arrangement and default investment alternative? Yes, you have to provide employees with advance notices explaining both of these plan provisions.

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RECENT DEVELOPMENTS In Benefit Plans

Matching Contributions. The percentage of 401(k) plans offering a 100% employer match is on the rise, according to a recent study by Mercer Human Resources Consulting. From 2002 to 2006, the percentage of employers matching employees' contributions dollar for dollar increased from 26% to 36%, and the percentage of employers offering a 50% match dropped correspondingly — from 53% to 45%. A 50% match remains the most popular formula.

Most Used Educational Materials. Written material received from an employer or the employer's retirement plan provider tops the list of materials employees use when making retirement savings and investment decisions.

| Information Source | % Using |
|--|---------|
| Written material received from employer or employer's retirement plan provider | 73 |
| The advice of a financial professional | 64 |
| The advice of family, friends, or coworkers | 62 |
| Retirement plan benefit statements | 61 |
| Information available over the Internet | 52 |
| Newspapers or magazines | 49 |
| Information from television or radio | 32 |
| Computer software | 28 |
| Information from seminars | 21 |
| Online professional investment advice services | 19 |

Source: 2007 Retirement Confidence Survey, Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc.

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