401(k) Plans for Business Owners

Flexible options for companies of all sizes

Because large corporations spearheaded the growth of 401(k) plans, many closely held business owners assume this type of plan won't suit their companies' needs. However, the implementation of the safe-harbor 401(k) provisions, in addition to other legislation, changes how businesses of all sizes are implementing 401(k) plans.

In general, 401(k) plans help employees fund their retirement by deferring a portion of their salaries into the plan on a pretax basis. Employees also may have the ability to make salary deferral contributions on an after-tax basis as a Roth contribution.* As the employer, you can also make contributions, which are a tax-deductible business expense, on behalf of eligible employees. These contributions can match employee contributions, be employer discretionary profit sharing contributions, or be a combination of the two.

How are profit sharing contributions allocated?

The allocation of profit sharing contributions can vary in many ways. Some of the more common formulas are:

- Pro rata (or uniform rate) formula; based on a percentage of compensation
- Integrated with Social Security, increasing the benefit to highly compensated employees
- Age weighted, benefiting employees closer to retirement
- New comparability, benefiting specified groups of employees and increasing benefits for those closer to retirement

2015 contribution limits for 401(k)s

Employee	Employer
$18,000 Salary Deferral	25% of eligible compensation of the plan participants
$6,000 Catch up (age 50 and older)	• profit sharing • match • safe harbor match or non-elective

Note: Combined employee and employer contributions cannot exceed 100% of compensation or $53,000 if under age 50, or $59,000 if age 50 or older.

Withdrawals from a 401(k) are subject to ordinary income tax and may be subject to a federal 10% penalty if taken prior to age 59 ½.

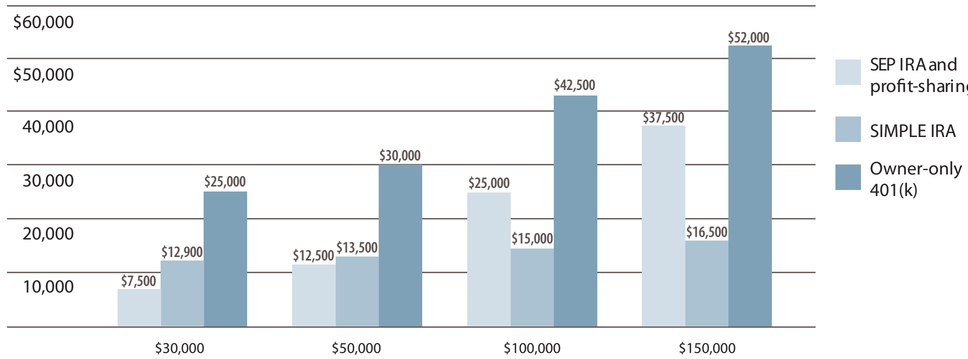
** The employer plan document must be amended to allow for the Roth 401(k) feature.*

Considerations

Eligibility criteria and vesting schedules are key aspects of 401(k) plans for businesses. Be sure to investigate all aspects of these topics when contemplating establishing a 401(k) plan for your business.

2015 maximum contribution for incorporated businesses

Owner younger than age 50



The chart shows the maximum contribution amounts for various plans. In addition, if you're age 50 or older, you can make additional catch-up contributions.

Establishing eligibility criteria

You can establish eligibility criteria by defining a service requirement (usually, defining a year of service as 1,000 hours in a consecutive 12-month period) and an age requirement (no greater than 21). The maximum eligibility requirements are age 21 and one year of service, but you can require two years of service for the profit-sharing contribution. You are permitted to lower these requirements to as little as no age or service. Using the 1,000 hours of service (one year) requirement is useful to exclude part-time employees. For new plans, you can elect to have prior service count toward eligibility (which can also be considered for vesting) or to begin eligibility as of the effective date of the plan.

Creating vesting schedules

There are several vesting schedules available for retirement plans, but certain criteria mandate specific vesting schedules. For example, if more than one year is required for eligibility, the employer contributions must be 100% immediately vested. The Internal Revenue Service (IRS) has developed other requirements and plan designs that could alter the structure of the vesting schedule. Maintenance of vested years, how to calculate a participant's vested benefits and providing the required disclosures to participants can be complex and often require the services of a third-party administrator. The maximum statutory vesting schedules are described on the following page.

Maximum statutory vesting schedules

Three-year cliff vesting

Years of service	Nonforeitable percentage
Fewer than 3	0%
3 or more	100%

Six-year graded vesting

Years of service	Nonforeitable percentage
Fewer than 2	0%
2	20%
3	40%
4	60%
5	80%
6 or more	100%

Comparing plans

There are several types of plans available and various ways to structure a 401(k). To determine the best plan design for your company, you should first understand the differences between a traditional and safe-harbor 401(k).

Traditional 401(k)

A traditional 401(k) requires annual nondiscrimination testing. There are two tests that must be performed to ensure the amounts deferred by employees and employer matching contributions do not discriminate in favor highly compensated employees.

- **Actual deferral percentage (ADP) test.** This test ensures the rate of deferrals for highly compensated employees (HCEs), as defined by the IRS, are not excessive compared with that of non-highly compensated employees (NHCEs). If the plan fails this test, you must refund contributions (which are taxable to the employee) to HCEs or make additional contributions on behalf of NHCEs.
- **Actual contribution percentage (ACP) test.** This test is applied to the rate of matching contributions on behalf of HCEs versus NHCEs in much the same way as the ADP test.

Safe harbor 401(k)

A safe harbor 401(k) eliminates discrimination testing and allows HCEs to maximize their salary deferral contributions at $18,000 (for 2015) per individual, regardless of the participation levels of NHCEs.

The plan must adhere to both the contribution and notification requirements to satisfy the safe harbor rules. As a result, you are required to make mandatory contributions that are 100% vested using one of the following methods:

- A minimum matching contribution of 100% on the first 3% and 50% on the next 2% of compensation for each eligible employee deferring through payroll deduction.
- Nonelective contributions of 3% of compensation for all eligible employees regardless of whether deferring or not.

You must also state in writing, at least 30 days prior to the beginning of each plan year, whether the plan will use the traditional or the safe harbor rules. If you choose to use safe harbor, you must indicate which contribution type will be made.

Owner-only 401(k) plan

If your business employs only you and/or your spouse, you may be subject to additional benefits when establishing a 401(k). You are able to contribute up to 25% of your eligible compensation in addition to salary deferral contributions of $18,000 (for 2015). The total contributed for any one individual cannot exceed 100% of the individual's compensation or $53,000 (for 2015).

Highlights of traditional and safe harbor 401(k) plans

Traditional	Safe harbor
Due to nondiscrimination testing, the level of participation by rank and file employees can greatly affect the deferral amounts allowed for highly compensated employees including business owners.	Eliminates nondiscrimination testing and allows business owners and highly compensated employees to maximize salary deferral contributions. Required contributions with the ability to make additional employer discretionary contributions. However, some restrictions may apply on discretionary matching contributions.
All employer contributions may be subject to a vesting schedule.	Safe harbor contributions are 100% vested; additional employer discretionary contributions may be subject to a vesting schedule.

Automatic enrollment features

Enrollment programs are an excellent way to educate your employees. In an enrollment program, employees must complete the proper paperwork and make investment choices. If employee participation in your 401(k) plan is not at the desired level, you may want to consider an automatic enrollment feature as one way to boost participation.

Automatic enrollment requires only those employees who do not want to participate to complete plan paperwork. Otherwise all employees who meet the plan's eligibility requirements automatically become participants with a preset deferral amount defined by you (the employer) in the plan document. In addition, the automatic enrollment component can be structured to automatically increase the salary deferral percentages annually.

If the concept of a safe harbor 401(k) is attractive to your business, but you are uncomfortable making fully vested contributions, you may want to consider a new safe harbor automatic enrollment plan design. The safe harbor provisions for this type of plan require:

- A 100% match on 1% of pay plus a 50% match of the next 5% of pay (maximum 3.5% of pay), or 3% of pay as a nonelective contribution
- Automatic-enrollment contribution levels of:
  - Not less than 3%, but no more than 10%, for entry level deferral contribution amounts
  - Annual increases to 4% in year two, 5% in year three and 6% in each year thereafter
- Employer safe harbor contributions must be 100% vested after two years (two-year vesting schedule available)

The automatic enrollment feature will potentially increase salary-deferral contributions in a traditional 401(k). Implementing one is also an overall strategy to help you and your employees reach your desired income replacement while in retirement, while also helping highly compensated employees pass the nondiscrimination tests (ADP/ACP). Whether you apply the automatic enrollment feature in the traditional safe harbor or the new "qualified automatic contribution arrangement," an increase in employee participation may also increase your overall contribution amount. Carefully consider the full effects of these various alternatives before implementing any of them.

Qualified default investment alternatives

If the participant has not made an investment election for the automatic salary deferral amounts, you (as the employer) can have qualified default investment alternatives (QDIA) preselected in the plan. Doing so provides relief from liability for investment outcomes on the QDIAs. Your third-party administrator (TPA) and Financial Advisor can work with you to ensure that the QDIA you select meets certain requirements.

You can count on us

Although a 401(k) plan offers many benefits, it may not be the best plan for every business. Wells Fargo Advisors offers a range of plans and can help you match the right plan with your needs and objectives.

Important deadlines and rules for 401(k) plans

Deadline for establishing plan	**Traditional:** Last day of the plan year, but no later than the commencement of employee contributions. **Safe harbor:** Three months prior to the end of the plan year. If the plan operates on a calendar year, the deadline is October 1.
Deadline for depositing contributions	**Employer contributions:** Due date of employer's tax return, including extensions. **Elective deferrals:** Must be deposited as soon as reasonably feasible, but no later than 15 days* following the end of the month in which they are withheld from pay.
Obligation to contribute	**Traditional:** Employer contributions are discretionary, unless the plan is top-heavy. **Safe harbor:** Requires one of the following employer contributions: • Basic matching contribution with a minimum of dollar-for-dollar on first 3% deferred; 50 cents on the dollar on the next 2% deferred • Enhanced matching contribution at least as good as the basic match and based on no more than 6% of compensation, such as dollar-for-dollar on 4%, 5%, or 6% compensation • Nonmatching contributions of at least 3% of compensation for all eligible employees
Income tax credit	Businesses with 100 or fewer employees can claim a nonrefundable tax credit for establishing and maintaining a retirement plan. The credit applies to 50% of the first $1,000 in administrative and retirement education expenses (start-up expenses) for the first three years the plan is established. The newly established plan must have at least one non-highly-compensated employee participating

** If your plan has fewer than 100 participants, your deposit is considered timely if it is made within seven business days after you withhold the salary deferrals even if you were able to deposit them earlier. If you don't deposit the salary deferrals within seven days after you receive or withhold them, then your individual facts and circumstances will determine whether your deposit was considered timely.*

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