



***THE COLONIAL
401(K) PLAN SOFTWARE***



USER'S GUIDE

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WELCOME MESSAGE

Thank you for choosing Colonial as your 401(k) plan provider. Colonial is committed to making the process of administering your 401(k) plan as simple and efficient as possible.

SELECTED FEATURES INCLUDE:

IRC Section 415 Limit Testing – Section 415 limits contributions that may be allocated to an individual account in any plan year. (Currently, 25% of taxable compensation or \$30,000, whichever is less.) Colonial's software assists you in keeping within prescribed contribution limits.

Top Heavy Testing – a plan is top-heavy if the total account balances of key employees exceeds 60% of the total account balances for all employees on the determination date. This software determines if the 60% limit is exceeded, and therefore whether or not the plan is top-heavy.

Vesting Analysis – vesting refers to an employee's non-forfeitable ownership of his/her account balance, based on a vesting schedule which corresponds to years of service with the company. Colonial's software estimates each participant's vested percentage based on specific plan parameters and assumptions.

Discrimination Testing – ensures salary deferrals under the plan do not discriminate in favor of the highly compensated employees. The Colonial 401(k) Software performs **Actual Deferral Percentage (ADP) testing**, which compares the average deferrals of highly and non-highly compensated employees, and **Actual Contribution Percentage (ACP) testing**, which compares the average employer matching and employee after-tax contributions of highly and non-highly compensated employees.

We hope the Colonial 401(k) Software proves helpful and we appreciate your continued confidence in Colonial. If you have any questions or comments, please call Colonial Retirement Plan Services at **1-800-799-7526 (PLAN)**.

Sincerely yours,



Frank X. Quirk
Vice President
Retirement Plan Services

New legislation has recently been signed into law. This legislation contains a number of pension simplification provisions that will impact the administration of 401(k) plans beginning in 1997. Colonial will be pleased to provide you with additional information in the near future.

ABOUT THIS SOFTWARE

This software was designed specifically to assist employers who adopt the Colonial prototype 401(k) plan in performing certain tests required to maintain the plan's qualified status under the Internal Revenue Code. While every effort has been made to ensure the accuracy of the information presented, it is impossible for this or any other software to fully reflect the complexity that currently exists in the qualified plan area, and the diversity among employers. Colonial cannot, therefore, accept responsibility for the appropriateness or effectiveness of the software in any particular employer's situation. As always, we strongly suggest that you consult with your own tax or legal advisers.

The software is designed primarily for corporations with a single qualified plan. The special rules that apply to self employed individuals, partners, and employers with multiple plans have not been reflected in the software. (For example, partners must, under IRS regulations, treat matching contributions as elective deferrals.) Further, the software is designed primarily for full plan years. If you have a short plan year you may need to pro-rate some of the testing limits (for example, the \$150,000 compensation limit under IRC Section 401(a)(17)). Finally, employers who maintain a section 125 cafeteria plan may have to make adjustments to reflect the effect of Section 125 elective deferrals on the definition of compensation for section 401(k) and section 415 testing purposes.

INSTALLING THE SOFTWARE

1. Turn on the computer.
2. At the DOS prompt, type **WIN**.
3. Press Enter.

RESULT

The **Microsoft Windows Program Manager Screen** will appear.

4. Use the mouse to move the pointer to the **Main** folder.
5. Double click the left mouse button.

RESULT

You will see the contents of the **Main** folder.

6. Use the mouse to move the pointer to the **File Manager** icon.

Note: if you do not see the File Manager icon in the Main folder and you cannot locate it in another folder, contact your company's computer support department.

7. Double click the left mouse button.

RESULT

You will see the contents of the computer's **C Drive**.

8. Insert **Disk 1** of the **Colonial 401(k) Software** into your computer's 3¹/₂ inch disk drive.

FYI

The Colonial 401(k) Software is available only for computers running Microsoft Windows© Version 3.1 or higher.

Some calculations use the current date as a reference. Therefore, it is important that the clock in your computer be set to the current date.

For more complete information about using MS-DOS and Microsoft Windows, contact your company's computer support department.

9. Use the mouse to move the pointer to the appropriate icon for your computer's 3¹/₂ inch disk drive (usually the **A Drive**).

10. Click the left mouse button.

RESULT

You will see the contents of the **Colonial 401(k) Software** program disk.

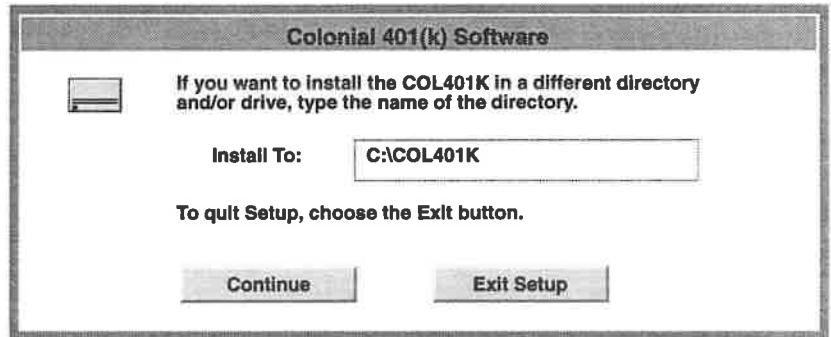
11. Use the mouse to move the pointer to the file named **setup.exe**.

12. Double click the left mouse button.

RESULT

You will see the **Colonial 401(k) Software Setup** dialogue box.

13. Use the mouse to move the pointer to the **Continue** button.



14. Click the left mouse button once.

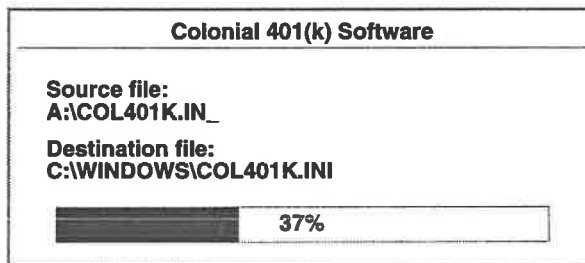
RESULT

The installation process will begin.

Note: Installation time may take several minutes, based on your equipment

14.1 A box will appear that shows the progress of the installation procedure.

14.2 When the contents of **Disk 1** is installed, you will be asked to install **Disk 2**.



15. Eject **Disk 1**.

16. Insert **Disk 2** of the **Colonial 401(k) Software** into your computer's 3¹/₂ inch disk drive.

RESULT

A dialogue box asking if you wish to proceed with the installation process will appear.

17. Use the mouse to move the pointer to the **OK** button.

18. Click the left mouse button once.

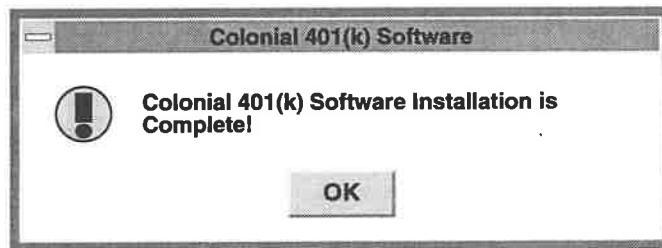
RESULT

The installation process will continue.

19. When the installation process is complete, a dialogue box will appear.

20. Use the mouse to move the pointer to the **OK** button.

21. Click the left mouse button once.



IMPORTING RECORDS

This procedure is for Colonial 401(k) Plan clients' using the prior version of the Colonial 401(k) Software.

1. Use the mouse to move the pointer to the **File** menu.

2. Hold down the left mouse button.

RESULT

You will see the **File** menu.

3. While holding down the mouse button, drag the pointer down the menu to **Import DOS Data**.

4. Release the mouse button.

RESULT

You will see the first **Select File** screen.

5. Use the mouse to move the pointer to the hard drive icon to the left of the **c:**.

6. Double click the left mouse button.

RESULT

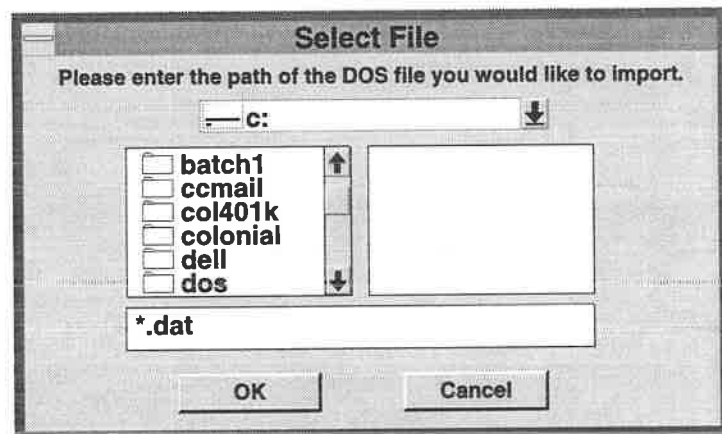
You will see the contents of the **c:** drive displayed in the window on the left side of the screen.

7. Use the mouse to move the pointer to the **elevator box**, located to the right of the window in which the contents of the **c:** drive is displayed.

8. While holding down the mouse button, slide the **elevator box** down the shaft until you see the **Colonial** folder.

9. Release the mouse button.

10. Double click the left mouse button.

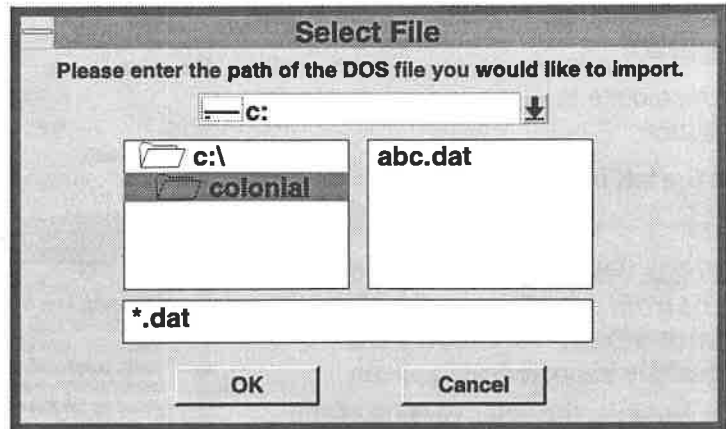


11. Use the mouse to move the pointer to the **Colonial** folder.
12. Double click the left mouse button.

RESULT

You will see the data file containing the records from the prior version of the Colonial 401(k) Software displayed in the window on the right side of the screen.

13. Use the mouse to move the pointer to the data file.

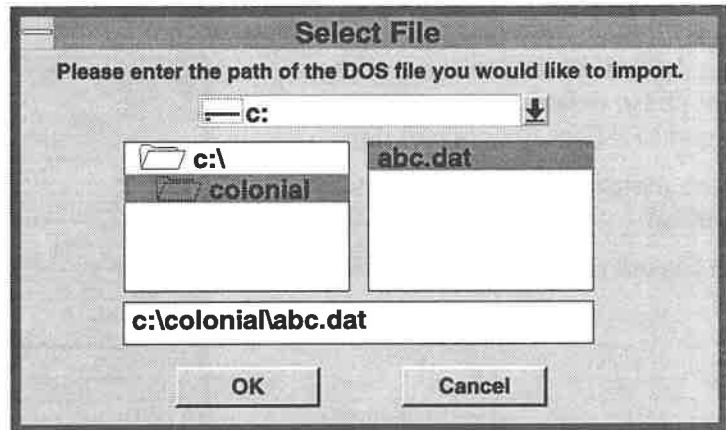


14. Click the left mouse button once.

RESULT

The name of the data file will be highlighted and the complete path name will appear in the window above the **OK** and **Cancel** buttons.

15. Use the mouse to move the pointer to the **OK** button.



16. Click the left mouse button once.

RESULT

A dialogue box notifying you of the number of records in the original data file will appear.

17. Use the mouse to move the pointer to the **Yes** button.

18. Click the left mouse button.

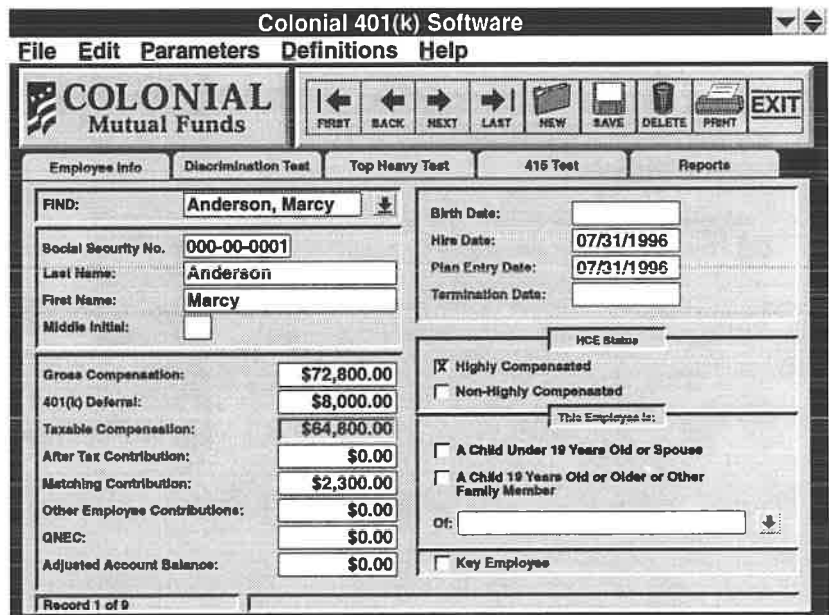
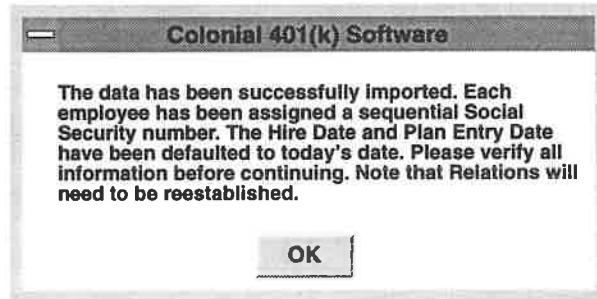
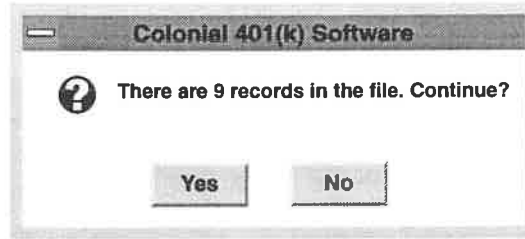
RESULT

A dialogue box notifying you that the records from the prior version of the **Colonial 401(k) Software** were successfully imported will appear.

Note: because the prior version of the **Colonial 401(k) Software** did not have fields for **Social Security Number**, **Birth Date**, **Hire Date**, and **Plan Entry Date**, these fields must be manually updated. The software will automatically create default values for some of these fields. These default values must be changed to reflect the correct data.

19. Use the mouse to move the pointer to the **OK** button.

20. Click the left mouse button.



RUNNING THE PROGRAM

1. Turn on the computer.
2. At the DOS prompt, type **WIN**.
3. Press Enter.

RESULT

The **Microsoft Windows Program Manager Screen** will appear.

4. Use the mouse to move the pointer to the **Colonial 401k Software** folder.
5. Double click the left mouse button.

RESULT

You will see the **Colonial 401(k) Software** icon.

6. Use the mouse to move the pointer to the **Colonial 401(k) Software** icon.



7. Double click the left mouse button.

RESULT

You will see the **Colonial Mutual Funds Splash Screen**.

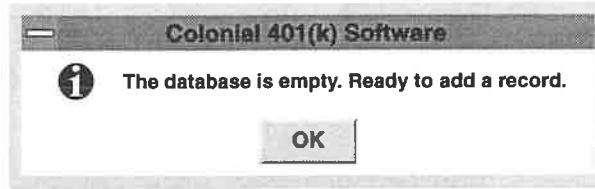
8. Use the mouse to move the pointer to the **Begin** button.



9. Click the left mouse button once.

IF YOU ARE RUNNING THE SOFTWARE FOR THE FIRST TIME

You will see the **Database is Empty** dialogue box.

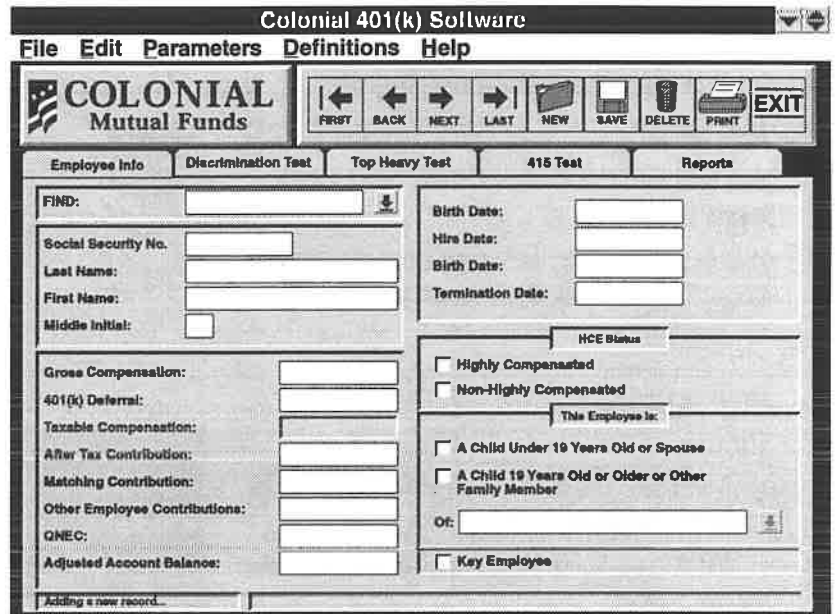


9.2 Use the mouse to move the pointer to the **OK** button.

9.3 Click the left mouse button once.

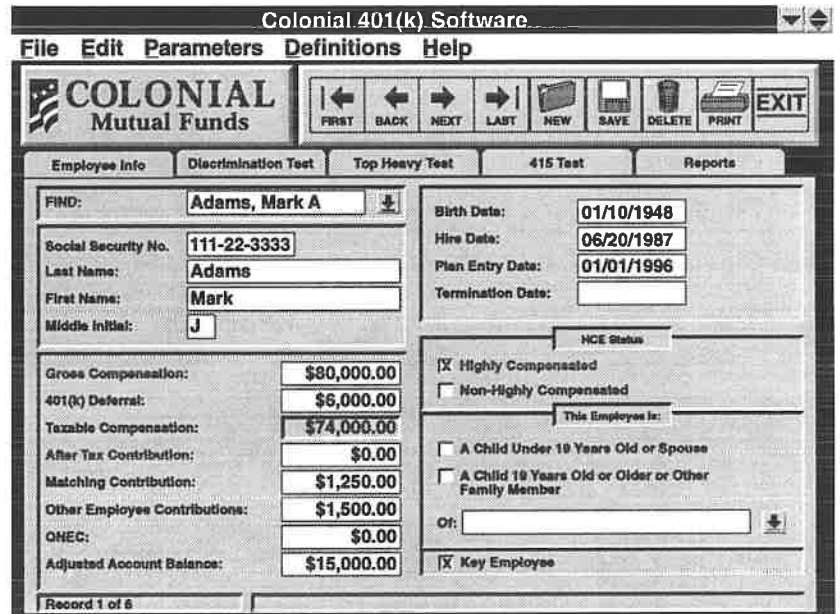
RESULT

A blank **Employee Info** screen will appear.



IF ONE OR MORE RECORDS HAVE BEEN ENTERED IN THE DATABASE

You will see the employee record for the first employee (listed alphabetically) in the data base.



CHANGING THE CONFIGURATION SCREEN

The information on the **Configuration** screen is used when the Discrimination, Top Heavy, and 415 Tests are run. This information may be changed annually, in conformance with IRS regulations. Colonial will send you updated information, when available, each calendar year.

1. Use the mouse to move the pointer to the **Parameters** menu.

2. Hold down the left mouse button.

RESULT

You will see the **Parameters** menu.

3. While holding down the mouse button, drag the pointer down the menu to **Configuration**.

4. Release the mouse button.

RESULT

You will see the **Configuration Information** screen.

Note: Colonial has preloaded the Configuration Information based on the 1996 plan year. This information reflects the 1996 limits in effect as of January 1, 1996.

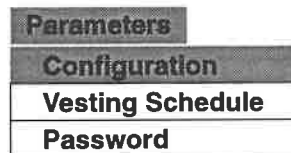
5. Enter new information in each field as needed, as indicated under **Field/ Button Definitions**.

Note: Use the mouse or the **Tab** key to maneuver the cursor around the screen.

- The mouse will move the cursor to a specific field by moving the pointer to the field and clicking the left mouse button once.
- The **Tab** key will move the cursor from field to field, in the order the fields appear on the screen.
- Enter your company name (if desired). This name will appear on all reports.
- Select either **Gross Compensation** or **Taxable Compensation** by using the mouse to position the pointer on the white box located to the left of either selection and clicking the left mouse button once.

6. Use the mouse to move the pointer to the **Save** button.

7. Click the left mouse button once.



A screenshot of a dialog box titled "Configuration Information". It contains several fields for inputting plan details. At the bottom, there are three buttons: "Save", "Cancel", and "Print".

Company Name:	Your Company's Name	
Plan Year End:	1996	
Compensation Limit:	\$150,000.00	
401(k) Deferral Limit:	\$9,500.00	
HCE Percent Ownership:	5 %	
HCE Salary:	\$100,000.00	
HCE Top 20% Salary:	\$66,000.00	
HCE Officer Salary:	\$60,000.00	
Plan Effective Date:	01/01/1996	
Top Heavy Percent:	60 %	
415 Total Contribution Limit:	\$30,000.00	% Limit 25
Discrimination Testing Based On:		
<input checked="" type="checkbox"/> Gross Compensation	<input type="checkbox"/> Taxable Compensation (Gross Less 401(k) Deferral.)	
Database Path:	C:\COL401K\col401k.mdb	

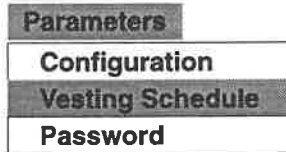
CHANGING THE VESTING SCHEDULE

1. Use the mouse to move the pointer to the **Parameters** menu.

2. Hold down the left mouse button.

RESULT

You will see the **Parameters** menu.



A screenshot of a menu titled "Parameters" with four options: "Configuration", "Vesting Schedule", and "Password". The "Vesting Schedule" option is highlighted with a grey background.

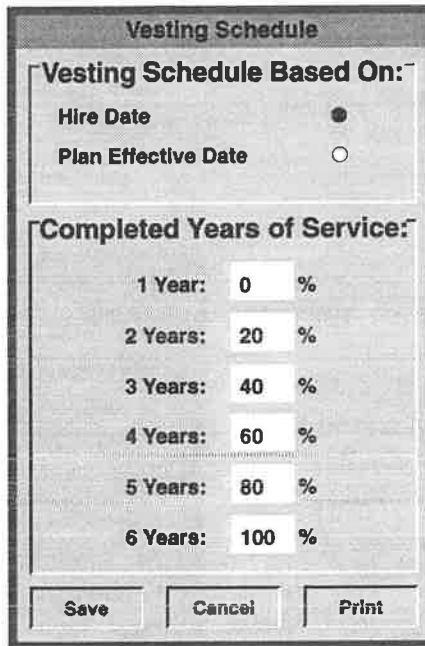
3. While holding down the mouse button, drag the pointer down the menu to **Vesting Schedule**.

4. Release the mouse button.

RESULT

You will see the **Vesting Schedule** screen.

Note: Colonial has preloaded the Vesting Schedule, as indicated in this example. Make changes as required based on the elections made in your Plan Adoption Agreement.



A screenshot of the "Vesting Schedule" screen. It has a title bar "Vesting Schedule". Below the title bar is a section "Vesting Schedule Based On:" with two radio buttons: "Hire Date" (selected) and "Plan Effective Date". Below that is a section "Completed Years of Service:" with a table of years and percentages. At the bottom are three buttons: "Save", "Cancel", and "Print".

Completed Years of Service:	Percentage
1 Year:	0 %
2 Years:	20 %
3 Years:	40 %
4 Years:	60 %
5 Years:	80 %
6 Years:	100 %

5. Enter information in each field if needed, as indicated under **Field/Button Definitions**.

Note: Use the mouse or the **Tab** key to maneuver the cursor around the screen.

- Select either **Hire Date** or **Plan Effective Date**, as indicated in your Plan Adoption Agreement, by using the mouse to position the pointer on the white "radio button", located to the right of each selection, and clicking the left mouse button once.
 - The **Completed Years of Service for Vesting** should be completed as indicated in Section XI of your Plan Adoption Agreement.
 - The mouse will move the cursor to a specific field by moving the pointer to the field and clicking the left mouse button once.
 - The **Tab** key will move the cursor from field to field, in the order the fields appear on the screen.
6. Use the mouse to move the pointer to the **Save** button.
 7. Click the left mouse button once.

CHANGING THE PASSWORD

1. Use the mouse to move the pointer to the **Parameters** menu.
2. Hold down the left mouse button.

RESULT

You will see the **Parameters** menu.

3. While holding down the mouse button, drag the pointer down the menu to **Password**.
4. Release the mouse button.

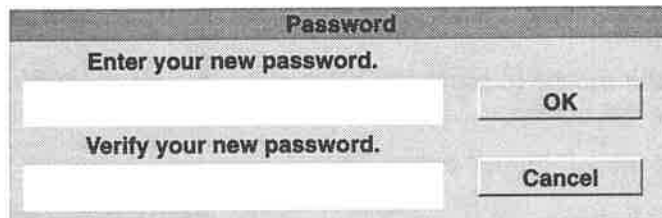
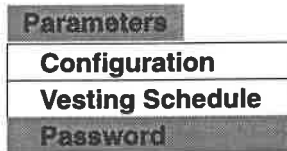
RESULT

You will see the **Password** screen.

5. Type your new password in the field under **Enter your new password**.
6. Verify your new password by typing it again in the field under **Verify your new password**.

Note: Use the mouse or the **Tab** key to maneuver the cursor around the screen.

- The mouse will move the cursor to a specific field by moving the pointer to the field and clicking the left mouse button once.
 - The **Tab** key will move the cursor from field to field, in the order the fields appear on the screen.
6. Use the mouse to move the pointer to the **OK** button.
 7. Click the left mouse button once.

A dialog box titled "Password" is shown. It contains two text input fields. The first field is labeled "Enter your new password." and the second field is labeled "Verify your new password.". To the right of each field is a button: "OK" for the first field and "Cancel" for the second field.

ADDING A NEW EMPLOYEE RECORD

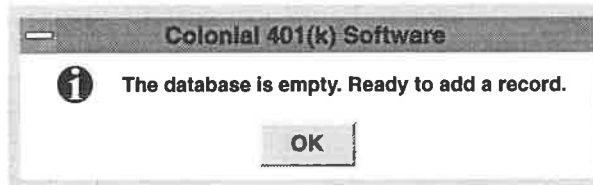
1. Use the mouse to move the pointer to the **New** button in the command bar.



2. Click the left mouse button once.

IF THERE ARE NO RECORDS IN THE DATABASE

You will see the **Database is Empty** dialogue box.



- 2.1 Use the mouse to move the pointer to the **OK** button.

- 2.2 Click the left mouse button once.

RESULT

A blank **Employee Info** screen will appear.

- 2.3 Type information in each field as indicated under **Field Definitions**.

The screenshot shows the 'Employee Info' screen in the Colonial 401(k) Software. The window title is 'Colonial 401(k) Software'. The menu bar includes 'File Edit Parameters Definitions Help'. The 'Employee Info' tab is selected, showing various input fields for employee details. The fields are organized into sections: 'Employee Info' (FIND, Social Security No., Last Name, First Name, Middle Initial), 'Discrimination Test', 'Top Heavy Test', '418 Test', and 'Reports'. The 'Employee Info' section includes fields for FIND, Social Security No., Last Name, First Name, and Middle Initial. The 'Discrimination Test' section includes Gross Compensation, 401(k) Deferral, Taxable Compensation, After Tax Contribution, Matching Contribution, Other Employee Contributions, QNEC, and Adjusted Account Balance. The 'Top Heavy Test' section includes HCE Status (Highly Compensated, Non-Highly Compensated) and This Employee Is (A Child Under 19 Years Old or Spouse, A Child 19 Years Old or Older or Other Family Member). The '418 Test' section includes Termination Date and Key Employee. The 'Reports' section includes an Of: field. The status bar at the bottom shows 'Adding a new record...'.

3. Use the mouse to move the pointer to the **New** button in the command bar.
4. Click the left mouse button once.



IF ONE OR MORE RECORDS HAVE BEEN ENTERED IN THE DATABASE

You will see the **Employee Info** screen for the first employee (listed alphabetically) in the data base will appear.

Colonial 401(k) Software

File Edit Parameters Definitions Help

COLONIAL Mutual Funds FIRST BACK NEXT LAST NEW SAVE DELETE PRINT EXIT

Employee Info Discrimination Test Top Heavy Test 415 Test Reports

FIND:

Social Security No.

Birth Date:

Last Name:

Hire Date:

First Name:

Plan Entry Date:

Middle Initial:

Termination Date:

HCE Status

Highly Compensated

Non-Highly Compensated

This Employee Is:

A Child Under 19 Years Old or Spouse

A Child 19 Years Old or Older or Other Family Member

Other:

Key Employee

Gross Compensation:	\$80,000.00
401(k) Deferral:	\$6,000.00
Taxable Compensation:	\$74,000.00
After Tax Contribution:	\$0.00
Matching Contribution:	\$1,250.00
Other Employee Contributions:	\$1,500.00
QNEC:	\$0.00
Adjusted Account Balance:	\$15,000.00

Record 1 of 8

Note: Use the mouse or the **Tab** key to maneuver the cursor around the screen.

- The mouse will move the cursor to a specific field by moving the pointer to the field and clicking the left mouse button once.
- The **Tab** key will move the cursor from field to field, in the order the fields appear on the screen.
- Select **Highly Compensated Employee** or **Non-Highly Compensated Employee, A Child Under 19 Years Old or Spouse** or **A Child 19 Years Old or Older** or **Other Family Members**, and/or **Key Employee** by using the mouse to position the pointer on the white box located to the left of each selection and clicking the left mouse button once.

If **A Child Under 19 Years Old or Spouse** or **A Child 19 Years Old or Older** or **Other Family Members** is selected, the HCE the employee is related to must be indicated.

3. Use the mouse to move the pointer to the **Down Arrow** button located to the right of the **Of** field.

Note: Do not type names in this field, since only HCEs already added to the database can be used.

4. Click the left mouse button once.

RESULT

A list of HCEs whose records have been entered in the data base will appear.

5. Hold down the left mouse button and use the mouse to “scroll” through the list of names.
6. When the name of the appropriate HCE is highlighted, release the left mouse button.

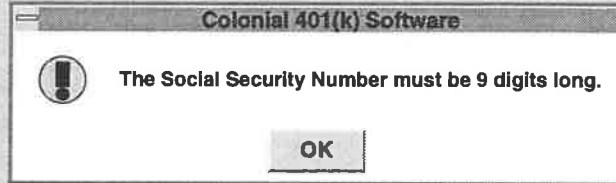
RESULT

The name of the selected HCE will appear in the **Of** field.

Field Definitions

Personal

Social Security Number – the employee’s Social Security number (hyphens are automatically inserted). The social security number must be entered in the format xxxxxxxxx or xxx-xx-xxxx. If an incorrect format is used, the following dialogue box will appear:

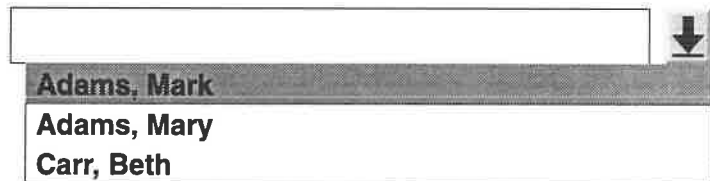


Last Name – the employee’s last name.

First Name – the employee’s first name.

Middle Initial – the employee’s middle initial.

Of:

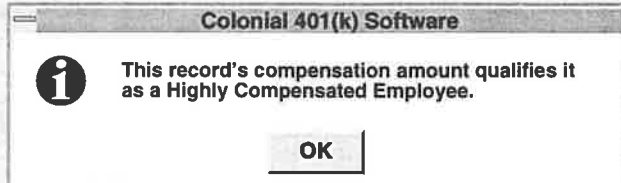


Field Definitions cont.

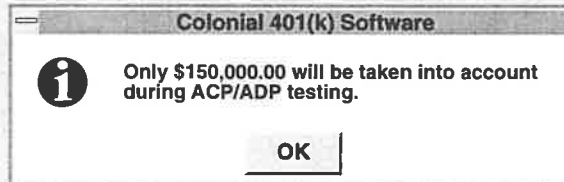
Wages & Contributions

Numbers can be entered in these fields with or without dollar signs, commas, and decimal points.

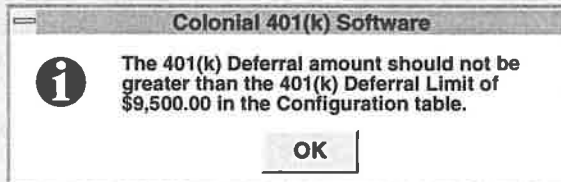
Gross Compensation – an employee's total compensation (normally what is reported as W-2 wages increased by any Section 401(k) and Section 125 elective deferrals). For self employed individuals, gross compensation is net earnings from self employment. If an amount greater than \$150,000 is entered, the following dialogue box will appear:



When you press OK, the following dialogue box will appear:



401(k) Deferral – the amount deducted from the employee's *gross pay* before taxes are calculated. If the amount exceeds the amount exceeds the 401(k) Deferral Limit shown in the Configuration Table, the following dialogue box will appear.



Taxable Compensation – the employee's *gross compensation* less the amount of the 401(k) deferral (calculated automatically).

After Tax Contribution – the amount deducted from the employee's *net pay* after taxes are deducted.

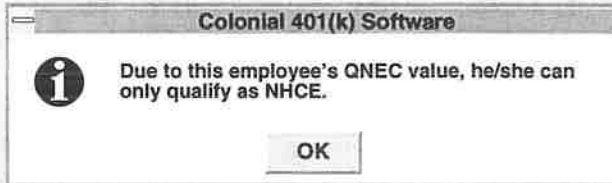
Matching Contribution – the amount the employer contributes to the plan on behalf of the employee based on the employee's 401(k) Deferral.

Field Definitions cont.

Other Employer Contributions – any other employer contributions included as annual additions for Section 415 testing, including discretionary profit sharing contributions, top heavy minimum contributions, and reallocations of forfeitures.

QNEC (Qualified Non-elective Contribution) – a 100% vested non-forfeitable contribution made by the employer to the plan on behalf of all Non-Highly Compensated Employees eligible to participate in the plan. If a value greater than zero is entered in this field and the employee is marked as highly compensated, the following dialogue box will appear:

Adjusted Account Balance – the employee's plan balance used in performing Top Heavy testing. Refer to Appendix VI – Definitions, for details.



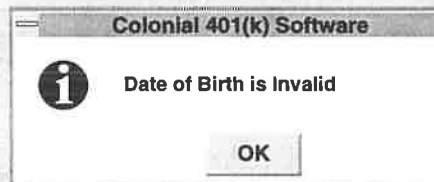
Dates

All dates must be entered in the format **MMDDYYYY**, where **MM** is number of the month (leading zero required if less than 10), **DD** is the number of the day (leading zero required if less than 10), and **YYYY** is a four digit year. Slashes "/" will automatically be entered. If an incorrect format is used, a dialogue box similar to the following will appear:

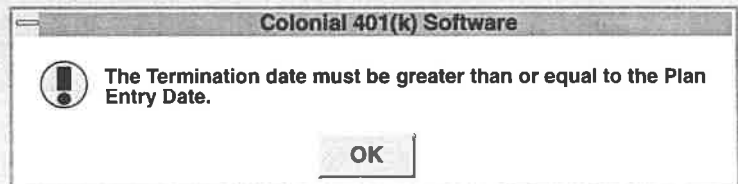
Birth Date – the employee's date of birth.

Hire Date – the employee's date of hire.

Plan Entry Date – the date the employee became a plan participant.



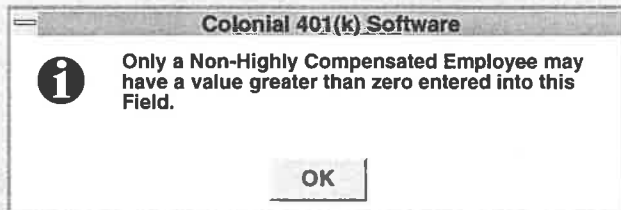
Termination Date – the date a participant's employment ended. If the Termination Date is less than the Plan Entry Date, the following dialogue box will appear:



Field Definitions cont.

HCE Status

Highly Compensated Employee – an individual who is a 5% owner, and any other employee who in a testing year (if one of the top paid 100 employees) or in the previous year: (a) made more than \$100,000, (b) made more than \$66,000 and was in the top 20% by compensation of all employees, or (c) was an officer and made more than \$60,000. See Appendix VI – Definitions, for details. If this is selected and a value greater than zero is later entered in the QNEC field, the following dialogue box will appear:

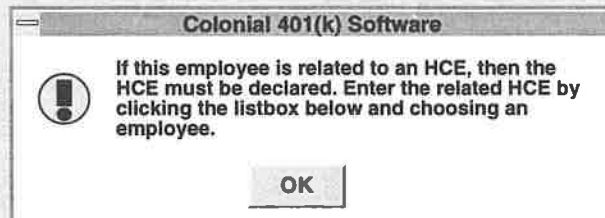


Non-Highly Compensated Employee – any employee not meeting the requirements for a Highly Compensated Employee.

A Child Under 19 Years or Spouse – the employee is either (a) the spouse or (b) a child or grandchild who will not be 19 years old by the end of the plan year, of another employee who is a 5% owner or one of the ten highest paid Highly Compensated Employees. Refer to Appendix VI – Definitions, for details.

A Child 19 Years Old or Older or Other Family Member – the employee is (a) a child or grandchild who will be 19 years old by the end of the plan year, (b) a parent or grandparent, or (c) the spouse of someone described in (a) or (b), of another employee who is a 5% owner or one of the ten highest paid Highly Compensated Employees. Refer to Appendix VI – Definitions, for details.

Note: If *A Child Under 19 Years or Spouse* or *A Child 19 Years Old or Older or Other Family Member* is selected, the relative of the employee must be declared or the following dialogue box will appear:



Key Employee – any employee meeting the definition provided in Internal Revenue Code Section 416(i)(1). Refer to Appendix VI – Definitions, for details.

SEARCHING FOR RECORDS

Search by Typing the Employee's Initial

1. If you do not see the **Employee Info** screen, use the mouse to move the pointer to the **Employee Info** file folder tab at the top of the screen.
2. Click the left mouse button once.

RESULT

You will see the **Employee Info** screen.

Employee Info	Discrimination Test	Top Heavy Test	415 Test	Reports
COLONIAL Mutual Funds				
FIRST BACK NEXT LAST NEW SAVE DELETE PRINT EXIT				
Employee Info Discrimination Test Top Heavy Test 415 Test Reports				
FIND: Adams, Mark A				
Social Security No. 111-22-3333		Birth Date: 01/10/1948		
Last Name: Adams		Hire Date: 06/20/1987		
First Name: Mark		Plan Entry Date: 01/01/1996		
Middle Initial: J		Termination Date:		
Gross Compensation: \$80,000.00		HCE Status		
401(k) Deferral: \$6,000.00		<input checked="" type="checkbox"/> Highly Compensated		
Taxable Compensation: \$74,000.00		<input type="checkbox"/> Non-Highly Compensated		
After Tax Contribution: \$0.00		This Employee is:		
Matching Contribution: \$1,250.00		<input type="checkbox"/> A Child Under 19 Years Old or Spouse		
Other Employee Contributions: \$1,500.00		<input type="checkbox"/> A Child 19 Years Old or Older or Other Family Member		
QNEC: \$0.00		Ot: [dropdown]		
Adjusted Account Balance: \$15,000.00		<input checked="" type="checkbox"/> Key Employee		
Record 1 of 6				

3. Use the mouse to move the pointer to the **Find** field.

RESULT

The pointer changes to an **I Beam** cursor.

4. Use the mouse to move the **I Beam** cursor to the left edge of the **Find** field.
5. Click the left mouse button once.

RESULT

A flashing cursor will appear at the left edge of the **Find** field.

6. Type the first letter of the employee's last name.

RESULT

The first employee record with a last name beginning with the letter that was typed will appear on the **Employee Info** screen.

Note: if the employee record that appears is not the record you were searching for, use the **Search Using the Pull Down Menu** procedure.

Search Using the Pull Down Menu

1. If you do not see the **Employee Info** screen, use the mouse to move the pointer to the **Employee Info** file folder tab at the top of the screen.
2. Click the left mouse button once.

RESULT

You will see the **Employee Info** screen.

3. Use the mouse to move the pointer to the **Down Arrow** button located to the right of the **Find** field.
4. Click the left mouse button once.

RESULT

A list of employees whose records have been entered in the data base will appear.

5. Hold down the left mouse button and use the mouse to "scroll" through the list of names.
6. When the name you are searching for is highlighted, release the left mouse button.

RESULT

The employee record for the employee whose name was selected will appear.

UPDATING RECORDS

1. Use the **Searching For Records** procedure to locate the record to be updated.
2. Type the updated information in each field as indicated under **Field Definitions**.

Note: Use the mouse or the **Tab** key to maneuver the cursor around the screen.

- The mouse will move the cursor to a specific field by moving the pointer to the field and clicking the left mouse button once.
- The **Tab** key will move the cursor from field to field, in the order the fields appear on the screen.
- Select **Highly Compensated Employee** or **Non-Highly Compensated Employee, A Child Under 19 Years Old or Spouse** or **A Child 19 Years Old or Older** or **Other Family Members**, and/or **Key Employee** by using the mouse to position the pointer on the white box located to the left of each selection and clicking the left mouse button once.

If **A Child Under 19 Years Old or Spouse** or **A Child 19 Years Old or Older** or **Other Family Members** is selected, the HCE the employee is related to must be indicated.

3. Use the mouse to move the pointer to the **Down Arrow** button located to the right of the **Of** field.

Note: Do not type names in this field, since only HCEs already added to the database can be used.

4. Click the left mouse button once.

RESULT

A list of HCEs whose records have been entered in the data base will appear.

5. Hold down the left mouse button and use the mouse to "scroll" through the list of names.
6. When the name of the appropriate HCE is highlighted, release the left mouse button.

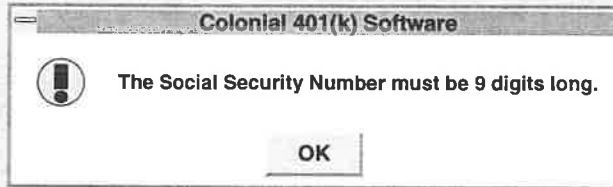
RESULT

The name of the selected HCE will appear in the **Of** field.

Field Definitions

Personal

Social Security Number – the employee's Social Security number (hyphens are automatically inserted). The social security number must be entered in the format xxxxxxxx or xxx-xx-xxxx. If an incorrect format is used, the following dialogue box will appear:



Last Name – the employee's last name.

First Name – the employee's first name.

Middle Initial – the employee's middle initial.

Of:

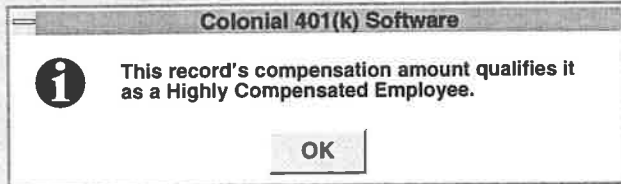
	↓
Adams, Mark	
Adams, Mary	
Carr, Beth	

Field Definitions cont.

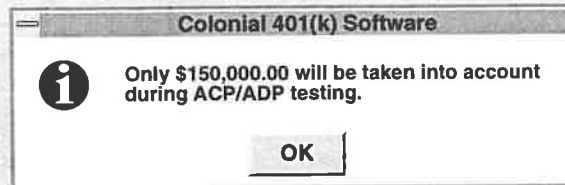
Wages & Contributions

Numbers can be entered in these fields with or without dollar signs, commas, and decimal points.

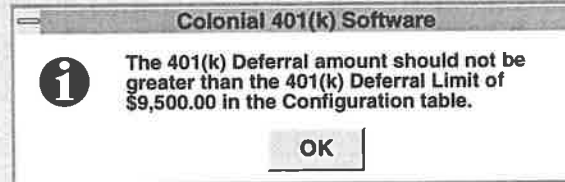
Gross Compensation – an employee's total compensation (normally what is reported as W-2 wages increased by any Section 401(k) and Section 125 elective deferrals). For self employed individuals, gross compensation is net earnings from self employment. If an amount greater than \$150,000 is entered, the following dialogue box will appear:



When you press OK, the following dialogue box will appear:



401(k) Deferral – the amount deducted from the employee's *gross pay* before taxes are calculated. If the amount exceeds the amount exceeds the 401(k) Deferral Limit shown in the Configuration Table, the following dialogue box will appear.



Taxable Compensation – the employee's *gross compensation* less the amount of the 401(k) deferral (calculated automatically).

After Tax Contribution – the amount deducted from the employee's *net pay* after taxes are deducted.

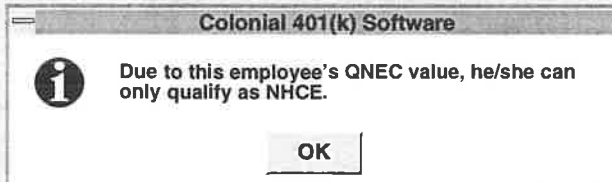
Matching Contribution – the amount the employer contributes to the plan on behalf of the employee based on the employee's 401(k) Deferral.

Field Definitions cont.

Other Employer Contributions – any other employer contributions included as annual additions for Section 415 testing, including discretionary profit sharing contributions, top heavy minimum contributions, and reallocations of forfeitures.

QNEC (Qualified Non-elective Contribution) – a 100% vested non-forfeitable contribution made by the employer to the plan on behalf of all Non-Highly Compensated Employees eligible to participate in the plan. If a value greater than zero is entered in this field and the employee is marked as highly compensated, the following dialogue box will appear:

Adjusted Account Balance – the employee's plan balance used in performing Top Heavy testing. Refer to Appendix VI – Definitions, for details.



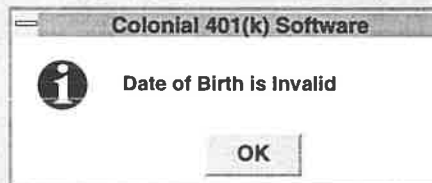
Dates

All dates must be entered in the format **MMDDYYYY**, where **MM** is number of the month (leading zero required if less than 10), **DD** is the number of the day (leading zero required if less than 10), and **YYYY** is a four digit year. Slashes “/” will automatically be entered. If an incorrect format is used, a dialogue box similar to the following will appear:

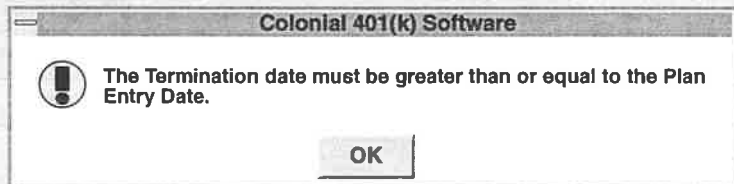
Birth Date – the employee's date of birth.

Hire Date – the employee's date of hire.

Plan Entry Date – the date the employee became a plan participant.



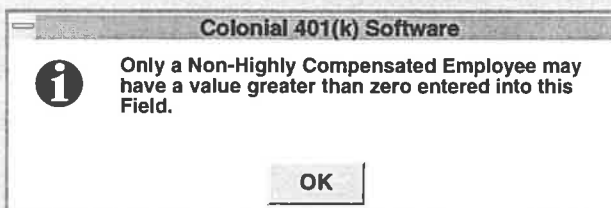
Termination Date – the date a participant's employment ended. If the Termination Date is less than the Plan Entry Date, the following dialogue box will appear:



Field Definitions cont.

HCE Status

Highly Compensated Employee – an individual who is a 5% owner, and any other employee who in a testing year (if one of the top paid 100 employees) or in the previous year: (a) made more than \$100,000, (b) made more than \$66,000 and was in the top 20% by compensation of all employees, or (c) was an officer and made more than \$60,000. See Appendix VI – Definitions, for details. If this is selected and a value greater than zero is later entered in the QNEC field, the following dialogue box will appear:

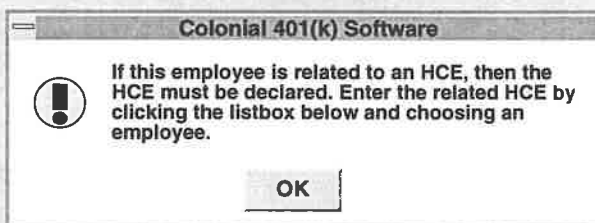


Non-Highly Compensated Employee – any employee not meeting the requirements for a Highly Compensated Employee.

A Child Under 19 Years or Spouse – the employee is either (a) the spouse or (b) a child or grandchild who will not be 19 years old by the end of the plan year, of another employee who is a 5% owner or one of the ten highest paid Highly Compensated Employees. Refer to Appendix VI – Definitions, for details.

A Child 19 Years Old or Older or Other Family Member – the employee is (a) a child or grandchild who will be 19 years old by the end of the plan year, (b) a parent or grandparent, or (c) the spouse of someone described in (a) or (b), of another employee who is a 5% owner or one of the ten highest paid Highly Compensated Employees. Refer to Appendix VI – Definitions, for details.

Note: If *A Child Under 19 Years or Spouse* or *A Child 19 Years Old or Older or Other Family Member* is selected, the relative of the employee must be declared or the following dialogue box will appear:



Key Employee – any employee meeting the definition provided in Internal Revenue Code Section 416(i)(1). Refer to Appendix VI – Definitions, for details.

DELETING RECORDS

Procedure

1. Use the **Searching For Records** procedure to locate the record to be deleted.
2. When the appropriate record has been located, use the mouse to move to the **Delete** button.
3. Click the left mouse button once.



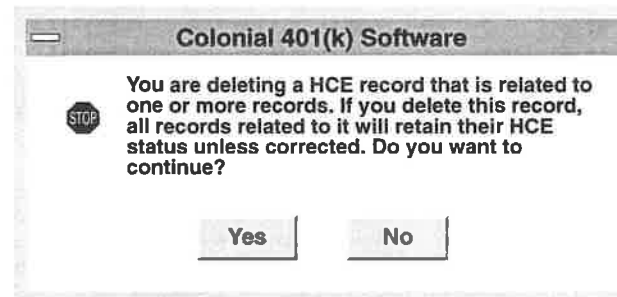
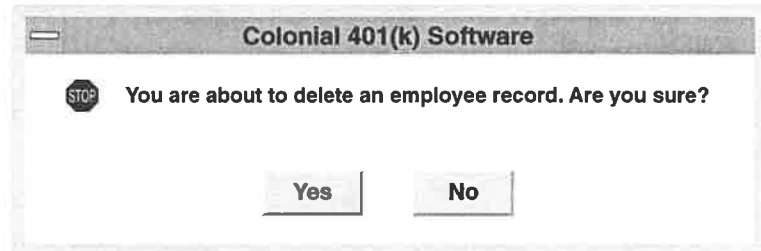
HCE EMPLOYEES

A dialogue box reminding you that the employee is an HCE and that all employees (spouse, children, other relatives) linked to the record will retain HCE status will appear.

- 3.1 Use the mouse to move the pointer to the **OK** button.
- 3.2 Click the left mouse button once.

RESULT

The **Delete Record** dialogue box will appear.



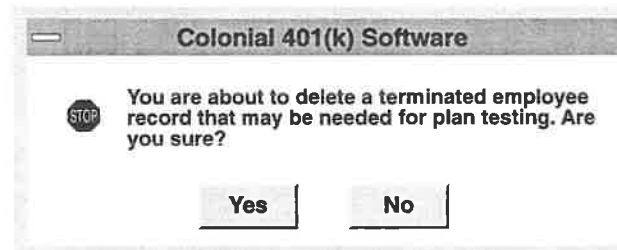
TERMINATED EMPLOYEES

A dialogue box reminding you that the employee has been terminated and that the record may be needed for plan testing will appear.

- 3.3 Use the mouse to move the pointer to the **OK** button.
- 3.4 Click the left mouse button once.

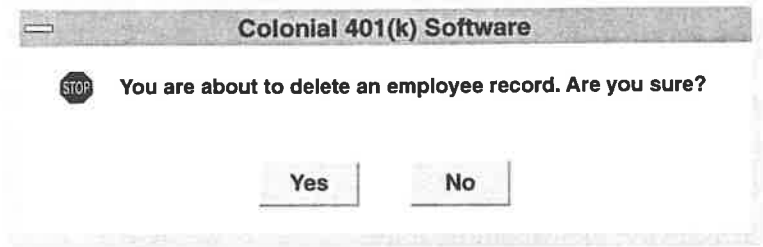
RESULT

The **Delete Record** dialogue box will appear.



NON-HCE/NON-TERMINATED EMPLOYEES

The **Delete Record** dialogue box will appear.



6. Use the mouse to move the pointer to the **OK** button.
7. Click the left mouse button once.

RESULT

The record will be deleted.

SAVING CHANGES

Procedure

1. Use the mouse to move the pointer to the Save button.
2. Click the left mouse button once.



RESULT

All changes will be saved.

RUNNING THE DISCRIMINATION TEST

1. Use the mouse to move the pointer to the **Discrimination Test** tab at the top of the screen.
2. Press the left mouse button once.

RESULT

The **Discrimination Test** screen will appear.

Note: the **Discrimination Test** results are automatically calculated.

For detailed Discrimination Test examples, refer to Appendix I.

Discrimination Test

Colonial 401(k) Software

File Edit Parameters Definitions Help

COLONIAL Mutual Funds FIRST BACK NEXT LAST NEW SAVE DELETE PRINT EXIT

Employee Info **Discrimination Test** Top Heavy Test 415 Test Reports

The Plan Passed the Test

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	5.00%	3.73%
Actual Contribution Percentage (ACP)	2.40%	2.49%

ADP Test:	Failed the 1.25 Test But Passed the 2 Times/2% Test
ACP Test:	Passed the 1.25 Test
Aggregate Limit Test:	Not Required

Print the Discrimination Test report and see documentation for additional information.

Colonial 401(k) Software

File Edit Parameters Definitions Help

COLONIAL Mutual Funds FIRST BACK NEXT LAST NEW SAVE DELETE PRINT EXIT

Employee Info Discrimination Test Top Heavy Test 415 Test Reports

The Plan Did Not Pass the Test

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	6.59%	3.73%
Actual Contribution Percentage (ACP)	2.40%	2.49%

ADP Test:	Failed Both the 1.25 and 2 Times/2% Tests
ACP Test:	Not Required
Aggregate Limit Test:	Not Required

Print the Discrimination Test report and see documentation for additional information.

Definitions

ADP (Actual Deferral Percentage) Test – a calculation that compares the average 401(k) Deferrals of Highly Compensated Employees (HCEs) with the average 401(k) Deferrals of Non-Highly Compensated Employees (NHCEs). This comparison determines if the average 401(k) Deferral of the HCEs is either 1.25x or 2x/+2% of the average 401(k) Deferral of the NHCEs. Refer to Appendix VI – Definitions, for details.

ACP (Actual Contribution Percentage) – a calculation that compares the average After Tax Contributions and employer Matching Contributions of Highly Compensated Employees (HCEs) with the average employee After Tax salary deferrals and employer Matching Contributions of Non-Highly Compensated Employees (NHCEs). This comparison determines if the contributions for the NHCEs is either 1.25x or 2x/+2% of the average contributions of the NHCEs. Refer to Appendix VI – Definitions, for details.

Aggregate Limit Test – an additional discrimination test that must be performed if both the ADP and ACP tests are satisfied only by using the more generous 2x/+2% alternative. Refer to Appendix VI – Definitions, for details.

RUNNING THE TOP HEAVY TEST

1. Use the mouse to move the pointer to the **Top Heavy Test** tab at the top of the screen.
2. Press the left mouse button once.

RESULT

The **Top Heavy Test** screen will appear.

Note: the **Top Heavy Test** results are automatically calculated.

For detailed Top Heavy Test examples, refer to Appendix II.

Top Heavy Test

Colonial 401(k) Software

File Edit Parameters Definitions Help

COLONIAL Mutual Funds

← FIRST ← BACK → NEXT → LAST NEW SAVE DELETE PRINT EXIT

Employee Info Discrimination Test **Top Heavy Test** 415 Test Reports

The Plan is Not Top Heavy

	Key	Non Key	Total
Number of Employees	2	4	6
Total of Adjusted Account Balances	\$28,467.00	\$19,427.00	\$47,894.00
Percent of Totals	59.44%	40.56%	
Top Heavy Definition	60.0%		

Print the Top Heavy Analysis report and see documentation for additional information.

Colonial 401(k) Software

File Edit Parameters Definitions Help

COLONIAL Mutual Funds

← FIRST ← BACK → NEXT → LAST NEW SAVE DELETE PRINT EXIT

Employee Info Discrimination Test **Top Heavy Test** 415 Test Reports

The Plan is Top Heavy

	Key	Non Key	Total
Number of Employees	3	3	6
Total of Adjusted Account Balances	\$38,467.00	\$19,427.00	\$57,894.00
Percent of Totals	66.44%	33.56%	
Top Heavy Definition	60.0%		

Print the Top Heavy Analysis report and see documentation for additional information.

RUNNING THE 415 TEST

1. Use the mouse to move the pointer to the **415 Test** tab at the top of the screen.
2. Press the left mouse button once.

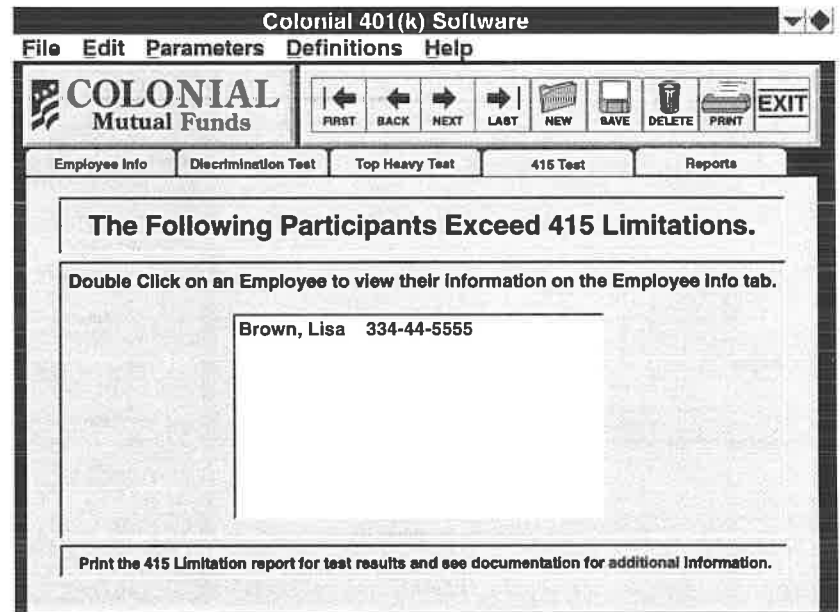
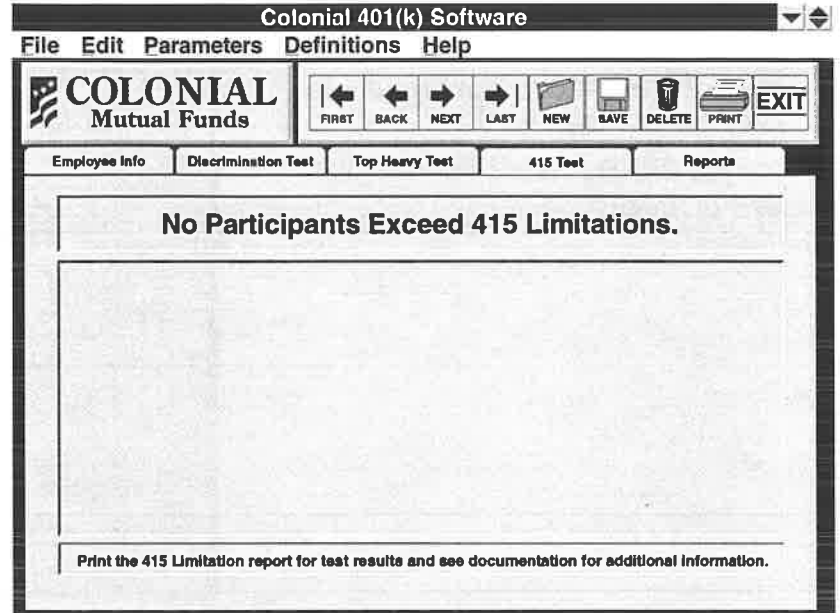
RESULT

The **415 Test** screen will appear.

Note: the **415 Test** results are automatically calculated.

For a detailed 415 Test example, refer to Appendix III.

415 Test



GENERATING REPORTS

Selecting a Report

1. Use the mouse to move the pointer to the **Reports** tab at the top of the screen.
2. Press the left mouse button once.

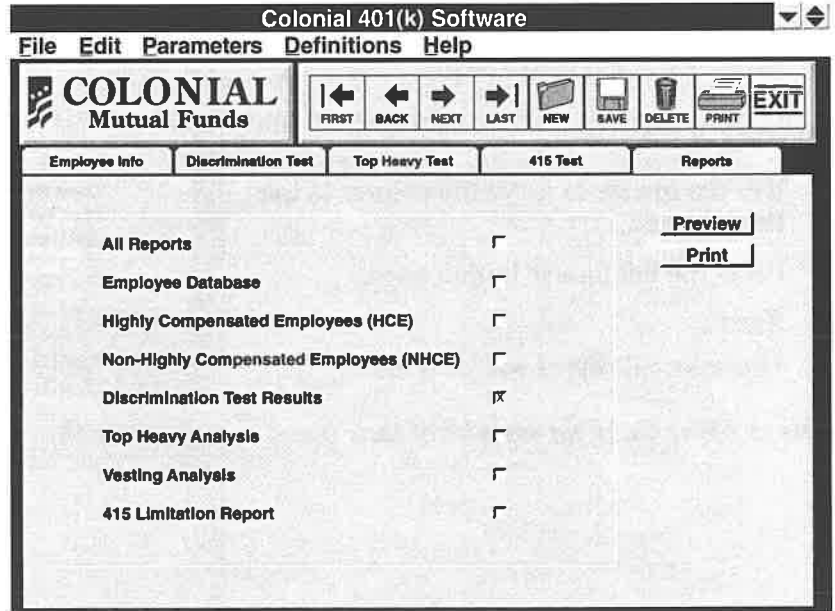
RESULT

The **Reports** screen will appear.

3. Use the mouse to move the pointer to the white "check box" across from the report to be printed.
4. Press the left mouse button once.

RESULT

An "x" will appear in the check box.



Previewing a Report

1. Use the mouse to move the pointer to the **Preview** button.
2. Press the left mouse button once.

RESULT

A full size **preview** of the selected report will appear on the screen.

Note: see **Button Definitions** below for additional preview operations.

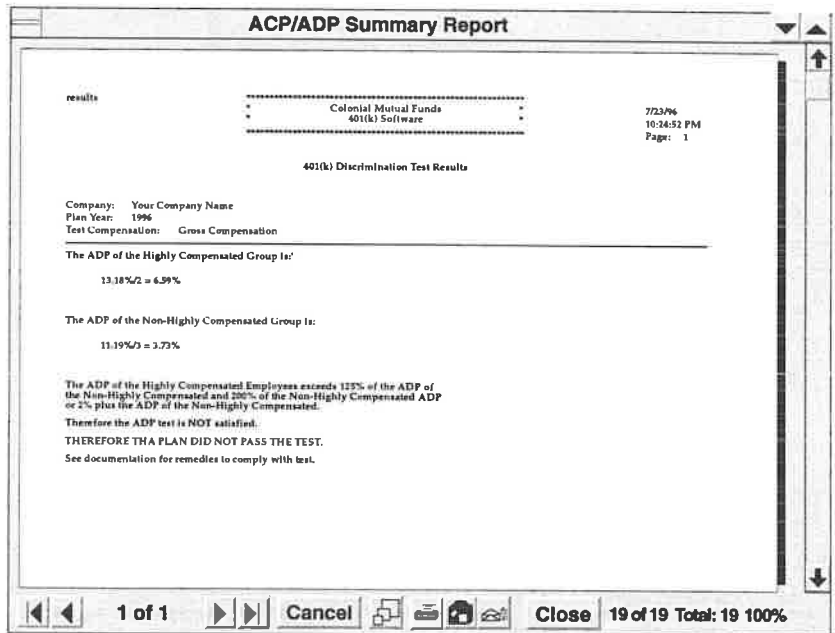
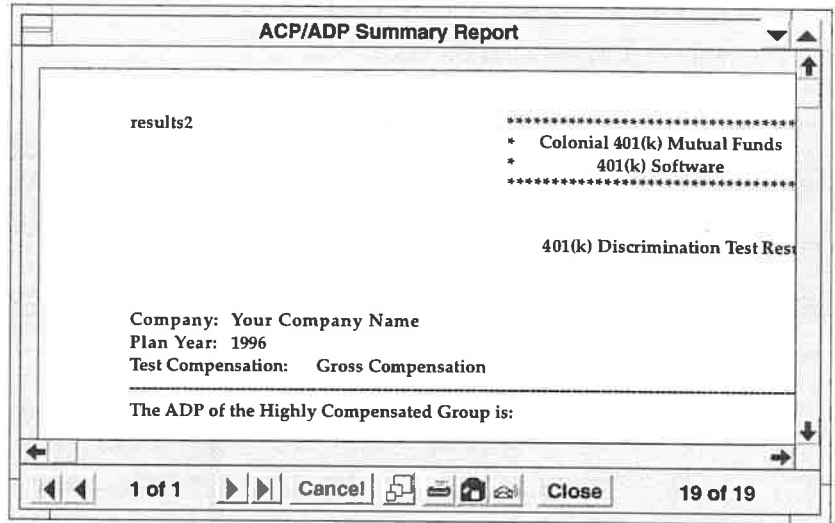
Printing a Report

1. Use the mouse to move the pointer to the **Print** button.
2. Press the left mouse button once.

RESULT

The selected report will be printed.

Refer to Appendix IV for samples of each report.



Button Definitions



Press this button to resize the report you are previewing.



Press this button to print a copy of the report you are previewing.



Press this button to export records to disk in a variety of formats, including EXCEL 4.0 (XLS).



Press this button to export records to your e-mail application.

E-MAILING RECORDS

1. Use the mouse to move the pointer to the **Export (Envelope)** located at the bottom of the **Print Preview** screen.
2. Click the left mouse button once.

RESULT

The **Export** screen will appear.

3. Use the mouse to move the pointer to the **Down Arrow** button located to the right of the **Format** field.
4. Click the left mouse button once.

RESULT

You will see a list of the file formats available for the report you will be exporting.

5. Hold down the left mouse button and use the mouse to “scroll” through the list of file formats.
6. When the desired format is highlighted, release the left mouse button.

RESULT

The file format you selected will appear.

7. Use the mouse to move the pointer to the **Down Arrow** button located to the right of the **Destination** field.
8. Click the left mouse button once.

RESULT

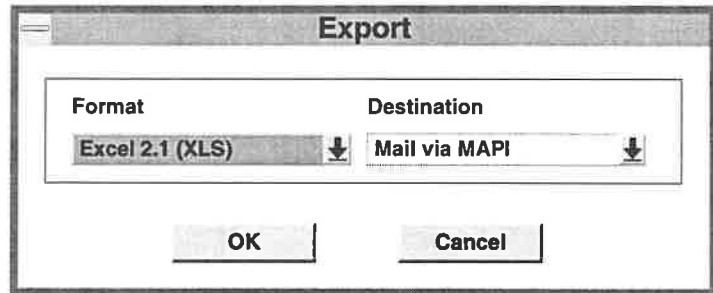
You will see a list of the destinations available for the report you will be exporting.

9. Hold down the left mouse button and use the mouse to “scroll” through the list of destinations.
10. When the desired destination is highlighted, release the left mouse button.

RESULT

The destination you selected will appear.

11. Use the mouse to move the pointer to the **OK** button.
12. Click the left mouse button once.



EXPORTING RECORDS

1. Use the mouse to move the pointer to the **Export (Suitcase)** located at the bottom of the **Print Preview** screen.

2. Click the left mouse button once.

RESULT

The **Export** screen will appear.

3. Use the mouse to move the pointer to the **Down Arrow** button located to the right of the **Format** field.

4. Click the left mouse button once.

RESULT

You will see a list of the file formats available for the report you will be exporting.

5. Hold down the left mouse button and use the mouse to “scroll” through the list of file formats.

6. When the desired format is highlighted, release the left mouse button.

RESULT

The file format you selected will appear.

7. Use the mouse to move the pointer to the **Down Arrow** button located to the right of the **Destination** field.

8. Click the left mouse button once.

RESULT

You will see a list of the destinations available for the report you will be exporting.

9. Hold down the left mouse button and use the mouse to “scroll” through the list of destinations.

10. When the desired destination is highlighted, release the left mouse button.

RESULT

The destination you selected will appear.

11. Use the mouse to move the pointer to the **OK** button.

12. Click the left mouse button once.



EXITING THE PROGRAM

1. Use the mouse to move the pointer to the **Exit** button.



2. Press the left mouse button once.

RESULT

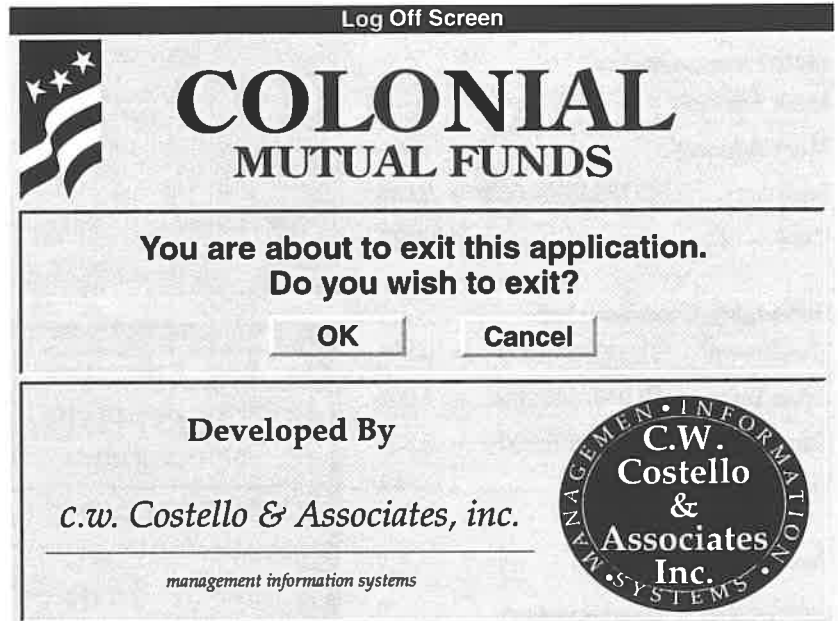
The **Logoff** screen will appear.

3. Use the mouse to move the pointer to the **OK** button.

4. Press the left mouse button once.

RESULT

You will exit the **Colonial 401(k) Software**.



APPENDIX I – SAMPLE DISCRIMINATION TEST RESULTS

Following are the results of the 401(k) Discrimination Test for a hypothetical six person company. In each example, the payroll information for employee Mark Adams, a Highly Compensated Employee (HCE), is altered to produce different test results. The information for the other employees remains the same.

Example 1A

ADP Test Totals

Highly Compensated

Mark Adams† } \$6,800/\$110,000 = 6.18%
 Mary Adams† }

Beth Carr \$5,730/\$150,000‡ = 3.82%

Total 10.00%

Non-Highly Compensated

Lisa Brown \$1,000/\$35,000 = 2.86%

Brian Dunn \$2,000/\$40,000 = 5.00%

Tom Evans \$1,000/\$30,000 = 3.33%

Total 11.19%

Test Results

ADP of Highly Compensated

Employees

10.00%/2 = 5.00%

ADP of Non-Highly Compensated

Employees

11.19%/3 = 3.73%

† For testing purposes, spouses, children, and other family members are combined.

‡ Maximum 1996 compensation cap as established by IRS regulations.

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	HCE Status
Adams	Mark	80,000	6,000	0	1,250	1,500	0	Y
Adams	Mary	30,000	800	1,000	200	560	0	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	N
Evans	Tom	30,000	1,000	0	500	1,000	0	N

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	5.00%	3.73%
Actual Contribution Percentage (ACP)	2.40%	2.49%

ADP Test: Failed the 1.25 Test But Passed the 2 Times/2% Test

ACP Test: Passed the 1.25 Test

Aggregate Limit Test: Not Required

Print the Discrimination Test report and see documentation for additional information.

Analysis

The plan passes both the ADP and ACP tests. Since the 2x/+2 test was not needed to pass both, the Aggregate Limit test is not required and no other tests are run.

Example 1B

ACP Test Totals

Highly Compensated

Mark Adamst	} \$2,450/\$110,000 = 2.23%
Mary Adamst	
Beth Carr	\$3,860/\$150,000‡ = 2.57%
Total	4.80%

Non-Highly Compensated

Lisa Brown	\$500/\$35,000 = 1.43%
Brian Dunn	\$1,750/\$40,000 = 4.38%
Tom Evans	\$500/\$30,000 = 1.67%
Total	7.48%

Test Results

ACP of Highly Compensated Employees

4.80%/2 = 2.40%

ACP of Non-Highly Compensated Employees

7.48%/3 = 2.49%

† For testing purposes, spouses, children, and other family members are combined.

‡ Maximum 1996 compensation cap as established by IRS regulations.

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	HCE Status
Adams	Mark	80,000	6,000	0	1,250	1,500	0	Y
Adams	Mary	30,000	800	1,000	200	560	0	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	N
Evans	Tom	30,000	1,000	0	500	1,000	0	N

Colonial 401(k) Software

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COLONIAL Mutual Funds

The Plan Passed the Test

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	5.00%	3.73%
Actual Contribution Percentage (ACP)	2.40%	2.49%

ADP Test:	Failed the 1.25 Test But Passed the 2 Times/2% Test
ACP Test:	Passed the 1.25 Test
Aggregate Limit Test:	Not Required

Print the Discrimination Test report and see documentation for additional information.

Analysis

The plan passes both the ADP and ACP tests. Since the 2x/+2 test was not needed to pass both, the Aggregate Limit test is not required and no other tests are run..

Example 2A

ADP Test Totals

Highly Compensated

Mark Adams†	} \$6,800/\$110,000 = 6.18%
Mary Adams†	
Beth Carr	\$5,730/\$150,000‡ = 3.82%
Total	10.00%

Non-Highly Compensated

Lisa Brown	\$1,000/\$35,000 = 2.86%
Brian Dunn	\$2,000/\$40,000 = 5.00%
Tom Evans	\$1,000/\$30,000 = 3.33%
Total	11.19%

Test Results

ADP of Highly Compensated Employees

10.00%/2 = 5.00%

ADP of Non-Highly Compensated Employees

11.19%/3 = 3.73%

† For testing purposes, spouses, children, and other family members are combined.

‡ Maximum 1996 compensation cap as established by IRS regulations.

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	HCE Status
Adams	Mark	80,000	6,000	2,000	1,250	1,500	0	Y
Adams	Mary	30,000	800	1,000	200	560	0	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	N
Evans	Tom	30,000	1,000	0	500	1,000	0	N

Colonial 401(k) Software

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COLONIAL Mutual Funds

Employee Info | Discrimination Test | Top Heavy Test | 415 Test | Reports

The Plan Passed the Test

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	5.00%	3.73%
Actual Contribution Percentage (ACP)	3.31%	2.49%

ADP Test: Failed the 1.25 Test But Passed the 2 Times/2% Test

ACP Test: Failed the 1.25 Test But Passed the 2 Times/2% Test

Aggregate Limit Test: Passed the First Aggregate Test

Print the Discrimination Test report and see documentation for additional information.

Analysis

Because neither the ADP nor the ACP satisfied the 1.25x test, the Aggregate Limit Tests must be performed. Under the Aggregate Limit Tests, the combined ADP and ACP of the HCEs must be less than the aggregate limit of the NHCEs.

Test 1

1. Greater of NHCEs' ADP or ACP 3.73
2. 1.25 number from Step 1 4.66
3. Lesser of NHCEs' ADP or ACP 2.49
4. Apply 2 times/2% test to number in Step 3 .. 4.49
5. Sum of Step 2 and Step 4 9.15

Test 2

6. Lesser of NHCEs' ADP or ACP 2.49
7. 1.25 number from Step 1 3.11
8. Greater of NHCEs' ADP or ACP 3.73
9. Apply 2 times/2% test to number in Step 3 .. 5.73
10. Sum of Step 2 and Step 4 8.84

The Aggregate Limit Test was satisfied because the combined ADP and ACP of the HCEs (8.31) was less than either the Test 1 (9.15) or Test 2 (8.84) aggregate limit of the NHCEs.

Example 2B

ACP Test Totals

Highly Compensated

Mark Adams†	} \$4,450/\$110,000 = 4.05%
Mary Adams†	
Beth Carr	\$3,860/\$150,000‡ = 2.57%
Total	6.62%

Non-Highly Compensated

Lisa Brown	\$500/\$35,000 = 1.43%
Brian Dunn	\$1,750/\$40,000 = 4.38%
Tom Evans	\$500/\$30,000 = 1.67%
Total	7.48%

Test Results

ACP of Highly Compensated Employees

6.62%/2 = 3.31%

ACP of Non-Highly Compensated Employees

7.48%/3 = 2.49%

† For testing purposes, spouses, children, and other family members are combined.

‡ Maximum 1996 compensation cap as established by IRS regulations.

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	HCE Status
Adams	Mark	80,000	6,000	2,000	1,250	1,500	0	Y
Adams	Mary	30,000	800	1,000	200	560	0	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	N
Evans	Tom	30,000	1,000	0	500	1,000	0	N

Colonial 401(k) Software

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COLONIAL Mutual Funds

Employee Info | Discrimination Test | Top Heavy Test | 415 Test | Reports

The Plan Passed the Test

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	5.00%	3.73%
Actual Contribution Percentage (ACP)	3.31%	2.49%

ADP Test:	Failed the 1.25 Test But Passed the 2 Times/2% Test
ACP Test:	Failed the 1.25 Test But Passed the 2 Times/2% Test
Aggregate Limit Test:	Passed the First Aggregate Test

Print the Discrimination Test report and see documentation for additional information.

Analysis

Because neither the ADP nor the ACP satisfied the 1.25x test, the Aggregate Limit Tests must be performed. Under the Aggregate Limit Tests, the combined ADP and ACP of the HCEs must be less than the aggregate limit of the NHCEs.

Test 1

1. Greater of NHCEs' ADP or ACP 3.73
2. 1.25 number from Step 1 4.66
3. Lesser of NHCEs' ADP or ACP 2.49
4. Apply 2 times/2% test to number in Step 3 .. 4.49
5. Sum of Step 2 and Step 4 9.15

Test 2

6. Lesser of NHCEs' ADP or ACP 2.49
7. 1.25 number from Step 1 3.11
8. Greater of NHCEs' ADP or ACP 3.73
9. Apply 2 times/2% test to number in Step 3 .. 5.73
10. Sum of Step 2 and Step 4 8.84

The Aggregate Limit Test was satisfied because the combined ADP and ACP of the HCEs (8.31) was less than either the Test 1 (9.15) or Test 2 (8.84) aggregate limit of the NHCEs.

Example 3A

ADP Test Totals

Highly Compensated

Mark Adams†	} \$10,300/\$110,000 = 9.36%
Mary Adams†	
Beth Carr	\$5,730/\$150,000‡ = 3.82%
Total	13.18%

Non-Highly Compensated

Lisa Brown	\$1,000/\$35,000 = 2.86%
Brian Dunn	\$2,000/\$40,000 = 5.00%
Tom Evans	\$1,000/\$30,000 = 3.33%
Total	11.19%

Test Results

ADP of Highly Compensated

Employees	13.18%/2 = 6.59%
------------------	------------------

ADP of Non-Highly Compensated

Employees	11.19%/3 = 3.73%
------------------	------------------

† For testing purposes, spouses, children, and other family members are combined.

‡ Maximum 1996 compensation cap as established by IRS regulations.

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	HCE Status
Adams	Mark	80,000	9,500	0	1,250	1,500	0	Y
Adams	Mary	30,000	800	1,000	200	560	0	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	N
Evans	Tom	30,000	1,000	0	500	1,000	0	N

Colonial 401(k) Software

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COLONIAL Mutual Funds

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Employee Info Discrimination Test Top Heavy Test 415 Test Reports

The Plan Did Not Pass the Test

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	6.59%	3.73%
Actual Contribution Percentage (ACP)	2.40%	2.49%

ADP Test:	Failed Both the 1.25 and 2 Times/2% Tests
ACP Test:	Not Required
Aggregate Limit Test:	Not Required

Print the Discrimination Test report and see documentation for additional information.

Analysis

The ADP of the HCEs exceeds both 1.25x and 2x/+2% of the NHCEs' ADP.

Note: The plan did not pass the ADP Test, so no other tests are run. See Appendix V for possible corrective measures.

Example 3B

ACP Test Totals

Highly Compensated

Mark Adams†	} \$2,450/\$110,000 = 2.23%	
Mary Adams†		
Beth Carr	\$3,860/\$150,000‡ = 2.57%	
Total	4.80%	

Non-Highly Compensated

Lisa Brown	\$500/\$35,000 = 1.43%
Brian Dunn	\$1,750/\$40,000 = 4.38%
Tom Evans	\$500/\$30,000 = 1.67%
Total	7.48%

Test Results

ACP of Highly Compensated Employees

4.80%/2 = 2.40%

ACP of Non-Highly Compensated Employees

7.48%/3 = 2.49%

† For testing purposes, spouses, children, and other family members are combined.

‡ Maximum 1996 compensation cap as established by IRS regulations.

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	HCE Status
Adams	Mark	80,000	7,500	0	1,250	1,500	0	Y
Adams	Mary	30,000	800	1,000	200	560	0	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	N
Evans	Tom	30,000	1,000	0	500	1,000	0	N

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COLONIAL Mutual Funds

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Employee Info Discrimination Test Top Heavy Test 415 Test Reports

The Plan Did Not Pass the Test

	HCE	Non-HCE
Number of Employees	2	3
Actual Deferral Percentage (ADP)	6.59%	3.73%
Actual Contribution Percentage (ACP)	2.40%	2.49%

ADP Test:	Failed Both the 1.25 and 2 Times/2% Tests
ACP Test:	Not Required
Aggregate Limit Test:	Not Required

Print the Discrimination Test report and see documentation for additional information.

Analysis

The ADP of the HCEs exceeds both 1.25x and 2x/+2% of the NHCEs' ADP.

Note: The plan did not pass the ADP Test, so no other tests are run. See Appendix V for possible corrective measures.


APPENDIX II – SAMPLE TOP HEAVY TEST RESULTS

Following are the results of the Top Heavy test for a hypothetical six person company. The Top Heavy test compares the total Adjusted Account Balances for Key Employees with the total Adjusted Account Balances for all employees. If this ratio exceeds 60%, the plan is Top Heavy.

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	Adjusted Account Balance	Key Employee
Adams	Mark	80,000	6,000	0	1,250	1,500	0	15,000	Y
Adams	Mary	30,000	800	1,000	200	560	0	10,000	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	8,797	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	13,467	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	6,400	N
Evans	Tom	30,000	1,000	0	500	1,000	0	4,230	N

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COLONIAL Mutual Funds

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Employee Info Discrimination Test **Top Heavy Test** 415 Test Reports

The Plan is Top Heavy

	Key	Non Key	Total
Number of Employees	3	3	6
Total of Adjusted Account Balances	\$38,467.00	\$19,427.00	\$57,894.00
Percent of Totals	66.44%	33.56%	
Top Heavy Definition	60.0%		

Print the Top Heavy Analysis report and see documentation for additional information.

Analysis

The Plan is top heavy. The total Adjusted Account Balances of the Key Employees (\$38,467) exceeds 60% of the total Adjusted Account Balance for all employees (\$57,894).

Last Name	First Name	Gross Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	Adjusted Account Balance	Key Employee
Adams	Mark	80,000	6,000	0	1,250	1,500	0	5,000	Y
Adams	Mary	30,000	800	1,000	200	560	0	10,000	Y
Brown	Lisa	35,000	1,000	0	500	1,000	0	8,797	N
Carr	Beth	300,000	5,730	1,000	2,860	1,000	0	13,467	Y
Dunn	Brian	40,000	2,000	1,000	750	1,000	0	6,400	N
Evans	Tom	30,000	1,000	0	500	1,000	0	4,230	N

Colonial 401(k) Software

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COLONIAL Mutual Funds

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Employee Info Discrimination Test Top Heavy Test 415 Test Reports

The Plan is Not Top Heavy

	Key	Non Key	Total
Number of Employees	2	4	6
Total of Adjusted Account Balances	\$28,467.00	\$19,427.00	\$47,894.00
Percent of Totals	59.44%	40.56%	
Top Heavy Definition	60.0%		

Print the Top Heavy Analysis report and see documentation for additional information.

Analysis

The Plan is not top heavy. The total Adjusted Account Balance of the Key Employees (\$28,467) is less than 60% of the total Adjusted Account Balance for all employees (\$47,894).

APPENDIX III – SAMPLE 415 TEST RESULTS

Following are the results of the 415 Limit Test for a hypothetical six person company. The Test limits annual additions to an employee's account to the lesser of 25% of taxable compensation or \$30,000.

Last Name	First Name	Taxable Compensation	401(k) Deferral	After Tax Contribution	Matching Contribution	Other Employer Contributions	QNEC	Adjusted Account Balance	Key Employee
Adams	Mark	74,000	6,000	0	1,250	1,500	0	15,000	N
Adams	Mary	29,200	800	1,000	200	560	0	10,000	Y
Brown	Lisa	31,500	3,500	2,000	1,500	1,600	0	8,797	N
Carr	Beth	150,000	5,730	1,000	2,860	1,000	0	13,467	Y
Dunn	Brian	38,000	2,000	1,000	750	1,000	0	6,400	N
Evans	Tom	29,000	1,000	0	500	1,000	0	4,230	N

Colonial 401(k) Software

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COLONIAL Mutual Funds

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Employee Info Discrimination Test Top Heavy Test **415 Test** Reports

The Following Participants Exceed 415 Limitations.

Double Click on an Employee to view their information on the Employee Info tab.

Brown, Lisa 334-44-5555

Print the 415 Limitation report for test results and see documentation for additional information.

Analysis

The test is failed because annual additions to Lisa Brown's account (\$8,600) exceed 25% of her taxable compensation (\$31,500). See Appendix V for possible corrective measures.

APPENDIX IV - SAMPLE REPORTS

Employee Database (page 1)

emp		Colonial Mutual Funds 401(k) Software		7/29/96 12:07:15 PM Page: 1	
Employee Database Report					
Company: Your Company's Name					
Plan Year: 1996					
Record No	1	Date Of Birth	1/10/48	QROC Compensation	\$80,000.00
SSN	111-22-3333	Start Date	6/28/87	401(k) Deferral	\$6,000.00
First Name	Mark	Plan Entry Date	1/1/96	Taxable Compensation	\$74,000.00
Last Name	Adams	Termination Date		After Tax Contributions	\$2,000.00
Middle Initial		Reliance	H	Matching Contributions	\$1,250.00
HCE	Yes	Reliance SSN		Other Employer Contributions	\$1,500.00
Key Employee	Yes			QROIC	\$0.00
				Adjusted Account Balance	\$15,000.00
Record No	2	Date Of Birth	6/6/49	QROC Compensation	\$30,000.00
SSN	222-33-4444	Start Date	6/10/88	401(k) Deferral	\$800.00
First Name	Mary	Plan Entry Date	1/1/96	Taxable Compensation	\$29,200.00
Last Name	Adams	Termination Date		After Tax Contributions	\$1,000.00
Middle Initial	M	Reliance	S	Matching Contributions	\$200.00
HCE	Yes	Reliance SSN	111-22-3333	Other Employer Contributions	\$800.00
Key Employee	Yes			QROIC	\$0.00
				Adjusted Account Balance	\$10,000.00
Record No	3	Date Of Birth	12/15/63	QROC Compensation	\$13,000.00
SSN	334-44-5555	Start Date	4/4/91	401(k) Deferral	\$1,000.00
First Name	Lisa	Plan Entry Date	1/1/96	Taxable Compensation	\$12,000.00
Last Name	Brown	Termination Date		After Tax Contributions	\$0.00
Middle Initial		Reliance	N	Matching Contributions	\$500.00
HCE	No	Reliance SSN		Other Employer Contributions	\$1,000.00
Key Employee	No			QROIC	\$0.00
				Adjusted Account Balance	\$8,797.00

*N= No selection
 *S= Indicates Child Under 19 Years Old or Spouse
 *O= Indicates Child 19 Years Old or Older or Other Family Member

Employee Database (page 2)

emp		Colonial Mutual Funds 401(k) Software		7/29/96 12:07:15 PM Page: 2	
Employee Database Report					
Company: Your Company's Name					
Plan Year: 1996					
Record No	4	Date Of Birth	9/8/43	QROC Compensation	\$300,000.00
SSN	445-55-6666	Start Date	3/28/82	401(k) Deferral	\$5,700.00
First Name	Barb	Plan Entry Date	1/1/96	Taxable Compensation	\$294,300.00
Last Name	Car	Termination Date		After Tax Contributions	\$1,000.00
Middle Initial		Reliance	N	Matching Contributions	\$2,800.00
HCE	Yes	Reliance SSN		Other Employer Contributions	\$1,000.00
Key Employee	Yes			QROIC	\$0.00
				Adjusted Account Balance	\$18,667.00
Record No	5	Date Of Birth	7/7/49	QROC Compensation	\$40,000.00
SSN	556-66-7777	Start Date	1/1/94	401(k) Deferral	\$2,000.00
First Name	Brinn	Plan Entry Date	1/1/96	Taxable Compensation	\$38,000.00
Last Name	Dunn	Termination Date		After Tax Contributions	\$1,000.00
Middle Initial		Reliance	N	Matching Contributions	\$750.00
HCE	No	Reliance SSN		Other Employer Contributions	\$1,000.00
Key Employee	No			QROIC	\$0.00
				Adjusted Account Balance	\$6,400.00
Record No	6	Date Of Birth	10/25/70	QROC Compensation	\$30,000.00
SSN	667-77-8888	Start Date	2/1/95	401(k) Deferral	\$1,000.00
First Name	Tom	Plan Entry Date	1/1/96	Taxable Compensation	\$29,000.00
Last Name	Dunn	Termination Date		After Tax Contributions	\$0.00
Middle Initial		Reliance	N	Matching Contributions	\$500.00
HCE	No	Reliance SSN		Other Employer Contributions	\$1,000.00
Key Employee	No			QROIC	\$0.00
				Adjusted Account Balance	\$4,200.00

*N= No selection
 *S= Indicates Child Under 19 Years Old or Spouse
 *O= Indicates Child 19 Years Old or Older or Other Family Member

**Highly Compensated Employees -
Average Deferral Percentage (ADP) Test**

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Average Deferral Percentage (ADP) Test

Company: Your Company's Name
 Plan Year: 1996

Highly Compensated Employees (HCE)

Record	SSN	Name	Test Compensation (1)	Deferral \$	Deferral %
1	111-22-3333	Adams, Mark	\$110,000.00	\$6,800.00	6.18
2	445-55-6666	Carr, Bob	\$190,000.00	\$5,790.00	3.02
Totals			\$300,000.00	\$12,590.00	10.00

(1) Test Compensation includes family aggregation and is limited to the DEC Compensation Limits and Testing Definition as entered in the Configuration Screen.

**Highly Compensated Employees -
Average Contribution Percentage (ACP) Test**

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 * 401(k) Software *

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Average Contribution Percentage (ACP) Test

Company: Your Company's Name
 Plan Year: 1996

Highly Compensated Employees (HCE)

Record	SSN	Name	Test Compensation (1)	After Tax \$ Employer Match	Contribution %
1	111-22-3333	Adams, Mark	\$110,000.00	\$4,450.00	4.05
2	445-55-6666	Carr, Bob	\$190,000.00	\$3,860.00	2.57
Totals			\$300,000.00	\$8,310.00	6.62

(1) Test Compensation includes family aggregation and is limited to the DEC Compensation Limits and Testing Definition as entered in the Configuration Screen.

**Non-Highly Compensated Employees –
Average Deferral Percentage (ADP) Test**

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Average Deferral Percentage (ADP) Test

Company: Your Company's Name
Plan Year: 1996
Non-Highly Compensated Employees (NHCE)

Record	SSN	Name	Test Compensation (1)	QNEC Plus Deferral \$	Deferral %
1	334-44-5555	Brown, Lisa	\$35,000.00	\$1,000.00	2.86
2	556-66-7777	Dunn, Brian	\$40,000.00	\$2,000.00	5.00
3	667-77-8888	Dunn, Tom	\$30,000.00	\$1,000.00	3.33
Totals			\$105,000.00	\$4,000.00	11.19

(1) Test Compensation includes family aggregation and is limited to the IRC Compensation Limits and testing Definition in the Configuration Screen.

**Non-Highly Compensated Employees –
Average Contribution Percentage (ACP) Test**

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Average Contribution Percentage (ACP) Test

Company: Your Company's Name
Plan Year: 1996
Non-Highly Compensated Employees (NHCE)

Record	SSN	Name	Test Compensation (1)	After-Tax \$ Plus Employer Match	Contribution %
1	334-44-5555	Brown, Lisa	\$35,000.00	\$500.00	1.43
2	556-66-7777	Dunn, Brian	\$40,000.00	\$1,750.00	4.34
3	667-77-8888	Dunn, Tom	\$30,000.00	\$500.00	1.67
Totals			\$105,000.00	\$2,750.00	7.48

(1) Test Compensation includes family aggregation and is limited to the IRC Compensation Limits and testing Definition as entered in the Configuration Screen.

Discrimination Test Results

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 = 401(k) Software =

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401(k) Discrimination Test Results

Company: Your Company's Name
 Plan Year: 1996
 Test Comparison: Cross Compensation

The ADP of the Highly Compensated Group is:
 10.00% / 1 = 3.00%

The ADP of the Non-Highly Compensated Group is:
 11.19% / 3 = 3.73%

The ADP of the Highly Compensated Employees is not more than
 2 times or 2% plus the ADP of the Non-Highly Compensated Employees.
 Therefore, the ADP test is satisfied.

The ACP of the Highly Compensated Group is:
 6.62% / 2 = 3.31%

The ACP of the Non-Highly Compensated Group is:
 7.47% / 3 = 2.49%

The ACP of the Highly Compensated Employees is not more than
 2 times or 2% plus the ACP of the Non-Highly Compensated Employees.
 Therefore, the ACP test is satisfied.

Aggregate Limit Test

Since neither the ADP or ACP passed under the 1.25 test, the
 aggregate limit test must be performed.

The plan passed the first aggregate limit test. The alternate
 limit test is not required.

THEREFORE, THE PLAN PASSED THE TEST.

Top Heavy Analysis

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Top Heavy Analysis Report

Company: Your Company's Name
 Plan Year: 1996

	Key Employees	Non Key Employees	Totals
Number of Employees	3	3	6
Total of Adjusted Account Balances	\$38,467.00	\$19,627.00	\$57,894.00
Percent of Account Balances	66.44 %	33.56 %	
Top Heavy Definition	60.00 %		

 == The Plan is Top Heavy ==

(1) Refer to Top Heavy definitions and de minimus for additional information.

Vesting Report

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* Colonial Mutual Funds *
* 401(k) Software *

Vesting Report

Termination Date: 7/25/96
 Company: Your Company's Name
 Vesting Based On: Date of Hire

Record	SSN	Name	Percent Vested (1)	Start Date
1	111-22-3333	Adams, Mark	100.00	6/30/87
2	223-33-4444	Adams, Mary	100.00	6/10/88
3	334-44-5555	Brown, Lisa	30.00	4/4/91
4	445-55-6666	Clark, Beth	60.00	3/28/92
5	556-66-7777	Dunn, Brian	30.00	1/1/94
6	667-77-8888	Dunn, Tom	.00	2/1/95

(1) The vesting calculation is an estimate, based on certain assumptions. Please refer to the vesting definitions for further details.

415 Limitation Report

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* Colonial Mutual Funds *
* 401(k) Software *

415 Limitation Report

Company: Your Company's Name
 Plan Year: 1996

Record	SSN	Name	Taxable Compensation	401(k) Deferral	After Tax Contributions	Employer Match	Other Employer \$	QNEC	Total Contribution	415 Passes?	Pass 415 Test?
1	111-22-3333	Adams, Mark	\$74,000	\$6,000	\$3,000	\$1,250	\$1,500	30	\$10,750	14,327	Yes
2	223-33-4444	Adams, Mary	\$22,200	\$300	\$1,000	\$200	\$360	30	\$2,560	4,767	Yes
3	334-44-5555	Brown, Lisa	\$34,000	\$1,000	60	\$500	\$1,000	30	\$2,500	7,353	Yes
4	445-55-6666	Clark, Beth	\$130,000	\$5,730	\$1,000	\$2,800	\$1,000	30	\$10,590	7,080	Yes
5	556-66-7777	Dunn, Brian	\$38,000	\$2,000	\$1,000	\$750	\$1,000	30	\$4,750	12,300	Yes
6	667-77-8888	Dunn, Tom	\$25,000	\$1,000	30	\$300	\$1,000	30	\$2,900	6,631	Yes
Totals:			\$354,200	\$16,330	\$5,000	\$6,050	\$6,050	30	\$33,650		

* Note: A "No" in the Pass 415 Test column indicates that this individual's total contributions exceed the allocation limits specified by IRC 415(a).

APPENDIX V – CORRECTIVE MEASURES

The following is a discussion of some of the corrective measures that may be taken if the Section 401(k)/(m), 415, or 402(g) limits are exceeded in any year.

1. ADP/ACP Tests

General: Article 4 of the 401(k) Plan Document

Many employers perform the ADP, ACP, and Aggregate Limit discrimination tests periodically during the plan year to monitor their plans' compliance. Performing periodic testing during the year, and projecting the results to year-end, allows you to anticipate a potential year-end failure. You may then be able to take corrective action by reducing the elective deferrals and/or after tax contributions for highly compensated employees for the balance of the plan year.

You should also keep in mind as you are performing the ADP, ACP, and Aggregate Limit tests that Treasury Regulations permit you to use "helper" contributions to pass each test. For example, in order to pass the ACP test you can use any "excess" elective deferrals that you don't need to pass the ADP tests. (These elective deferrals still count as elective deferrals for purposes of the 401(k) withdrawal restrictions and vesting.)

Similarly, in order to pass the ADP test you can use certain "excess" matching contributions that you don't need to pass the ACP tests. These are called Qualified Matching Contributions (QMACs). In order to use these matching contributions in the ADP test they must have been fully vested when made to the plan. (In Colonial's prototype 401(k) plan these contributions automatically meet the requirement that they not be distributable before age 59 1/2.) If you use QMACs in the ADP test, they are excluded from the ACP test.

You can also try to pass the tests by using different definitions of compensation for testing purposes (you may use any definition acceptable under IRC Section 414(s)).

If you still fail the ACP or ADP tests you can make additional contributions for your NHCEs (QMACs or Qualified Non-Elective Contributions (QNECs)), recharacterize elective deferrals as after-tax contributions, and finally, if necessary, distribute excess amounts to HCE's. These corrective actions are discussed in more detail below. You can use one or any combination of these techniques.

Terminology: for purposes of the discussion below, "excess contributions" means the amount by which a plan is failing the ADP test, and "excess aggregate contributions" means the amount by which a plan is failing the ACP test.

Additional Contributions: Section 4.8(c) of the 401(k) Plan Document

A QNEC is a 100% vested non-forfeitable contribution made by the employer to the plan on behalf of all NHCEs who are eligible to participate in the 401(k) plan.

A QNEC in an amount necessary to pass the test is added to the employee pretax salary deferral to pass the ADP test, or treated as a matching contribution if the QNEC is being used to satisfy the ACP test. (The same QNEC can be used in both the ADP and ACP tests.)

Using Appendix I, Example 3, a QNEC can be used to pass the ADP test under the more lenient alternate method (2X/+2).

ADP for the HCEs	6.59%
subtract max 2% differential allowed	-2.00%
ADP for NHCE necessary to pass test.....	4.59%
subtract current ADP of NHCE.....	-3.73%
Percent increase for each NHCE necessary to pass ADP test	0.86%

Additional QNEC Contribution

Brown: \$35,000 x .86% = \$301.00

Dunn: \$40,000 x .86% = \$344.00

Evans: \$30,000 x .86% = \$258.00

A QMAC is a 100% vested nonforfeitable contribution made by the employer on behalf of all NHCEs who have made a pretax salary deferral. The QMAC is used to pass either a failed ACP test or a failed ADP test — it can not be used for both. The procedure for calculating the QMAC is the same process used for calculating the QNEC.

QNECs and QMACs may be contributed as late as 12 months after the year for which they are allocated. (Contributions made after the filing date for Form 5500 are not deductible for the prior plan year but count with other employer contributions against the deduction limits of IRC Section 404 in the year they are made.)

Recharacterization: Section 4.8(e) of the 401(k) Plan Document

In this method a pretax salary deferral is recharacterized as an after tax employee contribution. Accordingly, the amount recharacterized is treated as income in the year it was deferred and subject to all federal, state, and local taxes that were not paid when the money was treated as a pretax salary deferral.

The “top down” method is used to determine how much of the excess contribution is to be allocated to each HCE. Starting with the HCE(s) with the highest actual deferral ratio (ADR), recharacterize the deferral as an after tax contribution until the ADP test is passed or the ADR equals that of the HCE with the next highest ADR. This process continues until the plan passes the ADP test (see Examples below).

Recharacterized deferrals are treated as employee after tax contributions for ACP testing but for most other qualification purposes (including Sections 404 and 415) continue to be treated as elective salary deferrals. Recharacterized amounts are not treated as compensation for purposes of Sections 404 and 415. It appears that recharacterized amounts are treated as employee after tax contributions for withdrawal purposes, and do not retain their Section 401(k) withdrawal restrictions.

Recharacterization may not be used if after tax contributions are not permitted pursuant to the Colonial 401(k) Plan Adoption Agreement. Similarly, it is unlikely that recharacterization is available where the excess contributions have been matched (because this would result in an employer match on after tax contributions only for HCEs). If no matching contributions are made to the plan and none of the NHCEs make after tax contributions then using recharacterization will cause the plan to fail the ACP test unless a QNEC is made (see QNEC above).

Plans may recharacterize excess contributions only within the first 2 1/2 months after the plan year in which the excess arose.

Distribution Method: Sections 4.8(f) and 4.10 of the 401(k) Plan Document

This method requires excess contributions and/or excess aggregate contributions to be backed out along with associated income or loss and given back to HCEs. Excess matching contributions may be distributed to correct the ACP test only if vested; and only after excess matching contributions that are not vested have been forfeited. If pretax salary deferrals are distributed to correct the ADP test, any associated employer matching contribution generally must be forfeited in order to avoid prohibited discrimination (unless these matching contributions have themselves been distributed as excess aggregate contributions). Any excess contributions, excess aggregate contributions or matching contributions distributed or forfeited as described above continue to be treated as employer contributions for purposes of IRC Sections 404 and 415.

Distributions should be made within 2 1/2 months from the end of the plan year to avoid a 10% penalty payable by the employer. Distributions made within this 2 1/2 month period are generally included in the HCEs gross income in the prior tax year (otherwise they are included in income when distributed). Distributions must be made within 12 months from the end of the plan year to avoid plan disqualification.

As before, the “top down” method is used to determine how much of the excess contribution or excess aggregate contribution is to be allocated to each HCE. Begin with the HCE(s) with the highest ADR or ACR, as applicable. Distribute the amount necessary to pass the test or equal the ADR/ACR of the HCE with the next highest rate. This process continues until the plan passes the applicable test.

Examples:

Elective deferrals by the three HCEs—Adams, Brown and Carter—are 10%, 8% and 6% of compensation, respectively. Assume that the ADP limit on elective deferrals for the HCEs under the plan is 7%. To reduce the ADP for Adams, Brown and Carter to 7%, it is necessary first to reduce Adams’ percentage, which is the highest, to 8% (the same as Brown, who has the next highest percentage). Because the ADP for HCEs still exceeds 7%, it is necessary next to reduce Adams’ and Brown’s deferrals to 7.5% (this reduces the ADP for the group to 7%). Thus, excess contributions of 2.5% of compensation (plus income) must be distributed to Adams; while 0.5% of compensation (plus income) must be distributed to Brown.

When making distributions to HCEs and related family members to correct the ADP test, the amount to be distributed to the family group is allocated by dividing each employee’s share of pretax salary deferral by the total salary deferral of the family group. Assume \$5,000 needs to be distributed to the family unit to pass the ADP test.

	Pretax Salary Deferral	Allocation
Dad	\$7,500	$(\$7,500/\$13,500) \times \$5,000 = \$2,778$
Mom	\$4,000	$(\$4,000/\$13,500) \times \$5,000 = \$1,482$
Son	\$2,000	$(\$2,000/\$13,500) \times \$5,000 = \740
Total	\$13,500	\$5,000

Multiple Use: Section 4.7(h) of the 401(k) Plan Document:

If correction is required because of the Aggregate Limit Test then the ACRs of HCEs are reduced to the extent necessary to pass the test. This reduction is treated as an excess aggregate contribution, and may be corrected as described above.

2. Section 402(g) Dollar Limit: Sections 4.4(b)(ii) and 4.9 of the 401(k) Plan Document

IRC Section 402(g) provides that pretax salary deferrals in excess of \$7,000 (indexed) are included in the employee’s income for the year. For 1996, the dollar limit as indexed is \$9,500. IRC Section 402(g) applies to the participant, for the participant’s tax year, rather than the plan. Thus, a participant covered by two or more plans (including 401(k) plans, SARSEPs, and 403(b) annuities) of unrelated employers can not defer more than \$9,500 overall in the participant’s tax year that begins in 1996.

In addition, IRC Section 402(g) applies through IRC Section 401(a)(30), which provides that accepting contributions from participants in excess of the dollar limit is a disqualifying event. If an employer has more than one plan then the plan documents must provide that the plans taken together will not accept pretax salary deferrals in excess of the dollar limit.

You should monitor your plan on an ongoing basis and stop pretax salary deferrals once the dollar limit is reached. However, even if you do so, an employee may be contributing to an unrelated plan without your knowledge, and may exceed the annual dollar limit. Treasury Regulation Section 1.402(g) provides a correction mechanism in the event the dollar limit is exceeded in an employee’s tax year.

- a. If the excess is attributable solely to the employee’s elective deferrals to your own plan(s), you may “deem” the employee to have requested a distribution of the excess. This amount (and any allocable gain or loss) must be distributed to the employee no later than April 15 of the year following the tax year in which the excess arose in order to avoid plan disqualification.
- b. If the excess is not attributable solely to the employee’s elective deferrals to your own plan(s), the employee may request a distribution of excess deferrals (and allocable income). This request must generally be made in writing by March 15 of the year following the tax year in which the excess arose. If the distribution is not made by April 15 the excess deferral will be taxed twice to the employee—once in the year contributed and again when distributed. If the employee doesn’t make a timely request for a distribution the excess must remain in the plan until there is a permitted distribution event.

Excess deferrals count as annual additions under IRC Section 415 unless distributed in accordance with (a) or (b) above. Excess deferrals count in the ADP test except for excess deferrals of NHCEs described in (a) above. Excess deferrals are generally treated as employer contributions for other Code purposes.

3. Section 415 Limits: Sections 4.3(b)(ii), 4.4(b)(iii), and Article 6 of the 401(k) Plan Document

Under IRC Section 415, “annual additions” to a defined contribution plan, such as a 401(k) plan, can not exceed the lesser of 25% of the employee’s compensation or \$30,000. Special rules apply if an employer maintains more than one qualified plan. Annual additions generally include all pretax salary deferrals, after-tax employee contributions, employer contributions (matching, discretionary, top heavy, QMAC, QNEC, etc.), and reallocated forfeitures.

Keep in mind that the 25% limit under Section 415 applies to an employee’s “taxable” compensation. Normally this is total compensation reduced by any Section 401(k), 403(b), 125, or SARSEP elective deferrals. This definition sometimes causes inadvertent problems under Section 415.

You should monitor your plan on an ongoing basis, and stop pretax salary deferrals or employee after tax contributions if necessary to avoid failing the IRC Section 415 limits for any year. There are only limited correction methods available if the Section 415 limits are exceeded and the penalty for failure is disqualification of the plan. Please refer to Treasury Regulation Section 1.415-6(b) (6) for additional information about correcting excess annual additions.

APPENDIX VI – DEFINITIONS

415 Test

Section 415 of the Internal Revenue Code limits the contributions that may be allocated to an individual's account in any limitation year. There is also a combined limitation on the benefits and contributions for an individual who participates in both a defined benefit and defined contribution plan. This 401(k) plan is a defined contribution plan. For a defined contribution plans annual additions are limited to the lesser of 25 percent of compensation or \$30,000. IRC Section 415(c) (1). When computing the 25% test, the employees compensation net of his or her elective deferrals (i.e. taxable compensation) is used.

The limitation year is generally the calendar year. However, another 12-month period may be elected by the employer in the Adoption Agreement.

An employer for purposes of the Section 415 limitations is:

1. A controlled group of corporations, or a group of trades or businesses under common control; and
2. All members of an affiliated service group.

The defined contribution limit applies on an annual basis to all additions (other than investment earnings) to the participant's account.

Annual Additions include:

1. Elective contributions;
2. Matching Contributions;
3. Employer non-elective contributions;
4. Employee mandatory and voluntary contributions;
5. Employer contributions to another defined contribution plan, including money purchase plans, SEPs, ESOPs, and profit sharing plans;
6. Forfeitures allocated to a participant's account;
7. Amounts allocated to an individual medical account, which is part of a qualified pension plan maintained by the employer; and
8. Employer contributions for a Key Employee allocated to a separate account under a welfare benefit plan for post-retirement medical benefits.

IRC Sections 415(c)(2), 415(l), 419A(d)(2)

Compensation

Generally, under the Colonial 401(k) plan, total compensation earned during the limitation year from the employer maintaining the plan is considered for purposes of Section 415. Specifically, the following items are included:

1. The participant's wages, salaries, fees for professional services, and other amounts received for personal services, to the extent that such amounts are includible in gross income;
2. For self-employed individuals, earned income;
3. Taxable amounts due to employer-provided accident and health insurance benefits and medical reimbursement plan benefits;
4. Moving expenses paid by the employer that are not deductible by the employee;
5. The value of a non-qualified stock option granted to an employee to the extent includible in gross income; and
6. The amount includible in gross income upon making an election to be taxed on the value of restricted property.

Treasury Regulation section 415-2(d)(2)

The following items are specifically excluded from compensation for the purposes of Section 415:

1. 401(k) deferrals and Code Section 125 deferrals to the extent that such deferrals are not included in the gross income of the employee for the taxable year contributed;
2. Employer contributions to a simplified employee pension plan;
3. Distributions from a deferred compensation plan;
4. Contributions made by an employer toward the purchase of an annuity contract under Section 403(b);
5. Amounts realized from the exercise of a non-qualified stock option, or when restricted stock or property held by either becomes freely transferable or is no longer subject to a substantial risk of forfeiture;
6. Amounts realized from the sale, exchange, or other disposition of stock acquired under a qualified stock option; and
7. Amounts that receive special tax benefits, such as premiums for group term life insurance, to the extent that such benefits are not includible in gross income of the employee;
8. Employer contributions to a deferred compensation plan to the extent such contributions are not included in the gross income of the employee for the taxable year contributed.

(Treasury Regulation Sections 415-2(d)(2) and (d)(3))

Adjusted Account Balance

What balances are used in calculating whether or not the plan is top heavy?

The adjusted account balances for both “key” and “non-key” employees are used in the determination of Top Heavy. (Refer to the definition of Top Heavy.)

The account balances for the key and non-key employees are adjusted to:

1. Include any distributions received by key, former key, and non-key employees during the 5-year period ending on the Determination Date.
2. Exclude any “unrelated” rollovers received after 19 83 with respect to key and non-key employees. An unrelated rollover is one received from the plan of an unrelated employer.

Account balances of key and non-key employees who have not rendered any services to the employer during the 5-year period ending on the determination date are not counted in determining whether the plan is top heavy.

Account balances of Key Employees who have become non-key employees (referred to as “former key employees”) are not counted in determining whether the plan is Top Heavy. (Because the determination period is five years in length, a former key employee will be treated as a key Employee through the end of the 5-year period. Thereafter, they are considered former key employees and they are disregarded in the Top-Heavy calculation.)

Note: If the employer maintains other plans in addition to this 401(k) plan, and they are considered a required aggregation group, then the data from this plan must be combined with the same data compiled for such other plans to determine whether the required aggregation group is top heavy. Each plan in that group will be considered Top-Heavy if the required aggregation group is top heavy.

Child 19 Years Old or Older or Other Family Member

Check this box if the employee is

- a. A lineal ascendant (e.g., parent or grandparent), or
- b. A lineal descendant (e.g., child or grandchild) who will be age 19 by the end of the plan year of another employee who is either a 5% owner or one of the ten highest paid Highly Compensated Employees. Also check the box if the employee is a spouse of an individual described in (a) or (b). Refer to the Highly Compensated Employee definition for further information.

Family Aggregation

Family aggregation rules apply whenever you are determining the identity of HCEs participating in your plan. Family aggregation rules also apply to the \$150,000 limit under IRC Sections 401(a)(17) (annual compensation limit) and 404(l) (deduction limit). The general reasoning is that the members of the family constitute an economic unit and thus should be treated as one employee.

1. Determination of HCEs

Under IRC Section 414(q)(6), the compensation and contributions of family members of (a) a 5% owner, or (b) an HCE who is one of an employer's 10 top paid workers, must be aggregated with the compensation and contributions of the HCE as though all the family members are a single HCE. The term "family member" means the employee's spouse and lineal ascendants or descendants (as well as the spouses of those lineal ascendants and descendants). Lineal relatives include children, parents, grandparents, grandchildren, etc., but do not include siblings, cousins, aunts, and uncles of the employee. This is the "IRC Section 414(q) family group."

This IRC section 414(q) family group is treated as a single HCE whenever the HCE rules apply, including ADP/ACP testing as discussed below.

2. Section 401(a)(17) Compensation Limit (\$150,000* Limit)

IRC Section 401(a)(17) limits the annual compensation that can be taken into account for plan contribution and discrimination testing purposes to \$150,000 per employee. The family aggregation rules described in (1) above also apply under IRC section 401(a)(17), with an important difference. For this purpose, "family member" includes only the employee's spouse, and any lineal descendants (children, grandchildren, etc.) who have not attained age 19 before the end of the Plan Year. This is the "IRC Section 401(a)(17) family group."

** The IRC Section 401(a)(17) limits is indexed, and may change annually. The limit is \$150,000 for 1995 and 1996.*

3. ADP/ACP Testing Procedure

While regulations have not yet been issued, the IRS has suggested the following four step approach in performing the ADP/ACP tests where these family aggregation rules apply:

- a. Determine the total compensation of the employee and all family members in the IRC Section 401(a)(17) family group (i.e., spouse and lineal descendants under age 19).
- b. Cap the compensation determined in (1) at the IRC Section 401(a)(17) limit (\$150,000 for 1996).
- c. Identify any other family members that must be aggregated for discrimination testing purposes (i.e., other family members who are in the IRC Section 414(q) family group). Cap each individual family member's compensation at the IRC Section 401(a)(17) limit and add their capped compensation together.

Example:

Tom Smith owns a business that employs his wife Ann, son Todd, who is age 15, and daughter Amy, who is age 21.

Step 1: Determine the total compensation of the employee and all family members in the IRC Section 401(a) (17) family group.

	Compensation	Deferral
Tom Smith	\$100,000	\$6,000
Ann Smith	\$40,000	\$4,000
Todd Smith	\$30,000	\$3,000
Total	\$170,000	\$13,000

Step 2: Cap the compensation determined in Step 1 at \$150,000.

Total	\$150,000	\$13,000
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Step 3: Determine other members of the IRC Section 414(q) family group. Cap the compensation of each member at \$150,000:

Amy Smith	\$60,000	\$6,000
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Step 4: Add the result for Steps 2 and 3.

Total	\$210,000	\$19,000
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The ADP for this Section 414(q) family group = $\$19,000/\$210,000 = .09048$ divided by .01 or 9.05%.

Note: Amy's compensation is not included in the \$150,000* cap but is added to the total. Note also that where the Section 401(a) (17) limit applies there may be a number of alternatives available for apportioning the \$150,000 among family members for purposes of allocating nonelective contributions under the plan.

Refer to the definition of Child Under 19 Years Old or Spouse.

Child Under 19 Years Old or Spouse

Check this box if the employee is:

- a. A lineal descendant (e.g., child or grandchild) who will not be age 19 by the end of the plan year, or
- b. The spouse of another employee who is either a 5% owner of the business or one of the ten highest paid Highly Compensated Employees. Refer to the Highly Compensated Employee definition for further information.

Family Aggregation

Family aggregation rules apply whenever you are determining the identity of HCEs participating in your plan. Family aggregation rules also apply to the \$150,000 limit under IRC Sections 401(a) (17) (annual compensation limit) and 404(l) (deduction limit). The general reasoning is that the members of the family constitute an economic unit and thus should be treated as one employee.

1. Determination of HCEs

Under IRC Section 414(q) (6), the compensation and contributions of family members of (a) a 5% owner, or (b) an HCE who is one of an employer's 10 top paid workers, must be aggregated with the compensation and contributions of the HCE as though all the family members are a single HCE. The term "family member" means the employee's spouse and lineal ascendants or descendants (as well as the spouses of those lineal ascendants and descendants). Lineal relatives include children, parents, grandparents, grandchildren, etc., but do not include siblings, cousins, aunts, and uncles of the employee. This is the "IRC Section 414(q) family group."

This IRC section 414(q) family group is treated as a single HCE whenever the HCE rules apply, including ADP/ACP testing as discussed below.

2. Section 401(a)(17) Compensation Limit (\$150,000* Limit)

IRC Section 401(a)(17) limits the annual compensation that can be taken into account for plan contribution and discrimination testing purposes to \$150,000 per employee. The family aggregation rules described in (1) above also apply under IRC section 401(a)(17), with an important difference. For this purpose, "family member" includes only the employee's spouse, and any lineal descendants (children, grandchildren, etc.) who have not attained age 19 before the end of the Plan Year. This is the "IRC Section 401(a)(17) family group."

* *The IRC Section 401(a)(17) limits is indexed, and may change annually. The limit is \$150,000 for 1995 and 1996.*

3. ADP/ACP Testing Procedure

While regulations have not yet been issued, the IRS has suggested the following four step approach in performing the ADP/ACP tests where these family aggregation rules apply:

- a. Determine the total compensation of the employee and all family members in the IRC Section 401(a)(17) family group (i.e., Spouse and lineal descendants under age 19).
- b. Cap the compensation determined in (1) at the IRC Section 401(a)(17) limit (\$150,000 for 1996).
- c. Identify any other family members that must be aggregated for discrimination testing purposes (i.e., other family members who are in the IRC Section 414(q) family group). Cap each individual family member's compensation at the IRC Section 401(a)(17) limit and add their capped compensation together.
- d. Add (2) and (3) but don't cap the total.

Example

Tom Smith owns a business that employs his wife Ann, son Todd, who is age 15, and daughter Amy, who is age 21.

Step 1: Determine the total compensation of the employee and all family members in the IRC Section 401(a)(17) family group.

	Compensation	Deferral
Tom Smith	\$100,000	\$6,000
Ann Smith	\$40,000	\$4,000
Todd Smith	\$30,000	\$3,000
Total	\$170,000	\$13,000

Step 2: Cap the compensation determined in Step 1 at \$150,000.

Total	\$150,000	\$13,000
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Step 3: Determine other members of the IRC Section 414(q) family group. Cap the compensation of each member at \$150,000:

Amy Smith	\$60,000	\$6,000
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Step 4: Add the result for Steps 2 and 3.

Total	\$210,000	\$19,000
-------	-----------	----------

The ADP for this Section 414(q) family group = $\$19,000/\$210,000 = .09048$ divided by .01 or 9.05%.

Note: Amy's compensation is not included in the \$150,000* cap but is added to the total. Note also that where the Section 401(a)(17) limit applies there may be a number of alternatives available for apportioning the \$150,000 among family members for purposes of allocating nonelective contributions under the plan.

Refer to the definition of Child 19 Years Old or Older or Other Family Member.

Determination Date

The assessment of whether a plan is Top Heavy for a plan year is made as of the determination date for the plan year. IRC Section 416(g) (4) (C) provides that the determination date for a plan year is:

1. The last day of the preceding plan year, or
2. In the case of a plan's first plan year, the last day of that plan year. This means that a plan (other than a plan that is in its first year) which becomes Top Heavy will not have to satisfy the Top Heavy rules in operation until the next plan year.

A Key Employee is any employee who at any time during the plan year containing the Determination Date (the determination date year) or the four preceding years is an officer who meets a compensation threshold, one of the ten largest owners of the employer who meets a compensation threshold, a 5% owner of the employer, or a 1% owner of the employer who meets a compensation threshold.

Example 1

An employer maintains Plan A, a defined contribution plan, in which key employees participate. Plan A's plan year is the calendar year. For Plan A's plan year starting in 1996, the determination date is December 31, 1995. As of the determination date, the aggregate of the accounts of the key employees under the plan exceeds 60 percent of the aggregate of the accounts of all employees under the plan. Plan A is top-heavy for the 1996 calendar year.

Example 2

You are examining a plan for the 1996 calendar year to determine whether it is top heavy. The determination date for the 1996 plan year is December 31, 1995. Individual A, an officer of the employer whose compensation exceeded the threshold limit, separated from service in 1991. Even though Individual A is no longer an employee of the employer, Individual A is treated as a key employee for purposes of determining whether this plan is top-heavy for the 1996 plan year. However, for the purposes of determining whether the plan is top-heavy for the 1997 plan year, Individual A is not treated as a key employee because five years have elapsed since Individual A performed any services for the employer.

Discrimination Testing

What is Discrimination Testing?

After the plan has satisfied the minimum participation and minimum coverage rules, it is necessary to test the plan to ensure that the amount of contribution or benefits under the plan does not discriminate in favor of the Highly Compensated Employees (HCEs). The elective contributions (deferrals) under a 401(k) plan is not considered discriminatory if the plan satisfies the actual deferral percentage (ADP) test. Similarly, employer matching and employee after-tax contributions are not discriminatory in amount if the plan meets the actual contribution percentage (ACP) test.

If a Section 401(k) plan provides for both elective contributions and employee after-tax and matching contributions, the plan must prevent the use of the "alternative method" being used to pass both tests. That is, it is not enough to show that the ADP and ACP tests are both satisfied by using the 200 percent and 2 percentage point test. If this occurs, an Aggregate Limit Test must also be performed.

What is the Actual Deferral Percentage (ADP) Test?

Elective contributions under a Section 401(k) plan must satisfy either of the following tests:

1. The ADP of the group of eligible HCEs cannot be more than 125 percent of the ADP of the eligible Non-Highly Compensated Employees (NHCEs).
2. The ADP of the eligible HCEs cannot be more than 2 percentage points greater than the ADP of the eligible NHCEs and the ADP of the eligible HCEs cannot be more than two times the ADP of the eligible NHCEs (This is the alternate method).

The following shows the maximum ADP for HCEs given an ADP for NHCEs:

ADP for NHCEs	ADP for HCEs
1	2.00
2	4.00
3	5.00
4	6.00
5	7.00
6	8.00
7	9.00
8	10.00
9	11.25
10	12.50

How is the ADP calculated?

The ADP for each group (HCEs and NHCEs) is determined by calculating an actual deferral ratio for each eligible employee, and averaging together the ratios of all HCEs and NHCEs.

How is an eligible employee's actual deferral ratio determined?

In general, an eligible employee's actual deferral ratio is the amount of employee's elective contribution (deferral) divided by the employee's compensation. Qualified matching contributions (QMACs) and qualified nonelective contributions (QNECs) that are treated as elective contributions for purposes of the ADP test are added to the employee's elective contributions. If elective contributions are treated as matching contributions for purposes of the ACP test then the ADP test must be satisfied both with and without those elective contributions.

You must count each employee who is eligible to make elective contributions, regardless of whether the employee actually chooses to do so. An eligible employee who makes no elective contribution has an actual deferral ratio of 0.

What is considered compensation for purposes of calculating actual deferral ratios?

The definition of compensation used in determining actual deferral ratios must be one that is non-discriminatory under Section 414(s). Generally, compensation paid during the plan year will be used for this purpose. Refer to the Test Compensation definition.

What happens if the ADP test for a plan year is not satisfied?

If the ADP test for a plan year is not satisfied, the portion of the Section 401(k) plan attributable to elective contributions - and, most likely, the plan in its entirety - will no longer be qualified. The regulations, however, provide several mechanisms for correcting an ADP test that does not meet the requirements of the law. These mechanisms are discussed in detail in Appendix V of your User's Guide.

What is the Actual Contribution Percentage (ACP) Test?

The employer matching and employee after-tax contributions to a plan must satisfy either of the following tests:

1. The ACP of the group of eligible HCEs cannot be more than 125 percent of the ACP of the eligible NHCEs.
2. The ACP of the eligible HCEs cannot be more than 2 percentage points greater than the ACP of the eligible NHCEs and the ACP of the eligible HCEs cannot be more than two times the ACP of the eligible NHCEs.

The following shows the maximum ACP for HCEs given an ACP for NHCEs:

ACP for NHCEs	ACP for HCEs
1	2
2	4
3	5
4	6
5	7
6	8
7	9
8	10
9	11.25
10	12.50

How is the ACP calculated?

The ACP for each group (HCEs and NHCEs) is determined by calculating an actual contribution ratio for each eligible employee, and averaging together the ratios of all HCEs and NHCEs.

How is an eligible employee's actual contribution ratio determined?

In general, an eligible employee's actual contribution ratio is the sum of employer matching and employee after-tax contributions allocated to the employee's account divided by the employee's compensation. You may use elective contributions not needed to pass the ADP test, as well as QNECs, as matching contributions in determining an employee's actual contribution ratio. Recharacterized elective contributions are also taken into account in determining an employee's actual contribution ratio. However, matching contributions treated as elective contributions for purposes of the ADP test are disregarded.

In addition, matching contributions that are forfeited because the elective or employee contributions to which they relate are treated as excess contributions or excess deferrals are not taken into account. If the ACP test is not satisfied, plan provisions calling for distribution and/or forfeiture of excess aggregate contributions are implemented first before determining whether matching contributions must be forfeited. You must count each employee who is eligible to make after tax contributions or to receive a matching contribution regardless of whether the employee actually chooses to contribute to the plan. An employee who makes an after tax contribution and received no matching contribution has an actual contribution ratio of 0.

What happens if the ACP test for a plan year is not satisfied?

If the ACP test for a plan year is not satisfied, the plan will no longer be qualified. The regulations, however, provide several mechanisms for correcting an ACP test that does not meet the requirements of the law. These mechanisms are discussed in detail in Appendix V of your User's Guide.

What is the Aggregate Limit Test?

The aggregate limit test (sometimes called the "multiple use test") is a special test that applies to prevent both the ADP and ACP tests from being satisfied using the alternate method. If the test applies, and is not satisfied, the plan is disqualified.

When is the Aggregate Limit Test performed?

If the plan can pass either the ADP or ACP test by using the 125% test, there is no need to perform the aggregate limit test. This test is also only used when the Section 401(k) plan has contributions subject to the ADP and ACP test. For example, if a plan only has elective deferrals (tested under the ADP test), there is no need to perform the aggregate limit test.

A detailed explanation and examples of all the above tests are located in Appendix I of your User's Guide.

Highly Compensated Employee (HCE)

Who is a highly compensated active employee?

An employee is a Highly Compensated Employee (HCE) for a plan year only if the employee performs services for the employer during the determination year, and is a member of one or more specified employee groups (see Example below) during the determination year or look-back year. "Leased employees" may have to be counted as your employees. Also, special rules may apply if the employer is a member of a controlled group of corporations, an affiliated service group, or a group of businesses under common control.

The determination of HCE vs NHCE is important, since the tests necessary to satisfy non-discrimination rules require that these employees be grouped, and ratios from each group be used to show non-discriminatory results.

To determine if an employee is a Highly Compensated Employee (HCE) for the determination year, two calculations are required: the determination year calculation and the look-back year calculation. The determination year is generally the current plan year. The look-back year is the twelve months preceding the determination year. The look-back year can never be less than twelve months.

Example

Plan A has adopted the calendar year as its plan year. The determination year for 1996 ends December 31, 1996, and the look-back year is the twelve months that ended December 31, 1995.

For the look-back year calculation, a highly compensated active employee is an employee who performs services for the employer during the determination year, and who during the look-back year:

1. Was a 5% owner of the employer;
2. Received compensation from the employer of more than \$100,000.*
3. Received compensation from the employer of more than \$66,000* and was a member of the top-paid group of employees; or
4. Was an officer of the employer who received compensation of more than \$60,000.*

For the determination year calculation, an employee is a highly compensated active employee only if, during the determination year, the employee is either (a) a 5% owner; or (b) both described in paragraph 2, 3, or 4 above (substituting determination year for look back year) and one of the 100 employees paid the most compensation.

** These dollar limits are indexed, and may change annually. You must use the dollar amount in effect for the calendar year in which the determination year or look-back year begins, whichever is applicable. The dollar amounts shown are applicable for both 1995 and 1996.*

Do family aggregation rules apply in determining Highly Compensated Employees?

Yes. Under IRC Section 414(q) (6), the compensation and contributions of family members of (a) a 5% owner, or (b) an HCE who is one of an employer's 10 top paid workers, must be aggregated with the compensation and contributions of the HCE as though all the family members are a single HCE. The term "family member" means the employee's spouse and lineal ascendants or descendants (as well as the spouses of those lineal ascendants and descendants). Lineal relatives include children, parents, grandparents, grandchildren, etc., but do not include siblings, cousins, aunts, and uncles of the employee. Refer to "Child 19 Years Old or Older or Other Family Member" and "Child Under 19 Years Old or Spouse" for further information.

Who is a 5 percent owner?

An employee is a 5 percent owner of the employer for the determination or look-back year if, at any time during the year, the employee is a 5 percent owner for top-heavy purposes. (IRC Section 414(q) (3) and 416(i) (1) (B) (i).) Also refer to the Top-Heavy definition for further information.

What is the top-paid group?

An employee is in the top-paid group of employees for the determination or look-back year if the employee is in the group consisting of the top 20 percent of the employer's employees when ranked on the basis of compensation received from the employer during the year. The identification of the employees who are in the top-paid group for a year involves a two-step procedure:

1. The determination of the number of employees that corresponds to 20 percent of the employer's employees; and
2. The identification of the employees who are among the number of employees who receive the most compensation during the year.

Employees who perform no services for the employer during the year are not included in making either of these determinations. For purposes of determining the number of employees in the top-paid group for a year, the following employees are excluded:

- a. Employees who have not completed six months of service by the end of the year;
- b. Employees who normally work less than 17 1/2 hours per week during the year;
- c. Employees who normally work six months or less during any year;
- d. Employees who are not age 21 by the end of the year; and
- e. Certain nonresident aliens.

The employer may elect to reduce the period of service or lower the age specified above, including a zero service or age requirement, provided the election applies to all plans of the employer.

Who is an officer?

To determine if an employee is an officer of the employer for Highly Compensated Employee purposes, the same general test in determining who is an officer for Top-Heavy plan purposes is applied.

For an officer to be a member of the group of HCEs, the officer must receive compensation during the determination or look-back year that is more than one-half of the defined benefit plan maximum dollar amount. If no officer satisfies the compensation requirement, the highest paid officer for the year is treated as a highly compensated employee by reason of being an officer without regard to the amount of compensation. If no officer of the employer meets the compensation requirement and an employee is both the highest paid officer and a 5 percent owner, the employee is treated as an includible officer for this minimum inclusion rule.

The number of employees that can be considered officers is equal to 10 percent of all employees, or three, whichever is greater. In no case, however, can the total number of officers exceed 50. Thus, if the employer has fewer than 30 employees, no more than three can be considered officers.

What "Compensation" is used for determining Highly Compensated Employees?

"Compensation" is based on compensation as defined in IRC Section 415(c) (3) of the Internal Revenue Code. This is, generally, the total compensation an employee receives from the employer during the year, and includes any salary deferrals under IRC Section 401(k) plans, IRC Section 403(b) tax sheltered annuities, SEP's, and cafeteria plans.

Key Employee

Who is a key employee?

A key employee is any employee (including any deceased employee) who, at any time during the plan year containing the Determination Date or any of the four preceding plan years, is (or was):

1. **An includible officer** having annual compensation in excess of 50 percent of the Section 415 annual dollar limitation for defined benefit plans in effect for such plan year;
2. One of the **top ten largest owners** of the employer having annual compensation in excess of the annual addition limitation in effect for such plan year;
3. A **5 percent owner**; or
4. A **1 percent owner** whose compensation exceeds \$150,000

(IRC 416(i)(1)(A); Treasury Regulation 1.416-1, Question T-12)

A family member (spouse, child, grandchild, and parents) of a key employee may also be a key employee as a result of the stock attribution rules of Internal Revenue Section 318. A family member of a 5% owner will always be a key employee. A family member of a top ten owner or 1 percent owner will be a key employee if the family member has the requisite amount of compensation.

The determination of key employee status is necessary to properly perform top heavy testing. Refer to the Top-Heavy definition.

Who is an includible officer ?

An includible officer is an employee who, at any time during a plan year in the determination period, is an officer and receives compensation in excess of 50 percent of the Section 415 defined benefit limitation in effect for the plan year. The Section 415 defined benefit dollar limit in effect for a plan year is the limit in effect for the calendar year in which such plan ends. For example, an officer who earns more than \$60,000 in a plan year that ends in 1996 will be an includible officer.

There are limits on the number of employees who are treated as key employees by reason of being officers. If the employer has less than 30 employees, then no more than three individuals will be treated as officers. If the employer has 30 or more employees then up to 10% (but not more than 50) can be treated as key employees by reason of being officers.

Who is a top ten owner?

An employee is considered a top ten owner if the employee's interest in the employer, during any of the plan years in the determination period in which the employee is eligible to be a top ten owner, is among the ten largest interests owned by employees during the determination period. If two or more employees have the same ownership interest, the employee having the greatest amount of compensation during the plan year will be treated as having the largest interest in the employer.

An employee is eligible to be a top ten owner if the employee meets both of the following requirements:

1. The employee has annual compensation for any plan year in the determination period greater than the Section 415 defined contribution plan dollar limit for the calendar year in which such plan year ends.
2. The employee owns (applying attribution rules under Section 318 as modified under Section 416(i)(1)(B)(iii)(I)) at any time during such plan year more than a one-half percent interest in the employer.

If an employee's ownership interest changes during a plan year in the determination period, the employee's ownership interest is the largest interest owned at any time during the plan year. The controlled group and affiliated service group rules are disregarded in determining whether an employee is a top ten owner.

Who is a 5 percent owner?

An employee is considered a 5 percent owner if at any time during a plan year in the determination period an employee owns or is considered to own (applying attribution rules under Section 318 as modified under Section 416(i)(1)(B)(iii)(I)) more than 5 percent of the value of the outstanding stock of a corporation, or stock having more than 5 percent of the total combined voting power of all stock of the corporation. If the employer is not a corporation, a 5 percent owner is any employee owning more than 5 percent of the capital or profits interest of the employer. The controlled group and affiliated service group rules are disregarded in determining a 5 percent owner.

Who is a 1 percent owner?

A 1 percent owner is determined in exactly the same way as a 5 percent, except that 1 percent is substituted for 5 percent. Although the controlled group and affiliated service group rules are disregarded in determining a 1 percent owner, they are taken into account in determining whether an employee has \$150,000 in compensation for a plan year in the determination period.

What is considered compensation for purposes of determining key employees?

"Compensation" is based on compensation as defined in IRC Section 415(c) (3) of the Internal Revenue Code. This is generally total compensation the employee receives from the employer during the year, and includes salary deferrals under IRC Section 401(k) plans, IRC Section 403(b) tax sheltered annuities, SARSEP's and cafeteria plan.

What is the determination period?

The determination period is generally the five year period ending on the Determination Date. Refer to the Top-Heavy definition.

Non-Highly Compensated Employee (NHCE)**Who is a non-highly compensated employee (NHCE)?**

Any employee who performs services for you in a determination year and who does not meet the definition of Highly Compensated Employee (HCE) is considered a Non-Highly Compensated Employee (NHCE). Please refer to the definition of Highly Compensated Employee. "Leased employees" may have to be counted as your employees.

The determination of HCE vs NHCE is important, since the tests necessary to satisfy non-discrimination rules require that these employees be grouped, and ratios from each group be used to show non-discriminatory results.

Test Compensation**What compensation is used to perform 401(k) discrimination testing?**

For 401(k) discrimination testing any definition of compensation permissible under IRC Section 414(s) may be used. The software provides two options, Gross Compensation and Taxable Compensation. You should run the test using both to see which works best in your particular case.

Gross Compensation means an employee's total compensation (normally, what will be reported as W-2 wages increased by any IRC Section 401(k), 403(b), 125, or SARSEP elective deferrals.) For self employed individuals gross compensation is net earnings from self employment.

Taxable Compensation means the employee's compensation which will be reported on his or her W-2 (that is not increased by any IRC Section 401(k), 403(b), 125, or SARSEP elective deferrals).

The maximum compensation that can be used for test purposes for a participant is \$150,000. Special family aggregation rules also apply if the spouse, children, or other family members are included in the plan. Refer to the definitions for Child Under 19 Years Old or Spouse, and Child 19 Years Old or Older or Other Family Members for details.

Note: this Colonial 401(k) software also provides 415(c) testing. This compensation election above is not used for this test, as 415 rules require this test be done using taxable compensation. (Gross Compensation less deferrals). The 415 Test is done to check if any participant is exceeding the IRS limit that can be contributed to any participant in the plan year. That limit is the lesser of 25% of compensation or \$30,000 for 1996.

Top Heavy

What is a top-heavy 401(k) plan?

A 401(k) plan is top-heavy if, as of the Determination Date, the total of all accounts of all key employees exceeds 60 percent of the total of the accounts of all employees. If this occurs, the plan is subject to additional requirements. These plans, referred to as top-heavy plans, must provide minimum contributions to non-key employees. If a 401(k) plan provides for employer contributions other than elective contributions, the account balances attributable to these contributions must vest at an accelerated rate.

Which factors must be considered in determining whether a qualified retirement plan is top-heavy?

To determine whether a qualified plan is top-heavy, it is necessary to consider;

1. Which employers must be treated as a single employer;
2. What the Determination Date is for the plan year (generally, the last day of the prior plan year; in the first plan year, the last day of that plan year);
3. Which employees are or formerly were Key Employee;
4. Which former employees have not performed any services for the employer during the five-year period ending on the determination date;
5. Which plans of such employers are required or permitted to be aggregated in determining top-heavy status; and
6. The present value of the account balances of key employees, former key employees, and non-key employees.

What is a required aggregation Group?

A required aggregation group consists of each retirement plan of the employer in which a key employee is a participant in the plan year containing the determination date or any of the four preceding plan years, and any other retirement plan of the employer that enables a retirement plan covering a key employee to satisfy the coverage and nondiscriminatory benefit requirements.

An aggregation group is a top-heavy group if, as of the determination date, the sum of (1) the present value of the accumulated accrued benefits for key employees under all defined benefit plans included in the group and (2) the account balances of key employees under all defined contribution plans included in the group exceeds 60 percent of the same amount determined for all employees under all retirement plans included in the group.

Are there any special qualification requirements that apply to top-heavy plans?

Yes. In addition to the qualification requirements that apply to all retirement plans, a top-heavy plan must satisfy the following requirements;

1. Minimum Vesting

A top-heavy plan must contain either a three year vesting provision or a six-year graded vesting provision. The Colonial 401(k) plan automatically satisfies this requirement. Under the three-year vesting, an employee who completes at least three years of service must be 100 percent vested. Under the six-year graded vesting, an employee must become vested as determined by the following table:

6 Year Schedule

Completed Years of Service	Vested Percentage
2	20
3	40
4	60
5	80
6 or more	100

2. Minimum Contributions

If a 401(k) plan becomes top-heavy, non-key participants who have not separated from service before the end of the plan year must be provided with a minimum employer contribution. In general, the minimum contribution (including reallocated forfeitures) will be equal to 3 percent of compensation.

A lower minimum is permitted when the allocation of contributions and forfeitures on behalf of any Key Employee is less than 3 percent of compensation. In that event, the minimum contribution is the largest percentage of compensation allocated to any key employee. There is, however, an exception to this rule. The top-heavy minimum remains at 3 percent of compensation if the 401(k) plan enables a defined benefit plan in the same required aggregation group to satisfy the minimum coverage rules under Section 410(b).

Some special rules apply to 401(k) plans:

1. Elective deferrals by non-key employees can not be used to satisfy the top heavy minimum contribution requirement. But elective deferrals of key employees are taken into account in determining the key-employee's contribution percentage.
2. Qualified nonelective contributions are treated as part of the employer's minimum required contribution.
3. Matching contributions allocated to key employees are taken into account in determining the key-employee's contribution percentage. They may also be used to satisfy the top heavy minimum contribution requirement but if they are, then they can not be used in the ADP or ACP tests.
4. In the case of elective contributions under a 401(k) plan, the required minimum contribution is based on an employee's compensation excluding the elective deferral.

Example #1

XYZ Company maintains a top-heavy 401(k) plan that provides for elective contributions only. Bob is the only key employee to defer 3 percent of compensation. The top-heavy minimum contribution for non-key employees is 3 percent of compensation.

Example #2

The facts are the same as in Example #1, except that Bob defers only 2 percent of his compensation, which is the largest rate of deferral by any key employee in the plan. The top-heavy minimum contribution for non-key employees is 2 percent of compensation.

Example #3

The facts are the same as in Example #2, except that XYZ Company sponsors a defined benefit plan that is required to be aggregated with the 401(k) plan and that satisfies the minimum coverage rules under Section 410(b) only when aggregated with the 401(k) plan. The top-heavy minimum contribution for non-key employees is 3 percent of compensation.

Vesting

The vesting calculation is an estimate. It generally assumes an employee has worked 1,000 hours in each completed vesting computation period (VCP). However, an employee is assumed to work 1,000 hours in the VCP containing his hire date only if the employee is hired in the first six months of that period. Vesting percentages for Plan purposes must be calculated based on the actual hours worked. A terminated employee who works 1,000 or more hours in the year of termination is entitled to a year of vesting service in that year. An employer may elect in the Plan adoption agreement to require less than 1,000 hours, in which case the estimate of vested percentage would require a mutual adjustment. This software will not perform this adjustment.

Example

- Vesting Analysis as of 11/1/1996
- Plan Year is calendar year
- Year of service for vesting purposes = 1,000 hours

An employee hired on 3/4/94, is assumed to work 1,000 hours in the 1994 plan year, as the employment date is between 1/1/94 and 6/30/94. Vested percentage would be based on 2 years of vesting service, 1994 and 1995.

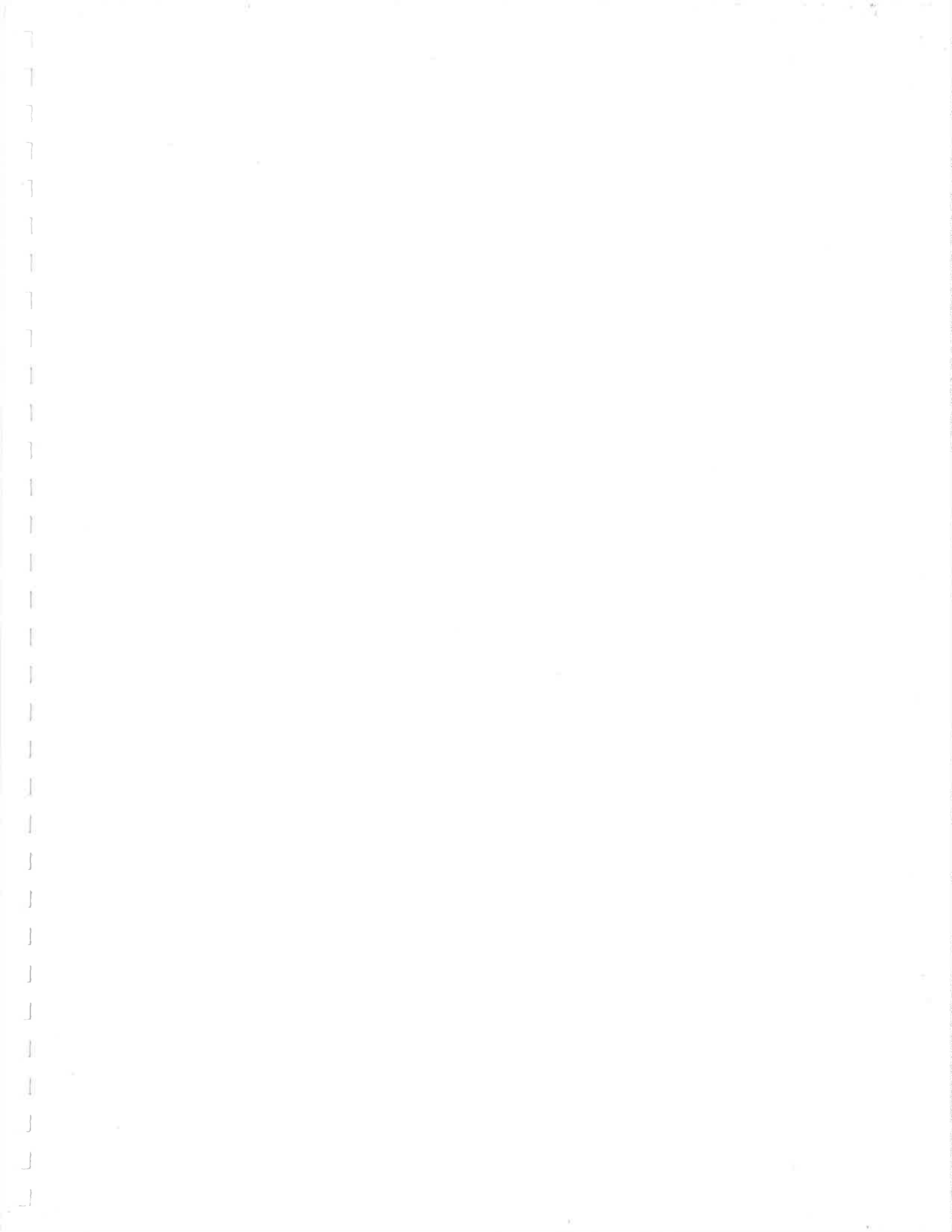
An employee hired on 8/3/94, is assumed to work less than 1,000 hours in the 1994 plan year, as the employment date is between 7/1/94 and 12/31/94. Vested percentage would be based on 1 year of vesting service, 1995.

After the first VCP, it is assumed a year of vesting service is accrued on 1/1 of the following year.

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THE COLONIAL
401(K) PLAN SOFTWARE
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