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# SAFE HARBOR 401(k) PLANS

## What is a Safe Harbor 401(k) Plan?

A safe harbor plan is similar to a traditional 401(k) plan; the primary difference is how a safe harbor plan satisfies the Internal Revenue Code's (IRC) nondiscrimination requirements.

The Small Business Job Protection Act of 1996 provided alternative, simplified methods of satisfying non-discrimination requirements as long as certain conditions are met. 401(k) plans that adopt one of these alternative methods are referred to as "safe harbor" 401(k) plans.

Plans established under IRC Sec. 401(k) (non-safe harbor) plans are subject to the "actual deferral percentage" (ADP) test. This test may limit the dollar amount that owners and/or highly compensated employees (HCEs) can defer.

By putting in a safe harbor matching contribution, a plan will also pass the "actual contribution percentage" (ACP) test, to which traditional matching 401(k) plans are subject.

## How Does it Work?

A 401(k) plan which operates as a safe harbor plan must meet one of the following employer contribution formulas for each employee, as well as a written notice requirement:

**EMPLOYER CONTRIBUTIONS:** One of the contributions below must be provided to all participating non-highly compensated employees (NHCEs). All safe harbor employer contributions are 100% vested immediately.

- **3% non-elective contributions:** Employer makes a 3% contribution
- **Matching contribution:**

  ***Basic Match:*** 100% of the first 3% of compensation deferred, plus 50% of the next 2% of compensation deferred

  ***Enhanced Match:*** 100% of the first 4% of compensation deferred

**WRITTEN NOTICE:** A safe harbor 401(k) plan must provide for written notification to the employees, with both content and timing elements.

**Content:** Must describe the various conditions concerning the employer's contribution(s), the conditions and methods for employee deferrals, and the employee vesting and withdrawal provisions of the plan

**Timing:** Notice must be given 30-90 days prior to the beginning of the plan year

## What are Some Other Considerations?

**Deferral Limits**

- Salary deferrals are limited to an annual amount. For 2019, the maximum limit is $19,000 up to 100% of compensation

**Catch-ups**

- A plan participant who attains the age of 50+ at any time during the year may defer an additional $6,000 to the plan

**Top Heavy**

- If certain owners and officers hold more than 60% of the total plan account balances, the plan may be considered top heavy and the company may have to make a minimum contribution of up to 3%
- If safe harbor is only given to NHCEs, top heavy requirements must still be met for non-key HCEs
- Plans consisting of solely 401(k) contributions and employer safe harbor contributions, meeting Code Sec. 401(k)(12) safe harbor requirements, are exempt from top heavy rules

**Discontinuing Safe Harbor Status**

- If the employer does not make the safe harbor contributions, or meet any other requirements, the IRS can disqualify the plan
- The employer can stop the 3% non-elective safe harbor contribution mid plan year but must provide at least 30 days' notice to eligible employees and must make safe harbor contributions accrued to the effective date of the notice
- The employer must continue to meet ADP non-discrimination requirements and the IRS top heavy minimum contribution (if applicable) for the entire year

## How Can a Safe Harbor Plan Enhance a Defined Benefit Plan?

Company contributions to a safe harbor plan provide tax deductions as in the non-401(k) options, such as cash balance and other defined benefit (DB) plans. The safe harbor 401(k) provisions increase the owner's ability to save for retirement. Therefore, a basic safe harbor 401(k) may be added to a DB plan to accomplish this goal.

## Why a Safe Harbor Plan?

This plan is the most popular type of 401(k) used by small businesses today because it allows "free passage" of annual ADP and top heavy minimum tests. It also:

- Allows owners and/or HCEs to maximize contributions to the plan
- Simplifies and eases administrative burdens on employers by eliminating some of the rules ordinarily applied to traditional 401(k) plans
- Employer safe harbor contributions with immediate 100% vesting encourages employee participation and is an attractive benefit to existing and potential employees

## Is a Safe Harbor 401(k) Plan Right for You?

If a business owner is willing to commit to minimal employer contributions, a safe harbor feature often lifts the burden of administrative costs and challenges associated with annual testing required for a traditional 401(k) plan. It also provides peace of mind knowing that the plan is automatically considered in compliance with the IRC's contribution and deferral requirements. This type of plan may be beneficial for a company with steady, reliable revenue looking for a user-friendly plan design that offers the most benefit to its employees.

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