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# Safe Harbor 401(k) Plan

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## Introduction

In general, the Internal Revenue Code (IRC) requires all qualified employer plans to meet certain nondiscrimination requirements. Employer plans established under IRC Sec. 401(k) are subject to one or two additional tests. The first test, applicable to employee deferrals only, is known as the “actual deferral percentage” (ADP) test. The second possible test is the “actual contribution percentage” (ACP) test and is applied only when there are employer-matching contributions.



The Small Business Job Protection Act of 1996 provided 401(k) plans with alternative, simplified methods of meeting these additional nondiscrimination requirements. 401(k) plans that adopt one of these alternative methods are referred to as “safe harbor” 401(k) plans. A safe harbor plan is very similar to a non-safe harbor plan. The primary difference is how a safe harbor plan satisfies the IRC’s additional nondiscrimination requirements.

## Requirements for a Safe Harbor 401(k) Plan<sup>1</sup>

Effective January 1, 1999, a 401(k) plan which operates as a safe harbor plan must meet one of two employer contribution formulas, as well as a written notice requirement:

- **Employer contributions:** One of two formulas must be followed.
  - **100% vested of 3% of compensation:** The employer may make a 100% vested contribution of 3% of compensation to all non-highly compensated participants. This contribution formula will also satisfy any “top-heavy” requirements, and may be used in the testing for a non-traditional profit sharing plan.<sup>2</sup>
  - **100% vested matching:** As an alternative, the employer may choose to make a 100% vested matching contribution to all non-highly compensated participants who defer under the plan. The match must be 100% of the first 3% of compensation deferred, plus 50% of the next 2% of compensation deferred. The match may also be at the rate of 100% of the first 4% of compensation deferred.

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<sup>1</sup> See IRS Notices 98-52, 2000-3 and IRS 401(k) regulations effective 1/1/06 for additional detail.

<sup>2</sup> This contribution formula serves triple duty for discrimination, top-heavy, and nontraditional profit sharing testing.

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This formula is considered to satisfy the deferral discrimination tests, and can also be used towards satisfying the top-heavy requirements.<sup>1</sup> If the employer is making the matching contributions during the year, the safe harbor rules permit the plan to compute the safe harbor match on a “per pay period” basis, or on an annual basis. If computed annually, the employer may have to true up the match after the plan year end for participants who changed their rate of deferral during the year.

The plan may not have any restrictions on receiving the safe harbor 3% employer or matching contributions, except the minimum age and service requirements needed for plan participation. Neither a 1,000-hour work requirement, nor a requirement that a participant be employed at the end of the plan year, is permitted.

- **Written notice:** To qualify as a safe harbor plan, a 401(k) plan must also provide for written notice to the employees, with both content and timing elements.
- **Content:** The notice 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:** The employer must give notice at least 30 (but not more than 90) days prior to the beginning of the plan year.

If the employer fails to make the required safe harbor contributions, or to meet any other safe harbor requirement, the IRS treats this like any other disqualifying plan failure. The required contributions must be made and any other failures corrected on a timely basis.

The IRS does allow the employer to stop either the safe harbor 3% or matching contributions during a plan year by following specific rules. The employer must provide at least 30 days’ advance notice to all eligible employees, ensure employees have a reasonable opportunity to modify their 401(k) contribution elections, and amend the plan accordingly. Furthermore, for an employer to stop the 3% non-elective safe harbor contribution in the middle of a plan year, it must be due to a substantial business hardship. This hardship requirement does not apply to stopping the safe harbor matching contribution.

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<sup>1</sup> The match will also satisfy the top-heavy requirements, provided there are no other employer contributions to the plan. If there are other contributions, the plan will have to separately satisfy both top heavy minimum contributions and the discrimination tests on the employer discretionary contributions. The matching contributions made to non-Key employees count toward satisfying the top-heavy minimum.

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If the employer stops the safe harbor contributions during the plan year, the plan must meet the regular 401(k) plan non-discrimination requirements and, if applicable, IRS top heavy minimum contributions.

### Automatic Enrollment Safe Harbor 401(k) Plan

A 401(k) plan with automatic enrollment will qualify as a safe harbor 401(k) plan if it provides for:

- Automatic enrollment of newly eligible employees, at a contribution rate of at least 3% of compensation, but no more than 10% of compensation.
- Automatic annual increases of 1% per year, such that the employee's 401(k) deferral is at least 6% by their fourth year in the plan.
- Employer matching contributions of 100% on the first 1% of compensation deferred and 50% on the next 5% deferred, or, alternatively, a 3% non-elective employer contribution to all participants.

This automatic enrollment safe harbor 401(k) plan is in addition to other safe harbor 401(k) plans available; it may provide that employer contributions vest 100% after two years of service.

### Stacked Matches

In addition to the basic match or the 3% of compensation employer contribution, the plan may provide for two additional types of matches. The plan may have a mandatory employer match, which is based on the first 6% of compensation. There may also be a discretionary match limited to 4% of compensation. The two examples shown on the following page assume the employee's compensation is \$265,000.

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Item Description	Value
Maximum compensation for 2015	\$265,000
Maximum deferral	18,000
Maximum total allocation	53,000
<b>Matching Approach</b>	
Participant deferral	\$18,000
Basic match (4% x \$265,000)	10,600
Mandatory match (86.79% x 6.00% x \$265,000)	13,800
Discretionary match (4% x \$265,000) <sup>1</sup>	<u>10,600</u>
<b>Total</b>	<b><u>\$53,000</u></b>
<b>3.0% Flat Approach</b>	
Participant deferral	\$18,000
Flat contribution (3% x \$265,000)	7,950
Mandatory match (103.46% x 6.00% x \$265,000) <sup>2</sup>	16,450
Discretionary match (4% x \$265,000)	<u>10,600</u>
<b>Total</b>	<b><u>\$53,000</u></b>

### Top Heavy Plans

Safe harbor 401(k) plans that consist solely of employee 401(k) deferrals and employer contributions that meet the Code Sec. 401(k)(12) safe harbor requirements are exempt from top heavy rules.<sup>3</sup>

### Catch-Ups

If a plan participant attains age 50 at any time during 2015 he or she may defer an additional \$6,000 to the Safe Harbor 401(k) Plan. This means in the illustrated examples the participant could defer an additional \$6,000 for a total allocation of \$59,000. The catch-up would not be subject to any of the matches.

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<sup>1</sup> The actual percentage calculated to satisfy the \$53,000 limit.

<sup>2</sup> The actual result rounded down to satisfy the \$53,000 limit.

<sup>3</sup> If more than 60% of the plan assets or accrued benefits are allocated to key employees, the plan is top heavy. A “Key” employee is someone who, at any time during the plan year was (1) an officer of the employer whose compensation from the employer exceeded \$170,000; or (2) a more than 5% owner; or (3) a 1% owner whose compensation from the employer exceeded \$150,000