

# SAFE HARBOR 401(k)

## AN ALTERNATIVE CONTRIBUTION TO YOUR RETIREMENT PLAN

As a general rule, 401(k) plan must satisfy certain nondiscrimination requirements. Many small businesses find this hard to do and, as a result, many don't set-up such plans. The Small Business Job Protection Act of 1996 provided 401(k) plans with alternative, simplified methods of meeting the nondiscrimination requirements. 401(k) plans that adopt one of these alternative methods are referred to as "safe harbor" 401(k) plans.

**What is a Safe Harbor 401(k) Plan?** Under a safe harbor plan, you can match each eligible employee's contribution, dollar for dollar, up to 3% of the employee's compensation, and 50 cents on the dollar for the employee's contribution that exceeds 3%, but not 5%, of the employee's compensation. Alternatively, you can make a non-elective contribution equal to 3% of compensation to each eligible employee's account. Each year you must make either the matching contributions or the non-elective contributions. The plan document will specify which contributions will be made and this information must be provided to employees before the beginning of each year.

### SUITABILITY

This plan is appropriate for businesses with the following characteristics:

- ~ A business with less than 25 employees, however businesses of any size may find these plans attractive.
- ~ Those who want to offer a pre-tax salary deferral plan to employees.
- ~ A business interested in permitting owners and key employees to always make maximum salary deferral contributions.
- ~ Employers who are open to required employer contributions.

With a clear understanding of how a safe harbor 401(k) plan works, smaller employers can enjoy the many advantages of adopting a 401(k) plan, while avoiding many of the arduous nondiscrimination requirements.

### SAFE HARBOR CONTRIBUTIONS

There are two types of contributions to safe harbor plans: Non-Elective Contributions (NECs) OR Matching Contributions. Below is a brief description of each type of contribution and their limitations, if any.

3% Non-Elective Contribution (NEC):

- ~ No allocation requirements may be imposed, such as a 1,000-hour or last-day requirement.
- ~ 100% vested
- ~ Not available for in-service withdrawal before age 59½, even for hardship
- ~ Can be used to satisfy top-heavy minimum contributions.
- ~ Must be used in cross-testing gateway test, may be counted towards satisfying cross-testing.
- ~ Cannot be used to satisfy permitted disparity.
- ~ Available in guaranteed or flexible formula:
  - ~ **Guaranteed** provides a required 3% (or more each year)
  - ~ **Flexible** allows employer to decide each year on 3% or more



HILLS PENSION  
ASSOCIATES

## SAFE HARBOR CONTRIBUTIONS, CONTINUED

### MATCHING CONTRIBUTIONS—TWO TYPES:

**BASIC MATCH:** 100% of first 3% deferred plus 50% of next 2% de-ferred.

- ↪ No allocation requirements may be imposed, such as a 1,000 hour or last-day requirement.
- ↪ 100% vested
- ↪ Not available for in-service withdrawal before age 59 1/2, even for hardship (EESA exceptions apply).
- ↪ Can be used to satisfy top-heavy minimum contribution

**ENHANCED MATCH:** Matching formula must be at least as generous as the basic formula.

- ↪ No allocation requirements may be imposed, such as a 1,000 hour or last-day requirement.
- ↪ 100% vested
- ↪ Not available for in-service withdrawal before age 59 1/2, even for hardship (EESA exceptions apply).
- ↪ Can be used to satisfy top-heavy minimum contribution
- ↪ Rate of match may not increase as deferral percentage increases

## TOP-HEAVY PLANS

A plan is considered to be top-heavy if more than 60% of plan assets are attributable to “key employees” as of the last day of the prior plan year. If the safe harbor 401(k) plan is top-heavy, the employer can get twice the mileage out of its safe harbor contribution. Under the top-heavy rules, a qualified plan is subject to certain minimum contribution and vesting requirements each year the plan is considered to be top-heavy.

What are the vesting requirements for top-heavy plans? Top-heavy plans must use a vesting schedule that, at a minimum, provides for either (1) 100% of vesting upon completion of three years of service, or (2) 20% vesting upon completion of two years of service, increased by 20% each year thereafter. Note: This requirement typically has a minimal impact because most plans already use vesting schedules that meet or exceed top-heavy standards.

Are there any exceptions to the top-heavy requirements? Yes. Certain safe harbor 401(k) plans qualify for an exception under the top-heavy rules. In general, if an employer makes no contributions to the plan other than a safe harbor matching contribution, safe harbor non-elective contribution, or matching contributions that satisfy ACP safe harbor, the plan is deemed to not be top-heavy even if the top-heavy ratio exceeds 60%. Caution: Forfeiture allocations can trigger top-heavy minimum requirements in safe harbor 401(k) plans, as this type of contribution is considered to be a discretionary contribution. Therefore, it is often advisable to include a plan provision allowing for forfeitures to be used to reduce plan expenses or other employer contributions so as to not require allocation of “surplus” forfeiture amounts.

What are the consequences of being top heavy? Top-heavy plans are subject to two additional requirements. First, the plan must meet minimum contribution requirements for non-key employees. Second, the plan must meet minimum vesting standards.

## SAFE HARBOR NOTICE REQUIREMENTS OF THE FINAL 401(K) AND 401(M) REGULATIONS

Timing Requirements:

- ↪ General rules: Provide the notice within a reasonable time before the beginning of the plan year.
- ↪ The notice is deemed to satisfy the timing requirement if it is provided to each eligible employee not less than 30 days but not more than 90 days before the beginning of each plan year.
- ↪ Newly eligible participant (defined as becoming eligible after the 90th day before the beginning of the plan year).
- ↪ Deemed to satisfy the timing requirement if provided by:
  - ↪ Not more than 90 days before the employee becomes eligible, but
  - ↪ Not later than the date the employee becomes eligible.
- ↪ A new plan provides timely notice if it follows the same rule as described above for a newly eligible employee. Thus, a new plan can provide the notice as late as the effective date of the plan.