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# Safe Harbor 401(k) Plans

401(k) plans typically cannot discriminate in favor of highly compensated employees (HCEs). To prove a plan is not discriminatory, it must pass the actual deferral percentage (ADP) test and the actual contribution percentage (ACP) test. However, safe harbor 401(k) plans do not require ADP/ACP testing. In addition, the employer does not need to make an extra contribution to the non-HCEs (NHCEs) or refund any elective deferrals of HCEs, which has to be done if a regular 401(k) plan fails these tests. As in all 401(k) plans, the maximum amount the company may contribute and deduct is 25% of eligible participants' compensation, and each participant is limited to total employer and employee contributions of the lesser of 100% of compensation or $54,000 (in). For ERISA purposes, compensation is limited to $270,000 (in 2017).

## Employer Contribution Options

Since safe harbor plans automatically comply with ADP/ACP tests, employers must provide a minimum, 100% vested contribution, which is either (1) a flat, non-elective employer contribution of 3% of pay for all participants, or (2) an employer matching contribution. Either minimum contribution may include the HCE group but is not required to do so.

- **Non-Elective Contribution**: This option provides a 3% employer contribution for each employee eligible to make elective deferrals, regardless of whether they are employed on the last day of the plan year or have a minimum number of hours of service. The option is satisfied by providing an employer contribution on behalf of all eligible, NHCEs equal to at least 3% of pay, regardless of whether or not the employees make elective deferrals into the plan.

  In addition to satisfying the contribution requirement, this 3%-of-pay contribution will satisfy the minimum contribution requirements in top-heavy plans. It can also be used as part of a tiered or new comparability contribution formula designed to maximize the contribution for executives. It cannot, however, be used for purposes of Social Security integration.

- **Employer Matching Contribution**: This option may take several forms. A plan must provide a safe harbor matching contribution that is at least as favorable as dollar-for-dollar on the employee elective deferrals, up to 3% of pay and 50¢ per dollar on the next 2% of pay. Compensation can be defined to include the entire plan year, or only from participant's entry into the plan. Thus, an employee must defer 5% of pay to get the maximum employer safe harbor matching contribution of 4%.

  Alternatively, the employer safe harbor matching contribution may be simplified to a dollar-for-dollar match on the first 4% of pay deferred by the employee. Under this structure, an employee must defer just 4% of pay to get the maximum safe harbor employer matching contribution of 4%.

  Where this employer matching safe harbor is used, an employee who defers nothing gets no employer matching contribution. Neither an employment on the last day of the plan year condition nor minimum hours of service test can be used as a condition for a safe harbor match for an employee who has met the plan's eligibility requirements.



June 2017

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## Additional Matching Contributions

If the employer makes additional matching contributions above the safe harbor matching contribution, the following additional requirements apply:

- **Match Rate**: The rate of matching contribution for any HCE cannot exceed the rate for any NHCE making the same level of employee deferrals. This makes it unlikely that a service-weighted matching formula will qualify for the safe harbor. Also, the rate of employer matching contribution cannot increase as the rate of employee deferral increases.

- **Employee Deferral Limit**: No other employer match (regardless of the formula) may be made on employee deferral contributions greater than 6% of the participant's compensation. The match itself can be more than dollar-for-dollar, but deferrals in excess of 6% of pay must be disregarded. For example, an employee earning $50,000 defers $4,000, which is 8% of pay. Any matching contribution must be based only on the first $3,000 deferred, which is 6% of pay.

- **Fixed Match with 3% Safe Harbor**: A fixed match of a lesser amount can be used if the 3% non-elective safe harbor match is used. For example, a plan that uses the 3% non-elective safe harbor may also match a percentage of employees' elective deferral contributions up to 6% of their pay.

- **Additional Discretionary Match**: Additional employer discretionary matching contributions can also be made. Employee deferral contributions greater than 6% of pay may not be matched, and the overall amount of the discretionary match must be limited to 4% of pay.

## Timing of Deposits

Safe harbor employer matching contributions done on a per pay period basis must be deposited at least quarterly during the plan year. Specifically, the deposit should occur by the last day of the next quarter. Late safe harbor employer matching contributions could jeopardize the safe harbor status, thus making the plan subject to compliance testing for that plan year. If the employer matching is done annually after the plan year, similar to the flat 3% employer contribution, the total amount is due for deposit no later than the date the employer files its business income tax return.

## Vesting and Other Safe Harbor Requirements

The safe harbor contribution must be 100% vested, and it may not be subject to 'hour of service' or 'last day of the plan year employment' requirements. However, the plan may require an age and year of service (typically at least 1,000 hours of pay in a 12 month period) requirement for an employee to be eligible. The plan may also provide additional employer profit sharing contributions, which may be subject to a vesting schedule and subject to 'hour of service' and 'last day of the plan year employment' accrual requirements. Finally, the plan may not allow for distributions of the employer's safe harbor contributions during employment, even for financial hardship, although employee deferral contributions can be withdrawn for financial hardship if the plan so provides.

## Notice Requirements

Notices for new plans, as well as required annual notices for existing plans, must be given to all eligible participants within a reasonable time (generally at least 30 but no more than 90 days prior to the beginning of each plan year). A second notice is required at least 30 but no more than 90 days before the end of the plan year if employees received a notice before the beginning of the plan year stating that the employer may contribute a safe harbor 3% non-elective contribution during that plan year.

## Annual Notice Requirements

- **Existing Plans**: Generally required at least 30 but no more than 90 days before first day of each plan year.

- **New Plans**: May give notice up to effective date of the plan unless it is a successor plan. The 401(k) arrangement must be in effect for at least 3 months during the first plan year. Adding a 401(k) arrangement to an existing non-401(k) plan is treated as new plan, and as such, the 401(k) arrangement must be in effect for at least 3 months during the first plan year. Finally, any employee who becomes eligible after the notice period must receive the notice by the date of eligibility.

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- **Successor Plans**: Under Notice 98-1, a successor plan is a 401(k) plan in which at least 50% of the eligible employees were eligible for another 401(k) plan maintained by the employer in the prior year. Successor plans may not use the new plan rule. However, a SEP-IRA or Simple IRA is not considered a plan for this successor plan rule, so a safe harbor 401(k) plan that replaces this type of IRA is considered a new plan.

## Amendment of an Existing Profit Sharing Plan to Add Safe Harbor Provisions

Notice 2000-3 provides that the addition of a 401(k) arrangement to a non-401(k) plan is treated as a new plan for purposes of the safe harbor 401(k) rules. Thus, the employer may add the arrangement after the first day of the plan year, and the notice requirements can be satisfied as the first day that the 401(k) arrangement is in effect.

As is the case with the establishment of a new plan, a safe harbor 401(k) arrangement may not be added to an existing non-401(k) plan unless the 401(k) arrangement will be in effect for at least three months during the first plan year. For example, suppose an employer maintains a calendar-year profit sharing plan. That employer may add a safe harbor 401(k) arrangement as late as October 1, 2017, so long as the safe harbor requirements are met from the effective date of the 401(k) arrangement to the end of that first year. The safe harbor notice would have to be given to employees no later than the effective date of the 401(k) arrangement, that is, October 1 in this example.

## Flexibility

If an employer with a regular non-safe harbor 401(k) plan wants to wait to decide to provide the 3% non-elective contribution, a decision can be made as late as 30 days before the last day of the plan year whether to make the contribution. If the contribution is not made, nothing needs to occur. But the plan must be amended so as to provide for the 3% contribution if the employer decides to use that option, and such amendment could be limited for just that plan year in question, leaving open the option for the next year if the requisite notice is given before the next year begins. The notice must be given to employees before the beginning of the plan year in which the 3% safe harbor might be used that would simply indicate that the employer may decide to make the non-elective contribution. If the employer later decides to do so, a supplemental notice would be given (no later than 30 days before the end of the plan year).

If the employer wants to do the safe harbor matching contribution instead of the non-elective contribution, the employees would have to be notified of that decision during the normal notice period (i.e., 30 to 90 days before the first day of the plan year), but the employer later could decide to discontinue the match during the plan year (with prior notice to employees) and opt to run ADP/ACP testing that year. The discontinuance of the match could take effect no sooner than 30 days after notice of such discontinuance is given to the employees.

## Conclusion

The Pension Protection Act of 2006 covers a broad range of rules affecting qualified retirement plans, plan sponsors (i.e. employers), and plan participants. Take advantage of optimal savings opportunity with the help of a qualified team. Contact United Retirement for assistance with safe harbor 401(k) plans.

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