EGPS
ECONOMIC GROUP
PENSION SERVICES

SAFE HARBOR PLANS

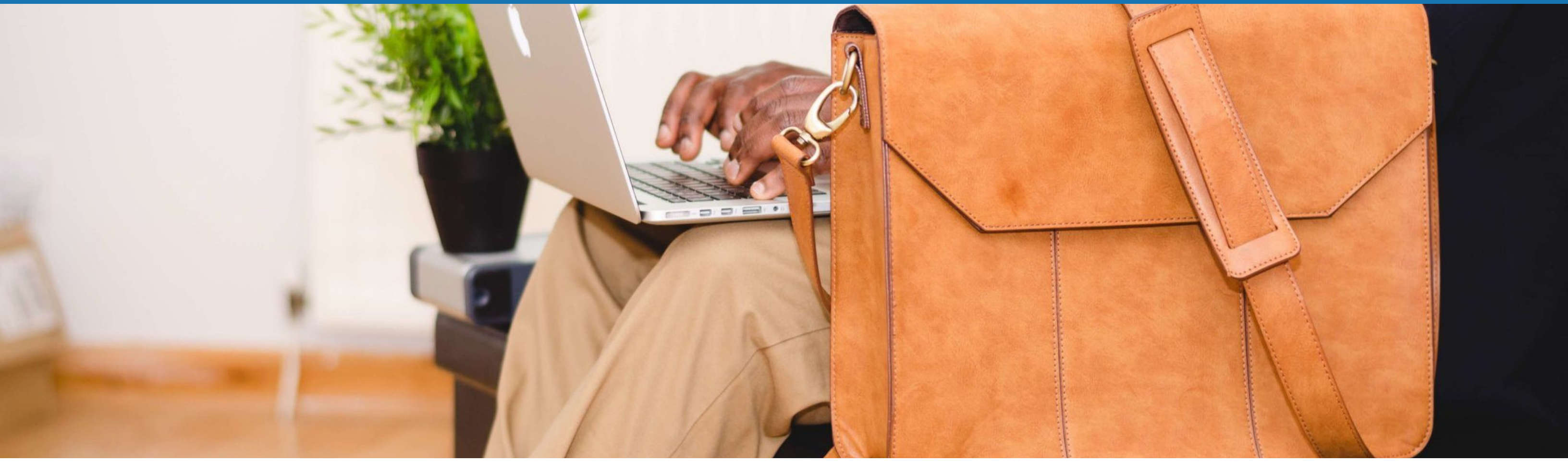
The background and benefits

Background

A 401(k) plan permits employees to contribute a portion of their compensation, known as an elective deferral, to the employer's retirement plan. Deferring compensation to the plan postpones state and federal income tax on the deferrals and permits them to grow on a pre-tax basis. 401(k) plans cannot discriminate in favor of Highly Compensated Employees (HCEs), or employees who make more than a certain amount in the prior year ($130,000 in 2021). To prove that it is not discriminatory, a 401(k) plan must pass the Actual Deferral Percentage (ADP) test and the Actual Contribution Percentage (ACP) test each year.

Benefits of a safe harbor plan

One of the main benefits of a safe harbor plan is it exempts employers from performing the ADP and ACP tests annually. In addition, the employer does not need to make an extra contribution to the Non-Highly Compensated Employees (NHCEs) or refund some of the elective deferrals of HCEs, which must be done if a regular 401(k) plan fails these tests. Consequently, HCEs, subject to certain limitations, may contribute the full 401(k) plan annual dollar amount without regard to the amount any NHCE defers.



Two alternative employer contribution options

To gain this automatic compliance with the ADP and ACP tests, employers must provide a minimum contribution that is either:

- A flat, non-elective contribution of 3% of pay for all participants, or
- An employer matching contribution

Either of these minimum contributions may include the HCE group, but it is not required. These contributions must also be 100% vested. Let's take a closer look at each option.

The 3% non-elective contribution

- Satisfies safe harbor by providing an employer-paid non-elective contribution of 3% for each eligible NHCE, regardless of whether they contribute or are employed on the last day of the plan year
- Also satisfies the minimum contribution requirements in top-heavy plans
- Can be used as part of a "tiered" or "new comparability" contribution formula designed to maximize contribution for executives
- ***Cannot*** be used for purposes of Social Security integration

Employer safe harbor matching contribution

- Can take many forms
- Must be as favorable as 100% match on the first 3% contributed, and then 50% on the next 2% contributed by employees
- If the above matching formula is chosen, an employee must defer 5% of pay to get the maximum employer matching contribution of 4%
- Alternatively, employers may make a 100% match on the first 4% of pay
- Employees in these scenarios receive nothing if they do not defer

Additional matching contributions

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

- **Match rate** - The matching contribution for any HCE cannot exceed the rate for an NHCE making the same level of employee deferrals.

- **Employee deferral limit** - No other employer match can be made on employee deferral contributions greater than 6% of the participant's compensation. The match can be more than 100%, such as $2 for each $1 of deferral, but deferrals more than 6% of pay must be disregarded.

- **Fixed match with 3% safe harbor** - A fixed match of a lesser amount can be used if the 3% non-elective safe harbor is used.

- **Additional discretionary match** - Additional employer discretionary matching contributions can also be made. Again, 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. If the safe harbor contribution is made late, this could jeopardize the safe harbor status, thus making the plan subject to compliance testing for that plan year.

If the safe harbor matching is done annually after the plan year, the total amount is due for deposit by the date the employer files its business income tax return.

Vesting and other safe harbor requirements

The safe harbor contributions described above must be 100% vested. They ***also must not*** be subject to an hours of service requirement or a last day of the plan year employment requirement. However, the plan may:

- Implement a 21 years of age and a year of service (at least 1,000 hours in a 12-month period) requirement
- Provide additional employer profit sharing contributions
- Not allow for distributions of the employer's safe harbor contributions during employment

Notice requirements

A safe harbor 401(k) arrangement cannot be added to an existing non-401(k) plan unless the arrangement ***will be in effect for at least 3 months*** of the 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, 2021, 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.

Interested? Contact us to learn more

If you have any questions regarding the safe harbor 401(k) plan or want to discuss the use of this option, please contact us.

This general information piece is distributed with the understanding that EGPS is not rendering any legal advice. Plan sponsors should consult with their legal representatives about the application of any law pertaining to retirement plans.