Employer Connect | When to Set Sail With Safe Harbor

MAKING IT ACTIONABLE

You already know that a 401(k) is a very popular retirement plan and, like other plan designs, it allows your employees to take advantage of tax deferrals on contributions and earnings while their money accumulates for retirement.

To enjoy this special status, the IRS put in place rules to assure your plan benefits rank and file employees and not just company owners and highly compensated employees. These are called nondiscrimination rules and there are three tests that must be performed each year to determine whether your plan measures up.

1. **The ADP test ("Actual Deferral Percentage")**—compares how the deferral rate for highly compensated employees compares to that of non-highly compensated employees. Typically, the deferral percent for highly compensated employees can't be more than two points more than that of the non-highly compensated employees to pass this test.

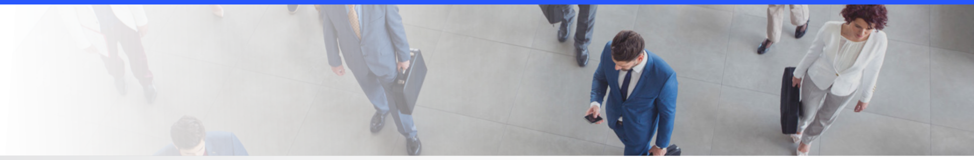
2. **The ACP test ("Actual Contribution Percentage")**—compares employer matching contributions between these two groups.

3. **The Top-Heavy test**—which determines if the account balances of key employees is greater than 60% of the total assets held by the plan.

We know that the goal of many company owners is to maximize how much you can contribute each year to your retirement. So, to avoid uncertainty about this, you can choose to make additional contributions for your employees in order to get a free pass on these non-discrimination tests. These are called "Safe Harbor" contributions.

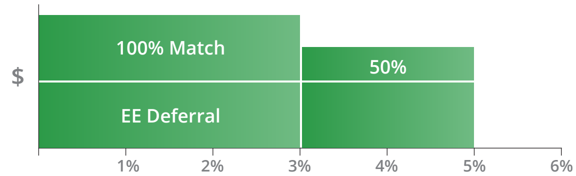
You can make a Safe Harbor contribution either through a matching formula or by making a non-elective contribution to all of your employees.

Let's take a quick look at ways to do this...



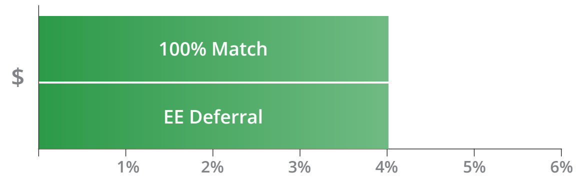
Safe Harbor Match

To satisfy the requirement and encourage plan participation, you may choose to offer a Safe Harbor Match. The Basic Match formula provides a 100% match on the first 3% of deferral compensation, plus a 50% match on deferrals between 3% and 5%.



Enhanced Match

An Enhanced Match has to be at least as much as the Basic Match at all levels and is typically a match of 100% on the first 4% of deferral compensation.



Non-Elective Contribution

The other Safe Harbor option is to make a contribution of at least 3% of annual compensation for all eligible employees. This includes those employees who don’t defer.

A quick note: *Safe Harbor contributions must always be 100% vested. That means that employees can count these contributions in their balances without forfeiture upon termination of employment.*

Adopting a Safe Harbor provision can help your plan in four important ways:

1. It can potentially reduce plan maintenance costs by eliminating annual nondiscrimination testing requirement
2. It allows you and other highly compensated employees to maximize your deferral to the annual limit
3. It relieves your plan’s potential top-heavy status, and
4. The matching or nonelective contributions represent additional competitive benefits to help recruit and retain employees

We encourage you to get in touch with us if you’d like to learn a little more about how Safe Harbor contributions can help make your plan more successful.