

Safe harbor 401(k) Plans



A retirement plan for engineers...by engineers.

A safe harbor 401(k) plan can be an attractive alternative for companies that might have difficulty satisfying antidiscrimination testing, or whose owners might be unable to maximize their contributions due to low employee contributions. A safe harbor 401(k) plan is unique in that satisfaction of the safe harbor requirements typically satisfy a plan's non-discrimination and top heavy testing requirements. To offer a safe harbor plan, a company must satisfy the following four conditions:

- A required contribution
- Initial and annual notice to all eligible employees
- Minimum vesting requirements
- Withdrawal restrictions

Safe harbor requirements

A safe harbor 401(k) requires that an employer make an non-elective contribution of 3% of compensation to all eligible employees or a tiered matching contribution, which must consist of 100% match on the first 3% of compensation and a 50% match on the fourth and fifth percent of compensation to all participating employees. In other words, for the matching contribution, if an employee contributes 3% of their compensation, the company would match dollar for dollar of what the employee contributes. If the employee contributes 4% of their compensation, the employer would need to match 3.5%, and if the employee were to contribute 5% or more of their compensation, the employer would need to match 4%. There are no accrual requirements for the safe harbor contribution; therefore, the plan can't require the participant to be employed on the last day of the plan year or satisfy an hours of service requirement to receive the safe harbor contribution.

The safe harbor 401(k) employer contribution must be 100% vested immediately. The plan may still have a vesting schedule for company contributions other than the safe harbor contribution.

A safe harbor 401(k) also requires participants to receive a notice explaining their rights under the plan. It must disclose certain information, including which safe harbor contribution will be made (non-elective 3% of pay or match) for the year. The notice must be given on an annual basis within a reasonable time (at least 30 days and not more than 90 days) before the first day of the plan year.

The final safe harbor requirement is the distribution restriction on the safe harbor employer contributions. For example, safe harbor employer contributions are not eligible for hardship withdrawal.

Qualified Automatic Contribution Arrangement (QACA) safe harbor

The Pension Protection Act (PPA) of 2006 created a new nondiscrimination safe harbor that, when adhered to by employers with automatic enrollment, will be deemed to pass ADP and ACP discrimination testing. These new regulations went into effect in 2008.

This safe harbor resembles the traditional 401(k) plan safe harbor but the QACA safe harbor requires employers to provide a minimum match of 100% on elective deferrals up to 1% of compensation and 50% on deferrals between 1% and 6%. Employers may also take advantage of the QACA safe harbor by making a 3% contribution to each participant, regardless of whether the participant makes contributions to the plan. QACA safe harbor contributions must fully vest within two years. To qualify for this safe harbor, employers must automatically enroll participants to contribute at least 3% of compensation from the participant's entry date and through the next full plan year. This rate is generally increased by 1% each plan year until participants contribute 6% of compensation to the plan.

The PPA safe harbor also allows employees who are automatically enrolled to have 90 days to stop participating in the plan and withdraw their contributions and any earnings. The 90-day permissible withdrawal rule only applies if the default investment, in the absence of participant direction, meets the requirements of a Qualified Default Investment Alternative (QDIA) and otherwise satisfies the requirements of an Eligible Automatic Contribution Arrangement (EACA).

These plan distributions are taxed in the year received and are not subject to the 10% penalty that normally applies to distributions made before participants reach age 59½. Employers must provide participants with initial and annual notices explaining the plan's automatic enrollment rules and describing participants' rights to opt out.

Safe harbor frequently asked questions

Q: Are safe harbor 401(k) plans exempt from "top heavy" rules and testing?

A: Safe harbor 401(k) plans that consist solely of employee 401(k) deferrals and employer contributions that meet the Code Sec. 401(k)(12) or QACA safe harbor requirements are exempt from top heavy rules.

Q: Do Qualified Automatic Contribution Arrangement (QACA) safe harbor 401(k) plans need to adhere to the 90 day withdrawal period rule?

A: No. QACA safe harbor 401(k) plans are not required to refund employee contributions within 90 days of enrollment without the employee being subject to early distribution penalties.

Q: Can an existing 401(k) plan be amended to a safe harbor 401(k) plan (either standard or QACA) at any time during the year?

A: No. Existing 401(k) plans can only be amended to a safe harbor 401(k) plan (standard or QACA) on the first day of the plan year, which is January 1 for most plans.

While the effective day of a new safe harbor plan for an existing 401(k) plan is the first day of the plan year, the plan should allow time for the amendment to be processed to ensure that the employee notification, which must be done no

later than 30 days before the effective date of the change, can be met. For example, if the first day of the plan year is January 1, the process to move to a safe harbor plan design should ideally begin in October of the preceding year.

Q: Can the safe harbor 401(k) plan use the safe harbor 3% non-elective contribution (NEC) to satisfy the ACP test?

A: Yes. If the plan provides a match formula, the ACP test will be satisfied if no match is provided on deferrals in excess of 6% of compensation, and if the match is made pursuant to a discretionary match formula, the match contribution produced by the formula does not exceed 4% of compensation. Also, entitlement to the match contribution cannot be conditioned on a participant's completion of a certain number of hours during the plan year or being employed on the last day of the plan year. Finally, the match formula cannot provide for a rate of match that increases with the rate of deferral.

Q: What are the requirements for providing a safe harbor initial notice and annual notice?

A: A Safe Harbor 401(k) plan needs to provide the Safe Harbor notice at anytime between 30 and 90 days before the effective date of the plan. An annual notice must also be provided 30 to 90 days before the first day of the plan year.

When an existing 401(k) plan amends to a safe harbor, notice must also be provided to participants between 30 and 90 days before the first day of the initial plan year.

Q: May a safe harbor plan accept Roth 401(k) contributions?

A: Yes, but the Final Roth regulations require that a designated Roth contribution and the safe harbor match made based on that contribution be accounted for separately.