DEFINITI

INSIGHT

WHAT YOU NEED TO KNOW

Safe Harbor 401(k) Plans

Safe harbor 401(k) plans have become increasingly popular with small business owners because they help you waive certain compliance testing, and allow greater savings flexibility — for you and your highly compensated employees.

The Big Picture

When your 401(k) retirement plan includes a safe harbor provision, you commit to a minimum level of contribution per participant, either as a percentage of their compensation or a specific match.

In exchange, your Highly Compensated Employees (HCEs) — or those earning more than $135,000 in 2022 — may make the maximum allowable deferral and you can waive certain 401(k) compliance tests each year.

Whether you're starting a new retirement plan or want to improve an existing one, it may be worth considering adding a safe harbor provision.

A safe harbor provision may be appropriate for your organization if:

- You're moved to help employees save for retirement;
- You plan to make employer contributions anyway;
- Your current retirement plan has recently failed compliance testing;
- Your highly compensated employees aren't able to contribute the maximum to the plan due to the risk of failing compliance testing;
- Many of your highly compensated employees don't contribute to the plan; or
- You have low participation in your current plan among your lower compensated employees or staff.

The Options

Safe harbor 401(k) plans require employers to choose one of three possible contribution options:

- Nonelective Contribution
- Basic Match
- Enhanced Match

NONELECTIVE CONTRIBUTION

Guaranteed or Flexible

You may be able to satisfy the safe harbor by making a Nonelective Contribution of at least 3% of compensation to each eligible employee.

Generally, the 3% nonelective contribution must be provided to all employees eligible to make elective deferrals to the plan. The nonelective contribution may be either a **Guaranteed Contribution** or a **Flexible Contribution**, and you make this selection in the Plan Document.

The Guaranteed Contribution requires that a nonelective contribution be made each plan year, unless you change the plan and remove the provision before the start of the new plan year.

The Flexible Contribution allows you to decide each year whether to provide a nonelective contribution.

A nonelective contribution satisfies the top-heavy requirement for a plan and you can waive the testing of elective deferrals (and matching contributions).

NONELECTIVE CONTRIBUTION

PARTICIPANT DEFERRAL		COMPANY CONTRIBUTION
0%	▶	3%
1%	▶	3%
2%	▶	3%
3%	▶	3%
4%	▶	3%
5%	▶	3%
6%	▶	3%

THE MATCHING CONTRIBUTION

Basic Match or Enhanced Match

The **Basic Match** is defined as a 100% match on the first 3% of compensation deferred, and a 50% match on deferrals between 3% and 5%. If this is the only contribution made to the plan, it can satisfy top-heavy requirements and you can waive certain compliance tests.

Alternatively, you may choose an **Enhanced Match**, which is a formula equal to at least the amount of the Basic Match; for example, 100% of the first 4% deferred. The enhanced matching contribution rate may not increase as the percentage of deferrals goes up.

The type of safe harbor matching contribution selected (basic or enhanced) must be described in the Plan Document and in the annual notice to eligible participants. Unlike the nonelective contribution, there is no flexible matching contribution option.

BASIC MATCH

PARTICIPANT DEFERRAL		COMPANY CONTRIBUTION
0%	▶	0%
1%	▶	1%
2%	▶	2%
3%	▶	3%
4%	▶	3.5%
5%	▶	4%
6%	▶	4%

ENHANCED MATCH

PARTICIPANT DEFERRAL		COMPANY CONTRIBUTION
0%	▶	0%
1%	▶	1%
2%	▶	2%
3%	▶	3%
4%	▶	4%
5%	▶	4%
6%	▶	4%

Safe Harbor Requirements

Safe harbor contributions are normally 100% vested immediately. If the plan adopts an automatic enrollment feature along with automatic increase, the vesting begins after two years of service.

All eligible employees receive a safe harbor contribution, even if they work fewer than 1,000 hours in a year, or are not employed on the last day of the plan year. This applies to the nonelective contribution (Guaranteed or Flexible), as well as the Basic Match and Enhanced Match.

The Basic Match and Enhanced Match can only be allocated to employees who defer monies into the plan.

The Plan Document must be amended to add the applicable safe harbor formula, and a safe harbor Basic Match and Enhanced Match notice must be given to all eligible employees between 30 and 90 days before the beginning of plan year.

COMMON SAFE HARBOR QUESTIONS

Can safe harbor contributions be stopped during a plan year in the event of financial setbacks?

If you chose to provide a 3% nonelective Guaranteed Contribution, you will be required to make that contribution regardless of any adverse business conditions during the plan year. As a result, the Flexible Contribution is a more popular plan design choice.

The safe harbor Basic Match and Enhanced Match design do allow you to stop making safe harbor matching contributions during the year if needed by providing a written notice to the employees at least 30 days before the contributions are to be stopped. However, the contributions must still be made until the effective date of the notice. If you stop making contributions, the ADP and ACP tests must be performed for the entire plan year.

Can a plan become a safe harbor plan mid-year?

Safe harbor 401(k) plans are generally required to be established for the entire plan year (before the plan year starts). Mid-year adoption is possible for either a new 401(k) plan or a profit-sharing plan that adds a 401(k) feature mid-year.

For more information about safe harbor 401(k) plans, or answers to more complex questions, contact sales@definiti-llc.com. We review your retirement plan design annually to ensure your safe harbor 401(k) plan will meet your needs.