

The Safe Harbor 401(k)—Advantage Business Owner?

The 401(k) is one of the most popular retirement plans, but nondiscrimination requirements often limit the amount business owners can contribute on their own behalf. If you are saving less for retirement than you'd like, a Safe Harbor 401(k) might work for you. **Safe Harbor** provisions under the **Small Business Job Protection Act of 1996** (SBJPA) will allow you to maximize your own 401(k) contributions while automatically satisfying Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) nondiscrimination testing rules as long as certain requirements are met.

Zeroing in on the Details

To satisfy the ADP and ACP testing requirements, you will have to do the following: 1) make contributions for your employees; 2) relinquish all **vesting requirements** placed on those contributions; and 3) formally inform each eligible employee of the transition to a Safe Harbor 401(k).

The employer contribution requirement provides you with two options. If you choose the first option, you must make a matching contribution for each non-highly-compensated employee (NHCE) who elects to contribute to the plan. The basic matching formula is 100% for at least the first 3% of employee compensation and 50% on the employee's own contributions above 3%, not to exceed 5% of compensation. Such matching contributions automatically satisfy the ACP test. Alternatively, an enhanced matching formula may be designed so long as the rate is non-increasing and the aggregate amount of the match at least equals the basic matching formula (e.g., 100% match on deferrals up to 4% of compensation).

If you choose the second option, you must make a flat, non-elective contribution for each NHCE who is *eligible* to participate in the plan, even if the employee opts not to contribute. The non-elective contribution must equal 3% of the employee's compensation for the year.

In either employer contribution option, you can make similar contributions for highly-compensated employees (HCE), including yourself, so long as the match percent for any HCE is no greater than the matching percent for any NHCE at the same rate of deferral. Thus, with the implementation of the Safe Harbor 401(k), you can make the maximum voluntary contribution permitted under the plan without being limited to the ADP test *and* receive the matching contribution or non-elective contribution provided under the plan.

Another requirement of the Safe Harbor 401(k) plan is that any employer contribution, either matching or non-elective, is fully vested to the employee for whom the employer contribution was made. Thus, employer contributions under a Safe Harbor 401(k) may lose some attraction as a way of retaining employees.

Finally, the Internal Revenue Service (IRS) stipulates that you must provide a written notice to employees of the intent to implement a Safe Harbor 401(k) plan. The notice must be sent out at least 30 days and not more than 90 days prior to the beginning of the plan year. In addition, specific information must be included in the notice as stipulated by the IRS.

If you are contemplating the Safe Harbor 401(k), you will need to carefully analyze the potential increase in expenses attributable to the employer contribution requirement. In some instances, your desire to make a full contribution may outweigh the increase in expenses. However, this will likely depend on such factors as overall plan participation, the size of your company, and whether or not you are already making any matching contributions or non-elective contributions under an existing plan.