401(k) Safe Harbor Plans

Background

The Small Business Job Protection Act of 1996 created a new plan design option -- 401(k) Safe Harbor. This option is available for plan years beginning after 12/31/98.

Eligible Plan Sponsors

A 401(k) Safe Harbor Plan is available to any size employer.

What is a 401(k) Safe Harbor Plan?

A 401(k) Safe Harbor Plan allows plan sponsors to eliminate the need to perform the ADP and ACP nondiscrimination tests by including certain plan design requirements. Plan sponsors can elect to use the arrangement solely for avoiding the ADP test. Or, they can elect to meet additional requirements to avoid both the ADP and ACP nondiscrimination testing.

ADP Test Safe Harbor Requirements for Elective Deferrals

To have a 401(k) Safe Harbor Plan for elective deferrals and avoid ADP testing, plan sponsors must satisfy either:

- A qualified matching contribution requirement or
- A qualified nonelective contribution requirement.

In addition, the plan sponsor must meet an annual notice requirement.

Qualified Matching Contribution

The plan may use the basic matching formula or an enhanced matching formula. Under the basic matching formula, the plan must make a qualified matching contribution equal to:

- 100 percent of each employee's elective deferrals up to 3 percent of pay, and
- 50 percent of each employee's elective deferrals for the next 2 percent of pay. (ex. 4 percent and 5 percent.)
Under the enhanced matching formula, the plan must make a qualified matching contribution that meets the following requirements:

• The rate of match does not increase as the rate of each employee’s deferrals increase.
• The total amount of match at each rate of deferral is at least equal to the total amount of match which would be made under the basic matching formula.

For purposes of the ADP test safe harbor, the plan can match any level of elective deferral — including deferrals over 6 percent of pay. However, in order to meet the ACP test safe harbor and also avoid ACP testing, the plan cannot match elective deferrals over 6 percent of pay, and other requirements must be met, as explained on the following page.

**Qualified Nonelective Contribution**

As an alternative to the matching contribution, the plan sponsor could choose to make a qualified nonelective contribution of at least 3 percent of pay to all employees who are eligible to participate in the plan, including those employees who are not making elective deferral contributions. (May be made to nonhighly compensated employees only.)

The plan sponsor can choose to make a matching contribution even if that plan sponsor makes the 3 percent qualified nonelective contribution to satisfy the ADP test safe harbor for elective deferral contributions. The match will not be subject to the ACP test if it meets the requirements listed in the ACP test safe harbor requirements for matching contributions.

**Annual Notice Requirement**

The annual notice requirement is satisfied if each employee who is eligible to participate in the plan is given written notice of his or her rights and obligations under the plan. The notice must be:

• Accurate and comprehensive including details about the plan design.
• Written in terms easily understood by the employee.
• Provided within a reasonable period before the plan year begins or before the date the employee becomes eligible, if later.

The notice must be given to each eligible employee at least 30 days, but no more than 90 days, before the beginning of each plan year or before the date the employee becomes eligible, if later.

**ACP Test Safe Harbor Requirements for Matching Contributions**

Matching contributions are treated as satisfying the ACP test if the following requirements are met:

• Each nonhighly compensated employee who is eligible to receive a contribution under the plan is also an eligible employee under a 401(k) plan that satisfies the ADP test safe harbor.
• The plan satisfies certain limitations on matching contributions.

In general, these limitations include:

• The plan doesn’t match elective deferrals and employee contributions that, in total, are over 6 percent of pay.
• The rate of the matching contribution doesn’t increase as the rate of an employee’s elective deferral contributions or employee contributions increases, and
• The matching rate for a highly compensated employee isn’t higher than the matching rate for an eligible nonhighly compensated employee.

Note: Employee after-tax contributions are still subject to the ACP nondiscrimination tests even if the plan satisfies the 401(k) Safe Harbor requirements for the match.

Other Contributions

A plan sponsor may choose to make a profit sharing contribution or an additional employer contribution to the plan. Additional matching contributions may be subject to certain limitations.

Elective Deferral Limits

All employees (both nonhighly and highly compensated) may defer up to the elective deferral limit each year, subject to the 415 limit.

Vesting

The contributions used to satisfy the ADP Safe Harbor requirements must be qualified and are therefore immediately 100 percent vested. Other contributions may be subject to a vesting schedule.

Top-Heavy

401(k) Safe Harbor plans that allow only elective deferral and matching contributions that satisfy ADP/ACP test safe harbor are deemed not to be a top-heavy plan. Qualified nonelective and matching contributions are used to satisfy the top-heavy minimum required contribution. A 401(k) Safe Harbor plan is deemed not to be a top-heavy plan even if the only plan contributions made during the plan year are:

• Elective deferral contributions and a qualified nonelective or qualified matching contribution used to satisfy ADP test safe harbor requirements.
• Other matching contributions, provided these matching contributions satisfy the ACP test safe harbor requirements.

Withdrawal Restrictions

The qualified matching contributions and qualified nonelective contributions used to satisfy the ADP test safe harbor are subject to the certain withdrawal restrictions. These contributions may be distributed only in the following situations:

• Severance from employment
• Retirement
• Death
• Disability
• Age 59 1/2
• Plan termination*
• Sale of assets or of a subsidiary*
Amending an Existing 401(k) Plan

An existing 401(k) plan, including a 401(k) SIMPLE plan, can adopt the 401(k) Safe Harbor Plan design at the beginning of the plan year.

Under IRS Notice 2000-3, an existing profit sharing, stock bonus, or pre-ERISA money purchase plan may add the 401(k) Safe Harbor Plan provisions to the plan during the year if the following requirements are met:

• The plan is not a successor plan
• The cash or deferred arrangement (CODA) must be in place at least three months prior to the end of the plan year; and
• All other 401(k) Safe Harbor Plan requirements are met for the entire period from the effective date of the CODA to the end of the plan year.

The notice requirements must be satisfied in order to amend an existing plan to a 401(k) Safe Harbor Plan.

Opting Out of the 401(k) Safe Harbor

Plan sponsors using the qualified matching contribution to meet the ADP/ACP test safe harbors, may opt out of the 401(k) Safe Harbor Plan design before the end of the plan year. A plan sponsor may opt out of the 401(k) Safe Harbor Plan design on a prospective basis only if certain requirements are met. See your local representative for more information.

Optional Qualified Nonelective Contribution

A plan sponsor may have the option of determining if a qualified nonelective contribution will be made for the plan year prior to the end of the plan year (to meet ADP test safe harbor).

This option is only available if certain requirements are met. See your local representative for more information.

*Special rules apply to distributions made on account of these events.