What is a Safe Harbor 401(k) Plan?

Under the Safe Harbor Plan Design, plan sponsors can escape the 401(k) and 401(m) discrimination tests. This allows the Highly Compensated employees to defer the maximum amount allowed by law ($19,500 for calendar year 2020, $26,000 for individuals age 50 or older) without receiving a refund of their 401(k) deferrals due to a 401(k) or 401(m) discrimination test failure. Employer contributions must follow the same distribution restrictions that are applied to salary deferral contributions.

How 401(k) Safe Harbor Works

New plans may be established at any time before October 1st, for a calendar year plan. An existing traditional 401(k) plan may be converted to a Safe Harbor 401(k) Plan on the first day of the plan year. Safe Harbor Plans have two basic requirements, a notice requirement and an employer contribution requirement.

Notice Requirement: The employer must provide to each eligible employee written notice regarding the employer's election to adopt the Safe Harbor provisions. This notice must be made within a reasonable time frame prior to the beginning of the year. IRS guidance states that a reasonable time is not less than 30 days before the beginning of the plan year. The employee notice must inform each eligible employee of his or her rights under the plan and must state the Safe Harbor contribution formula used.

Contribution Requirement: The design based Safe Harbor contribution can be made by one of the three allowable contribution methods:

> **Non-elective Contribution Approach:** The employer makes a fully vested employer contribution equal to 3% of compensation for all employees who are eligible to participate in the plan or (at least all non-highly compensated employees eligible to participate in the plan). This contribution must be made without regard to whether the employee makes salary deferral contributions. This contribution must be immediately vested.

> **Matching Approach**: As an alternative to the non-elective contribution, the employer matches either based on the Basic Formula - 100% up to 3% of compensation, plus 50% of the next 2% of compensation deferred, with no match on amounts deferred over 5% of compensation, or; an Enhanced Formula – 100% match on at least 4% of salary deferred, not more than 6% of salary deferred. This contribution must be immediately vested.

> **Qualified Automatic Contribution Arrangement (QACA) Approach:** As an alternative to either tradition Safe Harbor Plan Design described above, a plan may also satisfy the 401(k) & 401(m) discrimination tests if it automatically enrolls participants at a specific level, automatically increases them annually, and provides a specific matching formula. Unlike the traditional Basic Match, the QACA match is 100% up to 1% of compensation, plus 50% of the next 5% of compensation deferred, with no match on amounts deferred over 6% of compensation. Although the maximum contribution percentage is lower, the overall employer contribution may be higher due to the automatic enrollment feature. It is also imperative that the plan follow the rules of the automatic escalation requirement with an annual notice. Additionally, unlike the contributions described above, the QACA match contribution may be vested after two years of service with the sponsor. Leaving prior to completing two years of service would forfeit any match received.

Under any contribution approach, the design eliminates 401(k) & 401(m) discrimination testing, and may satisfy the top-heavy minimum contribution requirement. The plan cannot require that employees be employed on the last day of the plan year or that they complete a specific number of hours of service during the plan year to receive the Safe Harbor contribution.