Your guide to Safe harbor 401(k) plans

What is a Safe harbor 401(k) plan?

A Safe harbor 401(k) plan allows a plan sponsor to automatically pass certain annual tests to ensure compliance with IRS regulations if specific contribution, vesting, and participant notification requirements are met.*

Safe harbor plans generally don't require the following compliance tests:

- **Actual deferral percentage (ADP).** A test for pre-tax elective and/or Roth deferrals by highly compensated employees (HCEs) to a 401(k) plan exceeding the maximum amount permitted under nondiscrimination testing rules for a plan year. The test compares HCE with non-HCE contributions to determine whether HCEs have exceeded certain thresholds.
- **Actual contribution percentage (ACP).** A test for employee after-tax contributions or employer matching contributions by HCEs to a 401(k) plan exceeding the maximum amount permitted under nondiscrimination testing rules for a plan year. The test compares HCE with non-HCE contributions to determine whether HCEs have exceeded certain thresholds.
- **Top-heavy plan.** A test measuring the degree to which certain officers and owners dominate a 401(k) plan. A top-heavy plan essentially favors officers and owners over other employees.

What are the potential benefits of a Safe harbor plan?

Safe harbor provisions can help:

- Reduce plan maintenance by eliminating annual testing requirements and the obligation of maintaining a vesting schedule.
- Maximize deferrals for highly compensated employees.
- Relieve a plan's top-heavy status.
- Provide additional employee benefits with profit-sharing or matching contributions.

What employer contributions are required?

There are many contribution possibilities, but many employers limit their contributions to the amounts required under their chosen Safe harbor formula.

The subsequent scenarios generally satisfy Safe harbor requirements:

- **Basic match.** A 100% match on an eligible employee's deferral up to 3% of annual compensation and a 50% match on the next 2% of their annual compensation.
- **Enhanced match.** A matching contribution that's at least as generous as the basic match at any level of an employee's deferral. For example, eligible employees may receive a 100% match on deferrals up to 4% of their annual compensation.
- **Nonelective contribution.** A contribution for all eligible employees—including employees who don't defer compensation—that equals a minimum of 3% of their annual compensation.
- **Vesting.** Safe harbor contributions must always be 100% vested. Therefore, these contributions aren't returned to the employer upon termination of employment.

* If an employer makes contributions, either matching, nonelective, or discretionary, that exceed certain limits/requirements, the employer is required to treat them as non-Safe harbor contributions and subject the plan to ACP and top-heavy testing. After-tax employee contributions also subject the plan to these tests.

What are the administrative requirements?

In addition to following plan provisions and other standard operational compliance rules, employers must:

- Adopt a 401(k) plan or amend their current 401(k) plan document to include Safe harbor provisions.
- Notify participants about Safe harbor provisions 30 to 90 days before the start of each plan year. Initially, this notice also must be provided to newly eligible employees.
- Offer a Safe harbor plan for an entire plan year.**

What are the costs?

The costs for a Safe harbor contribution plan depend on the participation level. If few eligible employees make deferrals, for example, a matching formula may be more cost-effective than the nonelective contribution. To increase deferral rates—even at a higher cost—an employer may choose an enhanced-match formula.

Employers who don't follow the administrative requirements of a Safe harbor plan, such as delivering the participant notice, may be subject to significant corrective costs.

Ultimately, employers may weigh any additional Safe harbor costs against significantly reducing the expense and administrative obligation of annual testing requirements.

Vanguard can provide in-depth plan design consulting, including ADP/ACP Safe harbor designs. To learn more, please contact your Vanguard representative.

** In limited circumstances, which require both notice and a plan amendment, an employer may suspend Safe harbor matching and nonelective contributions.

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