Safe Harbor Plans

Find protection from compliance testing in a Safe Harbor Plan

A safe harbor 401(k) plan is not a separate type of plan. Rather, it is a traditional 401(k) plan that includes a "safe harbor" provision. In a 401(k) plan, employees can choose to defer a portion of their compensation on a pre-tax basis and an employer can choose to add additional contributions to the plan. In a safe harbor plan, however, those employer contributions are required. Because of these required contributions, the safe harbor 401(k) plan is not subject to many of the complex rules that apply to a traditional 401(k) plan.

A safe harbor plan can accomplish many goals for the employer. Like all 401(k) plans, it can help to attract and retain qualified employees, provide a tax deduction to the employer, provide a low-cost visible benefit to employees and save the employer money by allowing employees to share in the cost of their retirement program. Because it is not subject to the same compliance tests as a traditional 401(k) plan, the owners of the plan sponsor have more freedom to contribute to the plan and avoid the costly correction of failed testing .

NOBLE-DAVIS CONSULTING, INC.

30275 Bainbridge Road
Building B
Solon, OH 44139

Phone: 440-498-8408
Fax: 440-498-9566
E-mail:
contactus@noblepension.com

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Why should you think about a Safe Harbor Plan?

In order to be a safe harbor plan, the employer must amend their plan document, provide an annual "safe harbor" notice and make a required plan contribution. There are certain rules about when a plan can begin to be a safe harbor plan—usually the decision, amendment and notification must take place at least 30 days prior to the start of the plan year.

Employer contributions can come in two different forms—either a match contribution based on employee deferrals or a profit sharing contribution. The profit sharing contribution would be equal to 3% of eligible compensation. The basic matching contribution would be 100% on the first 3% of deferrals and 50% on the next 2% of deferrals. These contributions must be immediately 100% vested.

Profit Sharing Example:

Compensation:	$25,000	
Profit Sharing:	$750	

Match Example:

Compensation:	$25,000	
Deferral (5%):	$1250	
Match (step 1):	$750	(equal to 100% on the first 3% of deferrals)
Match (step 2):	$250	(equal to 50% on the first 2% of deferrals)
Total Match:	$1,000	

Note: The match would remain at $1,000 even if the employee contributes greater than 5% because the match contribution only recognizes the first 5% of deferrals.

In some plans where the deferral participation is low, it may be advantageous to provide the matching contribution. In a plan where the employer is already required to contribute a 3% contribution for top heavy purposes, the profit sharing contribution might make more sense.

These guaranteed contributions allow the plan to have a "free pass' on ADP and ACP testing. This means that "Highly Compensated Employees" are allowed to contribute 401(k) deferrals with no regard to what the other participants in the plan have contributed, unlike a traditional 401(k) plan where there is a correlation between the two. The required contribution also allows the plan sponsor to bypass any required top heavy contributions (unless an additional contribution is given).

The safe harbor 401(k) plan allows an employer to avoid many problems associated with nondiscrimination testing. Let us use our expertise in this area to provide you with objective projections to let you see if this plan design is the right one for you!