Choosing the Right Safe Harbor Contribution for Your Firm:

What You Need to Know

FuturePlan by Ascensus

Many small businesses rely on safe harbor 401(k) plans to stay compliant with the IRS and to allow owners and key employees to maximize their salary deferrals while providing meaningful retirement savings for all participants. Plan sponsors may select a match or nonelective safe harbor contribution to achieve their individualized goals. Employee demographics play a significant role in determining the appropriate safe harbor option.

Notable Safe Harbor Plan Features

- Safe harbor plans provide an automatic pass for ADP/ACP nondiscrimination testing and top-heavy requirements if the only employer contributions to the plan are safe harbor contributions.
- Employers may exclude highly compensated employees (HCEs) from safe harbor contributions.
- Safe harbor contributions generally require 100% immediate vesting and no allocation conditions.

Safe Harbor Options and Key Benefits

Basic Safe Harbor Match:

- In this scenario, the employer only contributes to participants who make employee deferrals. The basic formula is 100% match for the first 3% deferred, and an additional 50% match for the next 2% deferred. The maximum match that any participant receives is 4% of eligible compensation ***only if*** they contribute at least 5% of their own pay.
- Employers can choose to provide a more generous match of up to 6% of eligible compensation.
- The most notable benefit to choosing the basic matching option is that it only benefits employees who actively participate. The match typically costs less than alternative designs for larger employers with employees who are less likely to participate in the plan.
- This option is also appropriate for employers who would like to maximize owner and key staff salary deferrals of $19,500 ($26,000 for participants over 50) but are ***not*** planning on making any additional new comparability profit sharing contributions.
- A safe harbor matching formula typically works best for employer demographics with younger owners, and owners with limited income.

Safe Harbor 3% Nonelective:

- This 3% of pay employer contribution is allocated to all eligible plan participants, regardless of whether an employee actively defers from pay or not. It differs from a match because participants will receive this employer contribution without needing to make their own contributions into the plan.

Safe Harbor 3% Nonelective (continued)**:**

- The value of a 3% nonelective formula is that it can work double duty. It provides the automatic pass for an ADP test, and if a profit sharing contribution is made, the 3% safe harbor contributions are used to help satisfy the minimum contribution requirement (generally 5%). Employers generally choose this safe harbor option when the owners and other key personnel are looking to maximize their own annual contributions at the current $57,000 limit ($63,500 for participants over age 50).
    - If owners and other key personnel are substantially older than most of the staff, they generally can receive 6% in profit sharing contributions (in addition to the 3% safe harbor) without additional contributions to the staff. This can translate to an extra $17,100 per owner each year, if compensation is at least $285,000.
    - Further, consider an employer who must make a 5% contribution to staff in order to maximize contributions for owners and key personnel. The 3% safe harbor contribution counts towards the 5% needed, so the employer only needs to contribute an additional 2% at year end. In a basic safe harbor match, the owner would have to contribute up to 4% as a match PLUS 5% as a profit sharing contribution, resulting in potentially 9% to employees who receive the full match.
- This safe harbor appeals to employers who want to benefit all eligible employees and are likely to contribute profit sharing each year. Demographics impact the profit sharing component and favor older, higher-earning owners vs. younger rank-and-file staff.

QACA (Qualified Automatic Contribution Arrangement) Safe Harbor Match *or* 3% Nonelective:

- Employers looking to increase plan participation may consider choosing a safe harbor option that also contains an automatic enrollment feature. This type of safe harbor is available in either match or nonelective formulas.
    - If eligible participants do not make an affirmative election, they become automatically enrolled to contribute 3%, or more, of their salary into the plan.
- This 3% is automatically increased each year by 1%, increasing to at least 6% but no more than 15%.
    - QACA Match - 100% match for the first 1% deferred, and an additional 50% match for the next 5% deferred. The maximum match is 3.5% of eligible compensation ***only if*** the participant contributes at least 6% of their own pay or more.
    - QACA Nonelective – 3% of pay, which works in the same cost efficient manner when combined with Profit Sharing contributions as the basic safe harbor 3% nonelective.
- The most notable benefit to choosing a QACA safe harbor option is the ability to require two years of service to vest at 100%.
- Additionally, employers enjoy an additional tax credit for implementing a safe harbor option with an automatic enrollment feature.
- This safe harbor appeals to employers who want increased employee participation and would like to have forfeitures available to reduce cost due to high turnover inside the first two years of service.

We're here for you.

Reach out to your FuturePlan TPA consultant for support and expert guidance. We're ready to help you answer client questions and make informed decisions, connecting you with ERISA experts and providing any other expert advice you may need.