TruePlan℠ Benefit and Retirement Advisors | Just the FAQs FOR PLAN SPONSORS

Safe harbor plans: 6 questions plan sponsors should ask

1. WHAT ARE SAFE HARBOR PLANS?

Safe harbor plans are retirement plans that generally satisfy the non-discrimination rules for elective deferrals and employer matching contributions and therefore are appealing to organizations that are at risk of failing the Actual Deferral Percentage and Actual Contribution Percentage tests. Safe harbor plans can be offered with the same flexible features as traditional retirement plans, including eligibility, participant loans and distributions. However, employers *must* satisfy certain contribution, vesting and notice requirements and employers may *not* apply allocation conditions to safe harbor contributions (e.g., last day of employment requirement, 1,000 hours in the year requirement, etc.).

2. WHAT IS NON-DISCRIMINATION TESTING?

Generally, the federal government wants to ensure that plans do not favor highly compensated employees over non-highly compensated employees. The government established required compliance tests to verify all employees have fair representation in a plan. There are generally three main types of compliance tests required to be performed on a retirement plan to ensure a plan does not treat employees unfairly:

- **Actual Deferral Percentage test:** Compares the deferral percentage of HCEs and NHCEs. (Generally, the HCE deferral amount cannot be more than two percentage points higher than the non-HCEs' average.) As a reminder, 403(b) plans are not subject to ADP testing.
- **Actual Contribution Percentage test:** Compares employer matching contributions between the HCEs and NHCEs.
- **Top-heavy test:** Determines if the account balances of key employees are greater than 60% of the total assets of the plan.

3. WHAT IS THE CONTRIBUTION REQUIREMENT A PLAN SPONSOR MUST SATISFY?

Once a safe harbor plan design is adopted, employer contributions are not discretionary and organizations that choose a safe harbor plan must commit to one of the following contribution options. Therefore, safe harbor plans work particularly well for organizations that have consistent streams of revenue.

- **A non-elective contribution** to all eligible participants:
  - Contribute at least 3% of the employee's compensation for each eligible employee, regardless of whether the employee chooses to participate in the plan. (As long as the 3% requirement is satisfied, the plan may provide additional non-safe harbor contributions at the employer's discretion.)
- **A matching contribution** under one of the following formulas:
  - **Basic Match:** 100% match on the first 3% of compensation deferred plus 50% match on the next 2% of compensation deferred (i.e., an employee who defers at least 5% of their pay is eligible to receive a maximum 4% safe harbor match from the employer.)
  - **Enhanced Match:** Any match formula that gets the employee to the 4% match sooner. (However, it must be at least as generous as the basic match; deferrals in excess of 6% of compensation may not be matched. The rate of match may not increase as deferrals increase and the rate of the match may not be greater for HCEs than for NHCEs.)

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- » 100% of each participant's elective deferrals, up to 4% of compensation
- » 100% of each participant's elective deferrals, up to 5% of compensation
- » 100% of each participant's elective deferrals, up to 6% of compensation

4. WHAT ARE THE VESTING REQUIREMENTS A PLAN SPONSOR MUST SATISFY?

The employer contributions must be fully vested. Sponsors are not allowed to attach a vesting schedule to the employer contributions they make within a safe harbor plan.

5. WHAT ARE THE NOTICE REQUIREMENTS A PLAN SPONSOR MUST SATISFY?

The IRS requires employers to give a safe harbor notice to each eligible participant 30 days prior to the beginning of the plan year in which safe harbor contributions will be given.

6. WHY MIGHT A PLAN CHOOSE THIS DESIGN?

- **Trouble passing ADP/ACP test:** Because safe harbor plans are deemed to satisfy these tests, highly compensated employees can defer the maximum contribution without risk of corrective distributions caused by low participation from non-highly compensated employees.
- **Top-heavy:** In addition to satisfying the safe harbor requirements, safe harbor contributions can be used to satisfy the top-heavy minimum contribution when a plan is deemed to be top-heavy.
- **Employee recruitment and retention:** Because safe harbor plans offer guaranteed employer contributions that are fully vested and not subject to allocation conditions, these plans are very attractive to employees and assist with employee recruitment and retention.

Your TruePlan retirement plan consultant can help you determine whether a safe harbor design would be advisable for your plan.

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