InWest Retirement Solutions

WORK...SAVE...PLAY!

INNOVATIVE SOLUTIONS SINCE 1983

Safe Harbor 401(k)

INTRODUCTION

The Small Business Job Protection Act (SBJPA) gave retirement plan sponsors the ability to add safe-harbor provisions to qualified plans. Adoption of safe-harbor provisions allows 401(k) plan sponsors to avoid the actual deferral percentage (ADP) test and the actual contribution percentage (ACP) test for employer contributions. These non-discrimination tests are deemed satisfied if the employer agrees to make certain contributions of behalf of plan participants. In other words, safe-harbor adoption will allow 401(k) participants (including Highly Compensated Employees) to defer up to the maximum IRS limit without fear of non-discrimination test failure.

SAFE-HARBOR CONTRIBUTION REQUIREMENTS

Employers may choose from three types of contributions to satisfy safe-harbor provisions and receive ADP/ACP test relief. These contributions also satisfy the minimum contribution requirements for Top-Heavy plans.

Non-Elective Contribution – Employer contributes 3% of pay for each eligible employee, without regard to whether the employee actually chooses to make 401(k) deferrals.

Matching Contribution – Employer matches 100% of the first 3% of employee deferrals, plus 50% of the next 2% of employee deferrals. Employers can also elect an enhanced safe-harbor match (i.e. 100% match on the first 4% of employee deferrals).

QACA Matching Contribution – Employer adopts an automatic enrollment feature that satisfies the definition of a Qualified Automatic Contribution Arrangement (QACA).

Participants become 100% vested in all safe-harbor non-elective and matching contributions as soon as they are made. QACA contributions can be made subject to a 2-year cliff vesting schedule.

SAFE-HARBOR DEADLINES

New plan sponsors wishing to adopt safe-harbor must offer the plan for a minimum of three months during its initial plan year. For example, plan sponsors adopting a calendar year plan must establish safe harbor provisions on or before October 1st. Existing plan sponsors wishing to add safe-harbor must amend their plan documents and provide a safe-harbor participant notice at least 30 days before the beginning of the plan year for which safe-harbor is being adopted..

Safe Harbor 401(k)

QUALIFIED AUTOMATIC CONTRIBUTION ARRANGEMENT

Plan sponsors can meet Safe-Harbor by adopting an automatic enrollment feature that satisfies the definition of a Qualified Automatic Contribution Arrangement (QACA). The requirements of a QACA are discussed below.

AUTOMATIC DEFERRAL REQUIREMENTS FOR A QACA

The automatic enrollment percentage under a QACA must be set between 3% and 10% of compensation. If the initial percentage is set at less than 6%, then the initial percentage must be no less than the following minimum percentage requirements:

1) 3% for the period beginning with the first automatic contribution and ending on the last day of plan year following the plan year of the first automatic contribution.
2) 4% during the first plan year following the period described in (1)
3) 5% during the second plan year following the period described in (1) and
4) 6% during any subsequent plan year

For example, if an employee is auto enrolled on 1/1/2016 then his minimum percentage can be set at 3% until 12/31/2017. It must then be increased to at least 4% for 2018, at least 5% for 2019 and at least 6% for 2020 and subsequent years.

Due to the administrative complexities of increasing plan deferral contributions as described above, we suggest that employers consider setting an initial automatic enrollment percentage at 6% or more.

BASIC MATCHING FORMULA REQUIREMENTS FOR A QACA

Under a QACA, the Employer matches 100% of the first 1% of compensation that is deferred by the employee plus 50% of the next 5% deferred by the employee. Thus, the maximum required match is 3.5% of compensation. This compares to the maximum non-QACA Safe-Harbor Match of 4% of compensation.

VESTING REQUIREMENTS FOR A QACA

Employer matching contributions under a QACA Safe-Harbor must be 100% vested for any employee who has completed at least 2 years of service. This compares to 100% immediate vesting of employer contributions under a non-QACA Safe-Harbor plan.

InWest Retirement Solutions

WORK...SAVE...PLAY!

INNOVATIVE SOLUTIONS SINCE 1983

New Comparability Profit Sharing

WHAT IS A NEW COMPARABILITY PLAN?

A new comparability plan is generally a profit sharing plan or a money purchase pension plan in which the contribution percentage formula for one category of participants is greater than the contribution percentage formula for other categories of participants. As with an age-based profit sharing plan, to satisfy the non-discrimination requirements, a new comparability plan is tested under the cross-testing rules.

WHAT DOES CROSS-TESTING MEAN?

A qualified retirement plan may not discriminate in favor of highly compensated employees with respect to the amount of contributions or benefits. Whether a defined contribution plan satisfies this requirement is generally determined with respect to the amount of contributions. As an alternative, however, a plan may be tested with respect to the equivalent amount of benefits or Equivalent Benefit Accrual Rate (EBAR). As an example, a 50-year old business owner's EBAR would be considerably less than a 25-year old employee's EBAR if they both received the same percentage of pay contribution. Cross-Testing would allow the sponsor to demonstrate that the owner should receive a greater percentage of pay contribution (or the employee a lower percentage) in order to receive an equivalent benefit at retirement.

WHO SHOULD CONSIDER A NEW COMPARABILITY PLAN?

This design is appropriate for plan sponsors looking to affordably increase business owner or key employee contribution rates. A traditional allocation formula would require every eligible employee to receive a uniform contribution as a percentage of pay. A new comparability formula allows the employer to divide eligible employees into multiple groups and potentially provide a different contribution amount to each group of participants. Some sponsors use this design as an incentive plan, tying company performance goals to plan contribution rates.

A new comparability plan design works best when the group(s) targeted for increased plan contributions are older and better paid than the average plan participant.

New comparability is often a great addition to a new or existing Safe-Harbor 401(k) Plan.

Super Safe Harbor 401(k) Plan

OVERVIEW

A Super Safe-Harbor 401(k) Plan combines a Safe-Harbor 401(k) Plan design along with a New Comparability Profit Sharing Plan. A Super Safe-Harbor 401(k) Plan often allows the sponsor to target a certain employee (business owner) or group of employees for higher plan contributions.

SAFE-HARBOR 401(k) PLUS…

We typically use the Non-Elective version of Safe-Harbor that requires the employer to make a 3% of pay contribution to all plan eligible employees. This contribution not only satisfies Safe-Harbor requirements (allowing the Highly Compensated Employees to maximize their personal plan deferrals), it also can be used to pass the non-discrimination testing on a New Comparability Profit Sharing allocation.

NEW COMPARABILITY PROFIT SHARING

A New Comparability allocation formula allows the sponsor to create multiple employee groupings and potentially give each group a different percentage of salary. These groupings are often determined based on job classification or title.

This design is appropriate for plan sponsors looking to affordably increase business owner or key employee contribution rates. Some sponsors use this design as an incentive plan, tying company performance goals to plan contribution.