

Consider adding a “safe harbor” feature to your plan if plan is going to fail ADP/ACP testing or if the plan is top heavy. Adding the Safe Harbor feature will automatically satisfy certain IRS Tests.

ADP test (average deferral percentage) - This test measures the ADP of the highly compensated employees (HCE’s) vs. the ADP of the non-highly compensated (NHCE’s). The IRS threshold is the ADP of the HCE’s cannot exceed 2% more than the ADP of the NHCE’s. A HCE is anyone has 5% or more ownership in the plan or earned more than \$115k in wages during the previous calendar year (with this company and indexed each year). This amount is indexed each year.

The only way to satisfy the ADP test is either limit the amount the HCE’s could contribute as an average so it did not exceed the IRS limits or add a “safe harbor” contribution feature to the plan. The safe harbor contribution would automatically satisfy ADP testing and therefore, the HCE’s could contribute up to the 401k annual limit without regard to what the NHCE’s contributed.

Top Heavy Test – This test is performed on the last day of the plan year and measures the total account balance of the “key employees”. If the key employees balances make-up at least 60% of the total plan assets, the plan is deemed to be top heavy. A key employee is an officer of the company who earned over \$165k in the calendar year; a 1% owner who earned \$150k in the calendar year; and any 5% or more owner of the company. If the plan is deemed to be top heavy and HCE’s contributes to the plan in any way, the employer is required to provide a 3% minimum top heavy contribution to all non-highly compensated employees.

THE BASIC SAFE HARBOR OPTIONS ARE:

Safe Harbor Match - A Safe Harbor match is equivalent to 100% match up to 3% of pay contributed and then an additional 50% match on the next 2% of pay contributed. This equates to a dollar for dollar match for anyone who contributed at least 5% of their pay into the plan. The safe harbor match would be provided to any employee who contributed pre-tax or Roth contributions to the plan. Therefore, if they choose not to contribute, they do not receive an employer contribution. A safe harbor match is always considered pre-tax contributions even if the participant elected Roth. All employer contributions are pre-tax contributions. The Safe Harbor match will automatically satisfy the ADP/ACP testing in most circumstances. It would automatically satisfy the Top Heavy requirements IF no other employer contributions are made to the plan (i.e. profit sharing).

Safe Harbor Non-elective Contribution – The Safe Harbor Nonelective Contribution is **NOT** a match. This contribution is a flat 3% of pay to all eligible employees. Again, this contribution **would be** required to be made regardless of whether or not the participant actually contributed to the plan or not. The Safe Harbor Nonelective Contribution would automatically satisfy the ADP/ACP test in most circumstances and it would automatically satisfy the top heavy minimum requirement if the plan is top heavy.

Safe Harbor Enhanced Match – A Safe Harbor Enhanced Match is equivalent to a 100% match on between 4-6% of pay. The employer would choose the percentage of pay to actually match which can be anywhere from 4% of pay to 6% of pay. The safe harbor match would be provided to any employee who contributed pre-tax or Roth contributions to the plan. Therefore, if they choose not to contribute, they do not receive an employer contribution. A safe harbor enhanced match is always considered pre-tax contributions even if the participant elected Roth. All employer contributions are pre-tax contributions. The Safe Harbor enhanced match will automatically satisfy the ADP/ACP testing in most circumstances. It would automatically satisfy the Top Heavy requirements IF no other employer contributions are made to the plan (i.e. profit sharing).

All safe harbor contributions would be 100% immediately vested at all times.