

# Safe Harbor 401(k) Plans

*With Robert M. Kaplan, CFP,  
CPC, QPA, APA*

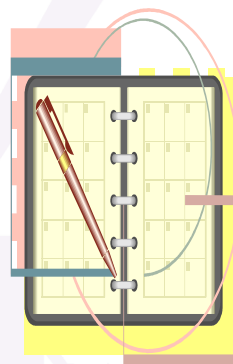


[www.asppaontour.org](http://www.asppaontour.org)



## AGENDA

- The Basics
- Getting Started
- Documentation and Disclosure
- Creative Plan Design
- The QACA
- Watch outs
- Distribution Issues
- It's Over
- Q & A



[www.asppaontour.org](http://www.asppaontour.org)



## Disclaimer



- *The general information in the presentation is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties*



[www.asppaontour.org](http://www.asppaontour.org)



## Consider When...



- Replacing PS contributions with match
- HCEs looking to maximize if some (many) of the NHCEs are not deferring
- HCEs looking to maximize benefits now fearing limit cutbacks under tax reform



[www.asppaontour.org](http://www.asppaontour.org)



## The Basics

- If certain contributions are made then no ADP and maybe no ACP testing is required (a plan may satisfy ADP SH but not the ACP SH)
- Plan document must contain method
- Annual participant notice is required



## The Basics – To Avoid ADP

- SH contributions are fully vested and subject to withdrawal restrictions (same as deferrals)
- No accrual requirement – no last day or 1000 hours allowed on SH money (allowed on “other” contributions)
- Plan is not limited to only SH contribs



## The Basics – SH Contribution Options

- At least 3% nonelective – to all eligible (fixed or flexible)
- Basic Match – Dollar for Dollar on the first 3% and 50 cents on the dollar for the next two percent (total of 4% on 5% deferred)
- Enhanced Match – any formula that gets you to the 4% match sooner (such as dollar for dollar on the first 4%)



## The Basics – 3% Contribution Options

- **Fixed** – plan document guarantees at least a 3% nonelective contribution to all eligible participants
- **Flexible or “maybe”** – plan document states that the plan MAY be amended during the plan year (at least 30 days before end of plan year) to become a SH. If so, a supplemental notice must be given



## The Basics – To Avoid ACP test

- Meet contribution and disclosure notices previously mentioned, **and**
- Do not match deferrals in excess of 6%
- Do not provide a discretionary match in excess of 4%
- Do not provide a match to HCEs that is a higher rate than to the NHCEs
- Do not increase rate of match as the deferrals increase



[www.asppaontour.org](http://www.asppaontour.org)



## The Basics – Timing of Contributions

- Safe Harbor contributions must be made within 12 months after end of plan year
  - However, in order to be deductible for the PY, must be made by due date of filing of tax return including extensions
- Safe Harbor for payroll based matching contribution deadline is end of quarter after deferral withheld



[www.asppaontour.org](http://www.asppaontour.org)



## Getting Started

- New Plan – must be in place for at least 3 months (in order to give all eligible participants a chance to defer)
- Converting an existing 401(k) Plan – must be done as of first day of a plan year
- Adding feature to a non-401(k) plan is subject to the 3 month rule



## Getting Started

- Plan may disaggregate SH:
- Those who would have been in the plan if the statutory eligibility requirements (age 21 and 1) had been in effect get the SH
- The short timers (those in plan but who would not have been...) must be tested - these are usually all NHCEs



## Documentation and Disclosure

- Plan document must reflect SH provisions and must be in place prior to first day of plan year (not like other discretionary amendments which may be adopted as late as the last day of the plan year)
- SH status may not be conditioned on providing notice or making contributions. **Either you are or are not a SH**
- Annual Participant notice must be distributed



## Documentation and Disclosure

### Content of Notice

- SH formula (match or nonelective)
- Other contributions or potential contributions
- Plan SH contribution made (if employer sponsors another plan)
- Compensation that may be deferred (type and amount)
- How to make deferral elections
- Periods available to make deferrals
- Vesting and withdrawal provisions of all sources of funds
- How to obtain other plan information



## Documentation and Disclosure

- Timing of Distribution of Notice must be “reasonable”:
- Newly Eligible employee – no sooner than 90 days before eligibility date and no later than eligibility date
- Note: For a newly established SH plan; all eligible employees are “newly eligible”, therefore, plans can be established during last month of prior year
- See example on next slide



## Documentation and Disclosure

- Plan adopted December 15, 2013
- Plan effective January 1, 2014
- Employees eligible to participate in January 1, 2014
- Notices distributed December 31, 2013
- This is deemed “*okay*” (technical ERISA term)





## Documentation and Disclosure

- Annual notice requirements - “reasonable period before each plan year”
- Deemed to be reasonable if distributed 30-90 days prior to plan year (Safe Harbor period for the Safe Harbor Notice)
- If less than 30 days before plan year still may be okay if it is deemed reasonable under a facts and circumstances test



[www.asppaontour.org](http://www.asppaontour.org)



## Documentation and Disclosure – Allowable Changes (non binding verbal guidance?????)

- Change of plan year, so long as the following plan year the plan followed the safe harbor rules
- Expand coverage to include employees previously not included (so long as existing participants are not affected)
- Change of investment vendor
- A retroactive corrective amendment to address a coverage failure
- Change of trustee



[www.asppaontour.org](http://www.asppaontour.org)



- Bob's Opinion - FWIW
- Closer to 30 days the better
- 3% nonelective does not really affect deferrals so you have a better argument if this is very close to first day of plan year
- SH match – deferral amounts may be affected so you will want to show IRS if the timing of the distribution of notice affected deferral elections.



## Documentation and Disclosure

- Method of delivery
- Paper or electronic – either is okay



## Late Notices – After PY begins

- You have violated the terms of the plan and are subject to EPCRS
- 3% nonelective generally does not affect deferrals so you distribute ASAP and then determine how bad the violation is
- SH match – take a look to see if any NHCEs were not deferring or not deferring to maximize the match. This will give you a clue to how the IRS may look at it
- Run (not walk) to an ERISA attorney



[www.asppaontour.org](http://www.asppaontour.org)



## Creative Plan Design

- Top Heavy Exemption
- Cross-testing
- Maximizing match



[www.asppaontour.org](http://www.asppaontour.org)



## Creative Plan Design – Top Heavy Exemption

- Plans that allow only elective deferrals and contributions that satisfy the safe harbor are exempt from TH



## Creative Plan Design – Top Heavy Exemption

Exemption does NOT apply if:

- Forfeitures are allocated to the accounts
- Nonelective discretionary contributions are allocated
- Longer eligibility is required for the SH contribution than for elective deferrals



## Creative Plan Design – Top Heavy Exemption

- If the plan is not exempt from TH rules, remember that the SH contributions can be applied to satisfy TH
- Example – if an employee defers 2% and receives a 2% match; then only an additional 1% is needed to satisfy TH



## Creative Plan Design – Cross Testing

- The 3% nonelective may be used to satisfy 401(a)(4) testing.
- It can be applied as part of the Gateway that needs to be satisfied prior to cross-testing
- But watch out for....



## Creative Plan Design – Cross Testing

- Note: that if any nonelective is received; then the total gateway must be satisfied
- So if an employee receives 3% nonelective SH but is not entitled to additional nonelective a problem may occur (see next slide)



## Creative Plan Design – Cross Testing

Example:

- Plan is a 3% nonelective SH plan
- Plan is cross-tested and needs a 5% gateway
- Profit Sharing nonelective is discretionary and subject to 1000 hours or last day rule
- If a participant leaves....must make sure somehow gets the full 5% (document should specify)



## Creative Plan Design – Cross Testing

### Triple Duty Nonelectives

- Satisfy SH
- Satisfy TH
- Apply towards Gateway
  
- Effective use of Employer \$



[www.asppaontour.org](http://www.asppaontour.org)



## Creative Plan Design – Maximizing Match

- Remember the rules
- Still satisfy SH if do not match deferrals in excess of 6% OR make a discretionary match of 4%
  
- Soooooo....How about an enhanced match of dollar for dollar on the first 4% and an additional match of 1% discretionary on the first 4%.  
(Reward those that defer and stay within rules)



[www.asppaontour.org](http://www.asppaontour.org)



## Creative Plan Design – “Triple Stacked Match “

- Basic Match, plus
- Additional Fixed match\*
- Additional Discretionary match\*

\* Note: as long as you do not match on deferrals in excess of 6% or the discretionary match is more than 4% you are good to go



## Creative Plan Design – Employer profile

- Many NHCEs are not deferring – so most employer contributions are directed to HCEs (**but watch out once you commit to match formulas just in case the NHCEs decide to contribute**)
- Employers that may not want to use a cross-tested or permitted disparity plan due to cost of gateway or disparity in age of HCEs





## The QACA

- How it differs from a traditional SH plan
- Auto enroll feature
- Specific range of auto enroll
- SH contributions do not have to be vested immediately but rather after two years of service



## The QACA

- Default contribution % must be uniform, except:
  - Varies based on years of service
  - Limited by 402(g) - \$17,500
  - Suspension due to hardship withdrawal
  - Deferral rate effective prior to effective date of QACA is not reduced
- See next slide for specific ranges



## The QACA

- Default deferral 1<sup>st</sup> period = at least 3% but no more than 10%
- 2<sup>nd</sup> Period = at least 4% but no more than 10%
- 3<sup>rd</sup> Period = at least 5% but no more than 10%
- 4<sup>th</sup> and later periods = at least 6% but no more than 10%
- 1<sup>st</sup> period can last until end of year following plan entry
- See next slide for example
- Note: Periods do not have to end on last day of PY
- May use anniversary or bonus date



[www.asppaontour.org](http://www.asppaontour.org)



## The QACA

- DoH = 1/16/14
- DOE = 2/01/14
- Calendar year plan
- Initial period may end as late as 12/31/15



[www.asppaontour.org](http://www.asppaontour.org)



## The QACA

- Match
- Dollar for Dollar on the first 1%
- 50 Cents on the Dollar for the next 5%
- Defer 6% = 3.5% Match
- Less expensive per participant but probably have more participants due to automatic enrollment feature



[www.asppaontour.org](http://www.asppaontour.org)



## Watch Outs for all SH plans

- SH required to only be given to the NHCEs.
- However, need to follow document and accrual requirements
- Example – if calendar year plan states that all participants get the SH, employer cannot decide after the PYE that the HCEs (even the owners) will not get the SH amounts!!!



[www.asppaontour.org](http://www.asppaontour.org)



## Watch Outs

- SH nonelective contributions may not be used to satisfy the permitted disparity (SS integration under 401(l))
- If a plan wants to use permitted disparity it must ignore the SH and start the nonelective from scratch
- Not so with cross testing gateways!!



## Watch Outs

- Testing may be required for match
- Testing if suspend or terminate SH
- Watch out for gateways in a cross-tested plan



## Watch Outs

- Plans with After-tax contributions must run an ACP test
- These are employee contributions not the Roth!



## Testing SH Plans – Example 1

- Plan makes 3% Nonelective Safe Harbor
- Plan makes a **discretionary match of 6%** for 2014
- Match is for both HCEs and NHCEs
- Match is on first 6% deferred
- Match is not subject to employment on the last day of the year
- Note: ADP still is SH



## Testing SH Plans – Example 2

- Plan makes 3% Nonelective Safe Harbor
- Plan makes a discretionary match of 4% for 2014
- Match is for both HCEs and NHCEs
- Match is on first 4% deferred
- Match is subject to employment on the last day of the year
  - HCE gets it
  - If one NHCE leaves then the ACP test must be run!
- Note: ADP still is SH



[www.asppaontour.org](http://www.asppaontour.org)



## Testing SH Plans – What to Test

- What to Test??
  - Include all matching contributions,
  - OR
  - Only those not considered safe harbor



[www.asppaontour.org](http://www.asppaontour.org)



## Testing SH Plans – Example 3

- What to Test??
  - In the following example assume that NHCE #3 leaves during year and does not get additional match



### Safe Harbor Matches – Example #3

Status	Comp	Deferral	4% SH Match	2% Add Match
HCE #1	\$260,000	\$17,500	\$10,400	\$5,200
HCE #2	\$260,000	\$17,500	\$10,400	\$5,200
NHCE #1	\$100,000	\$16,500	\$4,000	\$2,000
NHCE #2	\$60,000	\$4,000	\$2,400	\$1,200
NHCE #3	\$40,000	\$1,200	\$1,200	\$0
NHCE #4	\$25,000	\$0	\$0	\$0



## Safe Harbor Matches – Example #3

Status	ACP w/ Excess	ACP w/ All	Result Excess	Result - All
HCE #1	2%	6%	Passes	Fails
HCE #2	2%	6%	2%	6%
NHCE #1	2%	6%		
NHCE #2	2%	6%		
NHCE #3	0%	3%		
NHCE #4	0%	0%	1.0%	3.75%



## Watch Outs

- Testing if suspend or terminate SH
- What to Test??
- Entire plan year – current year testing method
- Per Final Regs – remember to pro-rate maximum salary (both match and nonelective plans)





## Watch Outs

- Gateway - 5%
- Remember – if an NHCE gets 3% SH and for some reason (hours or termination) does not get full gateway – trouble may ensue



## Distribution Issues

- Hardship distributions – Active employees may not take funds from a SH source prior to age 59 ½
- Same as QNECs/QMACs



## 2009 IRS Q & As

- Post-Severance Compensation (part 3 of 5)
- Employee terminates in December 2009
- Final payment of salary made in January 2010
- Plan allows elective deferrals of post-severance
- Plan does NOT use the special “first few weeks rule”
- Plan is a Safe Harbor plan
- Participant is entitled to 2010 Safe Harbor (Either nonelective or match) – remember that there are no accrual requirements (hours or last day) to receive SH



[www.asppaontour.org](http://www.asppaontour.org)



## 2009 IRS Q & As

- Post-Severance Compensation (part 5 of 5)
- Employee terminates in December 2009
- Final payment of salary made in January 2010
- Plan has Safe Harbor contributions for 2010
- Plan also has non Safe Harbor nonelective contributions for 2010
- Participant would not receive any since not employed on last day (assume plan has that provision)
- Still has to meet gateway for 2010 if cross testing is used



[www.asppaontour.org](http://www.asppaontour.org)



## It's Over – IRS Notice 2013-74

Safe Harbor 401(k) plans that must make a mandatory 3% nonelective contribution are provided relief if there is either:

- The Employer is operating at an economic loss, or
  - The SH Notice contains wording that the SH may be terminated during the year
- Note: You do not have to apply for relief now (but document for audit)



[www.asppaontour.org](http://www.asppaontour.org)



## It's Over – IRS Notice 2013-74

Safe Harbor 401(k) plans that must make a SH match contribution have previously been allowed to terminate the SH but for PYs after 2014:

- The Employer is operating at an economic loss, or
  - The SH Notice contains wording that the SH may be terminated during the year
- Note: You do not have to apply for relief now (but document for audit)



[www.asppaontour.org](http://www.asppaontour.org)



## It's Over

### Must still

- Test for full Year (current year testing)
- Top heavy applies
- Plan is amended
- Notice to Participants 30 days
- All contributions made up until effective date of the amendment



[www.asppaontour.org](http://www.asppaontour.org)



## Still no answers on the following

- What mid-year changes to a SH plan can be made once the SH notice has been distributed (other than adding Roth deferral, Roth Conversion or Hardship). You can also adjust the definition of spouse in light of the Windsor decision, if necessary.
- We might get further guidance...stay tuned



[www.asppaontour.org](http://www.asppaontour.org)



## Final Thoughts

- Employers may want to re-consider the option of a SH plan
- Maximize deferrals
- Limit employer contributions with creative use of match
- Avoid TH in some plan designs
- Get as much into plans now in case limits get tinkered with because of deficit reduction actions



[www.asppaontour.org](http://www.asppaontour.org)



## Had Enough for One Day

- Questions???
- Thank you for your attendance and participation



[www.asppaontour.org](http://www.asppaontour.org)

