401(K) SAFE HARBOR

401(K) PLAN | SAFE HARBOR PROVISION | QACA SAFE HARBOR

401(K) PLAN

401(k) Plans are required to have a plan document that outlines the rules and procedures an employer must follow to comply with IRS regulations. Within this plan document, employers have many provisions to decide between. One provision allows for pre-taxed employee contributions, called deferrals*, while another allows for after-tax employee contributions or Roth deferrals. Employees decide how much they will defer out of their paycheck and if those deferrals will be taken on a pre-Tax or Roth basis.

The assets of the 401(k) Plan will be held in a Trust and each employee is commonly able to direct their own investments.

Many owners and highly compensated employees (HCE) are limited to the amount they are able to defer or contribute because non-highly compensated employees (NHCE) choose to defer very little or sometimes don't participate at all. This is when a Safe Harbor provison or QACA Safe Harbor becomes beneficial to the success of a 401(k) Plan.

401(K) PLAN

Employer sponsored retirement plan where employees elect how much to contribute* into their retirement account directly through payroll deductions.

SAFE HARBOR

A tax-deferred employer contribution given to eligible employees within their 401(k) Plan. Fully vested and promised annually.

QACA

Qualified Automatic Contribution Arrangement requires an automatic employee deferral minimum of 3% that increases 1% annually up to 15%. Employee may opt-out.

*Deferrals or Employee Contributions are always fully vested.

Safe Harbor Provision

Allows owners and HCE's to defer or contribute up to the IRS Maximum each year that the provision is in place. Safe Harbor exempts the plan from the actual deferral percentage (ADP) test and may help with the actual contribution percentage (ACP) test. Safe Harbor is a fully vested employer contribution. There are three types of Safe Harbor contributions if we consider the QACA Safe Harbor Provision.

Types of Safe Harbor Contributions

Safe Harbor Match: Basic Safe Harbor Match is 100% up to the 1st 3% of Deferrals and 50% up to next 2% of Deferrals. Employee must defer at least 5% of they pay to receive the full Safe Harbor Match. Enhanced Safe Harbor Match is 100% up to the 1st 4% of Deferrals. Both are equal and do not exceed 4% of an employee's pay. Like any employer match, an employee must participate (defer money into the plan) to receive a Safe Harbor contribution.

Safe Harbor Non-Elective: Employer contribution is equal to 3% of an eligible employee's pay. Employee is not required to participate to receive the Safe Harbor nonelective contribution.

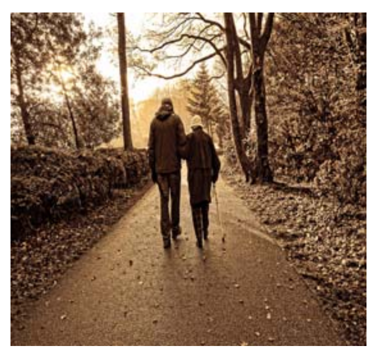
QACA with Safe Harbor

An Automatic Contribution Arrangement that defaults employee deferrals starting at 3% of pay and gradually increases each year an employee participates (not to exceed 15%). Employer must either:

- Make a Safe Harbor matching contribution of 100% up to 1st 1% of deferral plus 50% up to next 5% of deferral equal to 3.5% of employee's pay
- Or make a nonelective contribution to all eligible participants equal to 3% of pay.

Employees must be 100% vested in the employer's matching or non elective contributions by two years of service.

Reference IRS Code Section 401(k)(3) or irs.gov/pub/irs-pdf/p560.pdf



Actual Deferral Percentage Test

Participants in a 401(k) Plan fall into one of two categories, HCE and non-HCE. An HCE (highly compensated employee) is a 5%+ owner or an employee who earned more than $150,000 in 2023 and $135,000 in 2022. One of several nondiscrimination tests a plan must satisfy in order to remain IRS compliant is an actual deferral percentage test. The average deferral of all NHCE contributions to the plan are directly compared to the average deferral percentage of all HCE. *See below*.

Sample ADP Test

Employees	Deferral %	Average Deferral %
NHCE 1	10%	10 + 5 + 0 + 3 ÷ 4
NHCE 2	5%	is
NHCE 3	0%	**4.5%**
NHCE 4	3%	
Owner 1	13%	13 + 10 + 8 ÷ 3
HCE 2	10%	is
HCE 3	8%	**10.33%**

Maximum Allowable Spread Between NHCE and HCE

NHCE Average	Maximum HCE Avg
Less than 2%	NHCE average x2
Between 2% - 8%	NHCE average +2
More than 8%	NHCE average x1.25

IRS Code Section 401(k)(3)

The Sample ADP Test <u>does not pass</u> because the NHCE Average is between 2%-8% and the Max Allowable Spread is 4.5% +2 = 6.5%. Owners and HCE are only allowed to defer 2% above the average deferral percentage of the non-highly compensated employees (NHCE). This is a good opportunity for Safe Harbor.

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