Safe Harbor 401(k) Plans

A "Next Level" Retirement Plan

Safe Harbor 401(k) Options vs. SEP-IRA

Census Data				401(k)	ADDITIONAL OPTIONS				
					Matching		Non-Elective		SEP-IRA*
	Age	Years Employed	Salary	Elective Deferral	Employer Match	Employee Total	Employer Contribution	Employee Total	Employer Total
Owner	55	10	$270,000	$24,000	$10,800	$34,800	$8,100	$32,100	27,000
Key	40	8	120,000	10,000	4,800	14,800	3,600	13,600	12,000
Staff 1	35	3	40,000	2,000	1,600	3,600	1,200	3,200	4,000
Staff 2	45	5	35,000	1,050	1,050	2,100	1,050	2,100	3,500
Staff 3	25	1	25,000	0	0	0	750	750	Ineligible
						$55,300		$51,750	$46,000
Percent to Owner						61%		60%	57%

*Does not include allowable employee IRA contributions and catch-up (maximum $5,000 and $1,000 in 2017 respectively).

New Opportunities

Recent very favorable tax law changes have greatly expanded and simplified the retirement plan world. Now, despite some administrative cost, a 401(k) plan may compare quite favorably to a low-cost SEP-IRA for a similar employer contribution. That's because the owners may primarily rely on salary deferrals and secondarily add employer matching or profit sharing contributions until a participant reaches 100% of pay, not to exceed $54,000 (indexed limit for 2017). Those who are age 50 or above may also add "catch-up" contributions, if any legal or plan limitation is reached.

	Deferral	Catch-up	Total Age 50+
2016	18,000	6,000	24,000
2017	18,000	6,000	24,000
2018+	Limits Indexed		

Salary deferrals may be either traditional pre-tax or after-tax using a "Qualified Roth Election" or both. Upon request, the plans offered by Security Administrators, Inc., can include a Roth option so that you may achieve "tax-diversification" at retirement should you so choose.

The Problems

ADP Test. The amount that "highly compensated" employees (i.e., the owners, their family members and other high-income participants) may save is dictated by the savings rate of the other employees. Although the rules are complex, these rules, as a percentage of pay, may be summarized as follows:

Average Deferral Percentage (ADP)

Non-Highly Compensated	Highly Compensated
0%	0%
1%	2%
2%	4%
3%	5%
4%	6%
6%	8%

Top Heavy. Another issue that is very common in the small-business world is the "top heavy" concern. Once more than 60% of the plan assets attribute to the owners, or certain officers, the plan becomes "top heavy." Although having more than 60% of the plan assets is often desired by the owners and other key employees, it may necessitate that the employer contribute 3% of salary to all the eligible employees, or the largest percentage contributed for a key employee, if less.

"Safe Harbor" Solutions

Congress recognized the pitfalls of traditional 401(k) plans and has offered two alternatives for you to consider. These provisions remove the Average Deferral Percentage (ADP) test and also satisfy the "top heavy" concern. However, any safe harbor contribution made using either method must be immediately vested and is owed to all employees even if they leave the plan during the plan year.

Safe Harbor Match. The employer agrees to match employee contributions, with immediate vesting as follows:

- 100% up to 3% of pay
- 50% on the next 2% of pay

Thus, an employee who defers 5% or more of pay will get total matches of at least 4% of pay. Of course, if employees defer less, they get less, or nothing if they are eligible and elect not to make salary deferrals.

Safe Harbor Nonelective. Another very easy way to add a fail-safe provision to the plan is simply to award 3% of pay, with immediate vesting, to each eligible participant. Thus, all employees receive some benefit in the plan, regardless of whether or not they elect to defer anything. This "non-elective" safe harbor may have particular appeal since the 3% required contribution may be used to satisfy the Gateway Minimum contribution required for Super Comparability allocations as discussed in our DASH 401(k) flyer.

Regardless of which "safe harbor" is used, the employer may also make regular profit sharing contributions.

Safe Harbor 401(k) Plans

Automatic Enrollment

One of the goals of the 2006 tax act was to expand the participation rate of all eligible employees in a 401(k) plan. Today, a Plan may use an automatic enrollment feature that presumes that all eligible participants will make a minimum deferral upon entering, unless they specifically elect to opt out.

Studies have proven that automatic enrollment often raises the participation rate from less than 66% to over 90% of eligible employees. The Act also allows the initial deferral rate to be raised in 1% increments each year and defines a Qualified Automatic Enrollment Arrangement to be as follows:

Qualified Automatic Contribution Arrangement	
Year	Deferral Rate
1	3%
2	4%
3	5%
4	6%

A new "safe harbor" was granted in 2008. If you, as the employer, combine a qualified automatic contribution arrangement of new employees with either a matching or non-elective safe harbor, you may add a two-year vesting schedule. The safe harbor matching scenario for a Qualified Contribution Arrangement is 100% up to 1% of pay and 50% on the next 5% of pay. Since most turnover occurs in the first two years of employment, this may be a very valuable tool to consider.

Using These Safe Harbors

As easy as these provisions are to understand, they become a bit trickier to implement. That's because the IRS is concerned that if plan sponsors choose to use these provisions at the end of the plan year, the employees may not be able to take full advantage of them in a short period of time.

1. *A brand new 401(k) can use either design as long as the plan is installed before the fourth quarter of the plan year (e.g., prior to 10/01 for calendar year plans).*
2. *An existing plan must provide notice at least 30 days prior to the beginning of the plan year (e.g., by 12/01 of the preceding year for calendar year plans) stating either that they MAY or they WILL use the provision the following year.*
3. *Assuming the "we may" notice was given in the prior year, the employer must decide 30 days before the end of the current plan year (e.g., by 12/01 for calendar year plan) whether or not he or she will be using the safe harbor to satisfy discrimination testing. If the employer chooses to use the safe harbor, then the plan must be amended to include the safe harbor provisions. Simultaneously, a notice for the next plan year must also be given.*

Because these rules are somewhat cumbersome, SAI recommends that the plan document specify whether or not this will be a safe harbor design in the next or first plan year.

Policy Form Nos: 2098-U, ICC08-2098-U, 2099-U, ICC08-2099-U, 2099-U-NY, IO-4149, IO-4150.

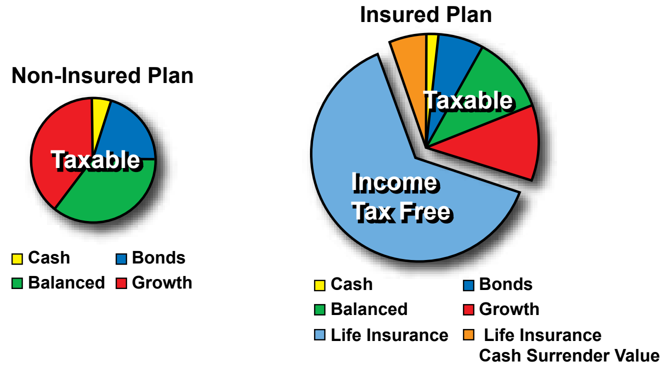
0011810XX 01/2017

Investment Options

Employer and employee contributions should be placed into an investment platform that is designed for 401(k) plans. Allowable investment options are selected by the Plan Trustees. Each eligible participant is typically given the ability to direct the investment of his or her own account by selecting from among the allowable options.

Our 401(k) plan document allows substantial freedom. Suitable investments include mutual funds, group annuity contracts, guaranteed interest contracts or combinations of all of the above.

Enhanced Survivor Benefits



Unlike most 401(k) plan documents offered through a mutual fund company, our 401(k) program can include an optional benefit that will allow you to purchase cash value life insurance to protect your family should you not live to retirement. It may be a wise part of your asset allocation strategy.

When life insurance is purchased inside your Plan, the death benefit in excess of the cash surrender value will be paid to your beneficiaries free of ordinary income tax. Each year while the policy is in the Plan, you will pay income tax on the cost of the life insurance protection. Upon your separation from service or retirement, the life insurance must be removed from the Plan. There are several options available to you at that time, each with its own advantages and tax consequences.

Plan Administration

Before you can make salary deferrals and employer contributions, you must first establish the Plan and Trust. SAI can provide everything you need at a competitive price.

You must adopt the plan prior to the last day of your tax or fiscal year (e.g., 12/31 if you have a calendar-year business, or 10/01 for a new safe harbor plan). All administrative fees are generally deductible to your business.

Let Us Know How We Can Help You

Follow Us