

FREQUENTLY ASKED QUESTIONS SAFE HARBOR

1. What is an ADP/ACP safe harbor 401(k) plan?

A safe harbor 401(k) plan allows adopting employers to automatically pass certain compliance tests if they meet specific contribution and notification rules. The term 'safe harbor' can generally apply to many different scenarios in which the IRS gives a break to those who operate their plan within well-defined boundaries.

2. What are some of the advantages of a safe harbor plan?

Generally, the IRS treats a safe harbor plan as passing the following compliance testing:

- The actual deferral percentage (ADP) test,
- The actual contribution percentage (ACP) test, and
- The top-heavy test.

3. What types of employers benefit from adopting a safe harbor plan?

Aside from owner-only plans, which are generally exempt from non-discrimination testing, employers may benefit from the relief given to safe harbor plans.

- Employers whose highly compensated employees (HCEs) deferrals are limited because of low participation rates or low contribution rates by non-HCEs,
- Employers whose plans are consistently top heavy, and who must make additional contributions to satisfy the top heavy requirements, or
- Employers who consistently make generous (more than 3%) profit sharing or matching contributions.

4. What employer contributions will satisfy the safe harbor requirements?

Employers must choose one of the following contribution formulas, which must be reflected in their plan document (an amended adoption agreement).

Basic Match

- A dollar-for-dollar (100%) match on an eligible employee's deferral that does not exceed 3% of compensation for the year; in addition, the employee receives a 50% match on the next 2% of the employee's deferrals.

Enhanced Match

- A matching contribution that is at least as generous as the Basic Match at any level of employee deferral. For example, the most common Enhanced Matching formula gives eligible employees a 100% match on deferrals that do not exceed 4% of the employee's compensation. This simple formula is more generous than the Basic Match.

Non-elective Contribution

- A contribution given to all eligible employees – even those who do not defer – that equals 3% of the employee's compensation for the year.

Safe harbor requires all match or non-elective contributions be 100% vested.

Safe Harbor Automatic Enrollment with Match Contributions

Minimum participant deferral of 3% of compensation with an automatic increase of 1% per year (up to 6% deferral) and an employer contribution of either:

- 3% of compensation; or
- 100% of the first 1% of compensation and an additional 50% match for deferrals between 1% and 6% of compensation.

A two year vesting schedule may be applied to these safe harbor contributions

Which safe harbor contribution formula best suits the employer depends on various factors, including administrative ease, total cost, and plan objectives. For example, the cost of the safe harbor contribution for the employer each year depends on the level of participation.

If few eligible employees make deferrals, a matching formula may be more cost-effective than the non-elective contribution. If the employer wants to bolster deferral rates, even at a higher cost, they may choose the 4% enhanced match formula.

5. What administrative requirements must the employer satisfy?

Aside from the typical operational compliance rules (following plan provisions, filing Form 5500 annually, etc.), the employer who selects an ADP/ACP safe harbor plan must:

- Operate as a safe harbor plan for the entire plan year,
- Amend the 401(k) document (or adopt a 401(k) for the first time) to add the safe harbor provisions, and
- Notify participants about the safe harbor provisions no less than 30 but no more than 90 days before the start of each new plan year.

If employers fail to provide the proper notice to their employees, additional steps are required.

- In any year that the employer fails to give proper notice, the plan is not considered a safe harbor plan, and is subject to ADP, ACP, and top-heavy testing.
- Because the plan states that a safe harbor contribution will be made, the employer must make the contribution even though this will not result in any testing exceptions.

Employers are responsible for sending this annual notice on time. Goldleaf Partners will supply this notice to the Plan Administrator annually for distribution to all employees.

6. What other information do I need to know about safe harbor plans?

Many employers limit their contributions to the amounts required under their chosen safe harbor formula. Employers may select provisions in their plan document, however, to provide more contribution flexibility.

For instance, an employer may want to make profit sharing or matching contributions in addition to the basic match. This is permissible, provided that the additional contributions do not exceed certain limitations. These limitations are in place to prevent HCEs from getting a disproportionate amount of employer contributions. To illustrate: an employer generally cannot provide a matching contribution on deferrals that exceed 6% of an employee's compensation because non-HCEs typically tend not

to defer higher percentages of their compensation. If an employer exceeds this limitation (and others), the safe harbor relief no longer applies and the employer is again subject to the various non-discrimination tests, thus losing the benefit of making the contributions. So contribution flexibility is permitted, but within limits.

Because of the vast number of contribution possibilities, you should be careful to defer to ERISA experts when an employer is interested in making contributions beyond what the safe harbor rules require.

7. Where can I get additional help on the ADP/ACP safe harbor issues?

Contact your Relationship Manager at 1-866-882-8442.