

# 401(k) Safe Harbor

If a small business owner wants to take advantage of the maximum 401(k) contribution levels allowed, we generally recommend that the plan adopt a safe harbor formula to avoid the ADP (average deferral percentage test) and top-heavy limitations. Since there are two safe harbor options available, a safe harbor match or a safe harbor non-elective contribution, we are often asked how to determine which one is the most appropriate choice for a particular plan.

The safe harbor non-elective alternative requires the employer to make a contribution of 3% of compensation for each eligible employee regardless of whether the employee makes salary deferrals into the plan or not. The benefit of using the 3% non-elective formula is that the 3% safe harbor contribution can also be counted in the new comparability profit sharing allocation formula. This means a higher percentage of compensation may be allocated to the owner(s) with little or no additional contribution required for the other employees. If the goal is to get the maximum contribution allocated to the business owner while still keeping the employee cost at a minimum then the 3% non-elective safe harbor is usually the best option.

The safe harbor matching formula requires the employer to make a match contribution of 100% of the first 3% of compensation that an employee defers and 50% of the next 2% of compensation deferred. The result is a maximum employer contribution of 4% of pay for those employees who defer at least 5% of pay. Of course, it will be less for those employees who choose to defer a smaller percentage of their pay and zero for those who choose not to defer at all. Many employers prefer the match option because they only have to make contributions for those employees who actually defer into the plan themselves. The match can be the best option if the employer does not intend to make any additional profit sharing contribution, since the match does not count in any allocation method that would favor the owner(s).

Another consideration that can impact the safe harbor decision is the percentage of pay the employees actually defer. If the employee participation is very low then the match formula would most likely produce the lowest cost for the employer. However, if the employees defer at the 5% level, the employer's match obligation could be as high as 4% of compensation, higher than the 3% non-elective commitment. The safe harbor election is done on an annual basis, so the owner's goals and costs will need to be reviewed in future years to determine the best safe harbor approach for the situation.

We will be happy to prepare a proposal and explain the pros and cons of both safe harbor applications for any specific business prospect. Remember, the right plan design serves the owner and participants and encourages larger contributions, and thus you will be earning larger and more consistent commissions.

To learn more about safe harbor 401(k) plans, please join us for a live 30-minute webcast on Tuesday, February 9<sup>th</sup> at 11:00 EST. We will discuss the pros and cons of safe harbor 401(k) and show you how you can get involved in the lucrative 401(k) marketplace. To reserve a seat and receive your instructions for web and phone access, email Pension Sales at [pensionproposals@anico.com](mailto:pensionproposals@anico.com) or call our toll free number 1-888-09-6504, option 6.



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