

# Avoid 401(k) Testing With Safe Harbor Matching Contributions

Another year of failed 401(k) testing? Once again having to refund salary deferrals – to yourself and possibly select highly-paid employees? Avoid year-end testing disasters and taxable refunds with a safe harbor 401(k) plan. By adding a “safe harbor” feature to your 401(k) plan, the special 401(k) test – the one that limits your deferrals based on the amount your employees’ defer – no longer must be met, allowing you to contribute the maximum deferral amount permitted by law.

## 401(k) Test vs. Safe Harbor Contribution

In exchange for avoiding the annual 401(k) test, employees must receive a certain level of fully vested employer contributions. Because of this required contribution, is it still beneficial to add the safe harbor feature? Consider the following example which illustrates a traditional 401(k) plan that has failed the annual 401(k) test. The example lists possible test corrections, including either a taxable refund to the owner or fully vested contributions to employees. Alternatively, if the plan was a safe harbor 401(k) plan with matching contributions, no refund of deferrals (\$11,100 plus earnings) would be needed, and the employees’ total safe harbor contributions (\$770) would be less than if the corrective contribution (\$2,400) was made to fix the failed test. The safe harbor 401(k) plan is hands-down the better option!

	Compensation	Deferral	Possible Taxable Refund	Possible Corrective Contribution	SH Plan Design Alternative
Owner	\$185,000	\$18,500	\$11,100	\$0	\$7,400
Employee 1	\$22,000	\$880	\$0	\$1,320	\$770
Employee 2	\$18,000	\$0	\$0	\$1,080	\$0
Total	\$225,000	\$19,380	\$11,100	\$2,400	\$8,170

## Safe Harbor Matching Contribution

A fully vested matching contribution must be made to all non-highly-paid participants who defer – although it can also be provided to owners and “highly-paid” participants as well. The plan document must specify the contribution that will be made, and this information must be provided to participants before the beginning of each plan year. The safe harbor is available under a basic or enhanced matching formula:

### Basic Match

- Under the basic formula, you must match 100% of the first 3% a participant defers, plus 50% of deferrals from 3% up to 5%, with a maximum match of 4% of pay.
- This match automatically satisfies a special matching nondiscrimination test.

### Enhanced Match

- A formula can be designed to equal or exceed the basic match at any rate of deferral, if the match rate does not increase as the rate of deferrals increases.
- This match may or may not automatically satisfy the special matching test.

The safe harbor feature works best in a plan with low employee participation, resulting in frequent testing failures. If that describes you, with careful plan design, you may be able to avoid complex 401(k) testing and maximize your annual salary deferrals. And that’s just one of the advantages of a safe harbor 401(k) plan!

Please contact us for more information on safe harbor 401(k) plans and how we can help you take advantage of this opportunity to use your 401(k) plan more effectively.

*Design Alternative – A safe harbor 401(k) plan can instead be designed with a required 3% of pay “nonelective” contribution to all eligible participants, even if they do not defer.*

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