



# Retirement Plans Safe Harbor

## Am I Safe?

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## Agenda

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- Introduction
- Definitions
  - Safe Harbor, Nondiscrimination
- Examples
- Other Benefit Plan Safe Harbors
- Other Current Retirement Matters
- Questions

## Introduction

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- Emily Toler, Partner
  - 17 years of experience
- Patricia Willhite, Senior Manager
  - 10 years of experience
- CapinCrouse LLP
  - 45+ years of serving nonprofit organizations
  - Majority are faith-based
  - National firm with clients in 45 states
  - Among the top 200 of 9,200+ firms performing employee benefit plan audits, based on Department of Labor statistics

## Definitions

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- Safe harbor – A plan that is designed to pass the ADP/ACP test and top-heavy minimum contributions testing
- ADP – Actual Deferral Percentage
- ACP – Actual Contribution Percentage
- Nondiscrimination – A set of tests designed to inform a plan sponsor if the plan is benefiting highly compensated employees (HCEs) more than non-highly compensated employees (NHCEs)

## Definitions

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- HCE:
  - Owned more than 5% of the interest in the business at any time during the year or the preceding year, regardless of how much compensation was earned or received, or
  - For the preceding year, received compensation from the business of more than \$120,000 (indexed annually), and if the employer chooses is in the top 20% of employees when ranked by compensation
- NHCE – Everyone else (mutually exclusive categories)

## Safe Harbor Design

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- Elective
  - Employer matches 100% of all employee contributions up to 4% of their compensation
  - Employer matches 100% of all employee contributions up to 3% of their compensation, plus 50% of the next 2% of their compensation
- Nonelective
  - Employer contributes 3% of the employee compensation, regardless of whether the employee contributes

## Safe Harbor Design

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- Compensation
  - Must use a definition of compensation under Section 414(s) of the IRC
  - Generally “W-2 wages,” income tax withholding income, or certain permitted modifications
  - Cannot include MHA in definition of compensation

## Safe Harbor Design

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- Nearly all safe harbor contributions must be 100% vested immediately
- 401(k), QACA 401(k), 403(b) plan designs can be safe harbor and have no top-heavy testing; profit-sharing safe harbor requires top-heavy testing

## QACAs

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- QACA 401(k) is a qualified automatic contribution arrangement 401(k) that enrolls any eligible employee who doesn't make an affirmative election at the specified deferral rate
- Matching formula is 100% on the first 1% and 50% on the deferrals 1% to 6% (3.5% total)
- Required to offer a qualified default investment alternative
- Default deferral rate must start at 3% and increase 1% annually to no less than 6% and no more than 10%
- Can do up to a 2-year cliff vesting schedule

## Safe Harbor Key Dates

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- October 1<sup>st</sup> – deadline to establish a new safe harbor plan for the current calendar year or for amending the IRS plan documents for existing plans to enact a safe harbor for the following calendar year
- January 1<sup>st</sup> – the date on which existing 401(k) and 403(b) plans can begin anew as safe harbor

## Safe Harbor Notice Requirements

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- 30 – 90 days before the beginning of the plan year, must send out safe harbor notice
  - Notify that the upcoming year is safe harbor and the related provisions
  - Any other contributions that can be made, including how those contributions will vest and when they are allowed to be distributed
  - Explanation of whether an employee is required to make a contribution in order to receive the safe harbor match

## Safe Harbor Notice Requirements

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- 30 – 90 days before the beginning of the plan year, must send out safe harbor notice
  - If Roth option exists, explanation of Roth and pre-tax contributions
  - Contact person's information if employee desires additional information
  - Disclaimer that employer is not required to offer safe harbor or other plan
  - Distribute to all eligible employees (electronic, hand, mail)

## Safe Harbor Design Pros

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- Automatically passes 2 of 3 non-discrimination tests
- Allows employees to contribute the maximum allowable amounts
- Doesn't restrict employee contributions from HCEs
- Incentivizes retirement savings by offering a match
- Match is tax-deductible for employers

## Safe Harbor Design Cons

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- Committed to the plan design for one year with annual review
- Less flexibility in changing plan design due to compensation rules, annual deadlines, and requirements
- Depending on employee salaries, can be rather expensive
- If design is 100% vested immediately and high turnover, can be more expensive

## Safe Harbor Is Not Always Safe When...

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- Employee deferrals are subject to shorter eligibility requirements than safe harbor contributions
- A discretionary profit-sharing contribution (including forfeiture reallocations) is made by the employer
- A discretionary match that is not exempt from ACP testing is made by the employer

## Safe Harbor Is Not Always Safe When...

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- Non-Roth after-tax contributions are made by participants
- Practice has not matched the plan document
  - Particularly regarding definition of compensation

## Definitions – ADP Test

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- The actual deferral percentage of the HCE group must be within a certain percent of the actual deferral percentage of the NHCE group
  - Include pre-tax and Roth deferrals; exclude catch-up contributions
  - Divide by compensation
  - Done on an individual basis and then averaged for each group
  - Must include eligible employees who do not contribute – 0% average

## Definitions – ADP Test

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- 1.25 Test – Average HCE % cannot exceed 125% of the average for the NHCE
- 2% Spread – Average HCE % cannot exceed the lesser of:
  - 200% of the average for the NHCE
  - Average of the NHCE, plus 2%

## Definitions – ADP Test

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- Purpose – ensure that all participants, both HCEs and NHCEs, are benefiting from the plan
- Note that 403(b) plans are not subject to ADP testing

## Definitions – ACP Test

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- The actual contribution percentage of the HCE group must be within a certain percent of the actual deferral percentage of the NHCE group
  - Include matching contributions and after-tax deferrals except Roth deferrals; exclude catch-up contributions
  - Divide by compensation
  - Done on an individual basis and then averaged for each group
  - Must include eligible employees who do not contribute – 0% average

## Definitions – ACP Test

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- 1.25 Test – Average HCE % cannot exceed 125% of the average for the NHCE
- 2% Spread – Average HCE % cannot exceed the lesser of:
  - 200% of the average for the NHCE
  - Average of the NHCE, plus 2%

## Definitions – ACP Test

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- Purpose – ensure that actual usage of the plan is widespread and not unfairly benefiting the HCEs

## Definitions – Top-Heavy Test

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- Add all key employees together and calculate their total account balance
- Key employees' balances cannot exceed 60% of the total account balance of the plan

## Why are the tests important?

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- Retirement plans are a tax-advantaged status, both for employers and employees
- Intention is to prove that the highly compensated employees are not receiving a favorable treatment because of their higher compensation status

## What happens when you fail?

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- Specific procedures outlined in IRS regulations on corrections required
- Timeline – 12 months to correct from plan year-end
- Failure to correct jeopardizes the tax-exempt status of the plan

## Common Corrections

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- Calculate required amount to raise ADP or ACP of the NHCEs to the percentage needed to pass the tests and make a qualified nonelective contribution (QNEC) to all eligible NHCEs in that amount
- Calculate excess contributions of HCEs and distribute those excess contributions adjusted for earnings
  - Distributing excess contributions must be done within 2.5 months of plan year-end to avoid excise taxes
  - If not vested, the applicable percentage is forfeited

## ADP Test Example

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- HCE Deferral Percentage – 5.2%, NHCE 3.8%
- 1.25 Test:  $3.8\% \times 1.25 = 4.75\%$  - FAIL XXX
- 2% Spread Test:  $3.8\% \times 2 = 7.6\%$ ,  $3.8\% + 2\% = 5.8\%$ 
  - 5.8% is lesser of the two, so use for testing
  - 5.2% is less than 5.8% so PASS
- ACP Test formulas are the same

## Plan Document Example

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- Compensation is W-2 wages increased by elective deferrals
- Box for annual compensation is checked
- Plan's payroll provider calculates employer match using 100% of the first 3% and 50% of the next 2% of employee elective deferrals each payroll
- No adjustment is done at plan year-end
- Is the plan still technically safe harbor?

## Options for Increasing Participation

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- Participant education
- Auto-enrollment
- Make participation easy and simple
- If not safe harbor, understand participant perception
  - 50% match on 5% or 25% match on 10% typically leads to participants attempting to reach 10% deferred

## Other Benefit Plan Safe Harbors

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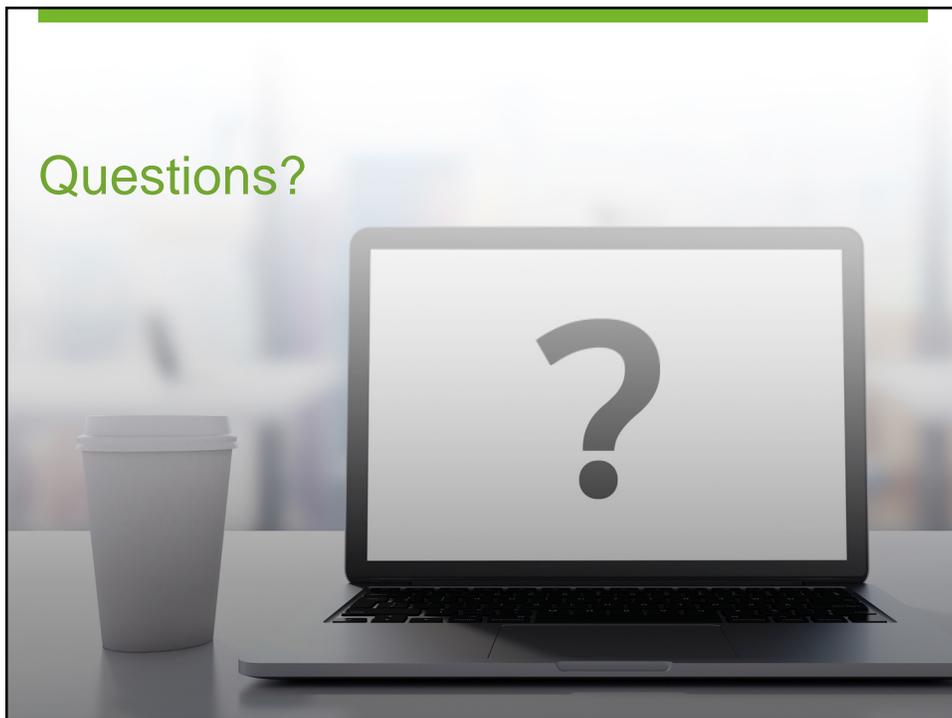
- Contribution remittances for small plans only – 7 business days after contributions are withheld
  - If you have more than 100 participants, the safe harbor does not apply.
  - DOL stands firm that contributions are to be remitted as soon as administratively possible. The “15th business day” rule isn’t a safe harbor for depositing deferrals.

## Other Current Retirement Matters

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- Potential change in limited scope opinion
- Additional scrutiny over PII (personally identifiable information), particularly electronically
- Moving from individually designed plans to preapproved plans
- Potential changes in fiduciary rules

Questions?



## Upcoming Webcast

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Please join us! Learn more at [capincrouse.com](http://capincrouse.com)

### **How Does Tax Reform Affect Your Organization?**

Thursday, February 8

1 p.m. Eastern

Presented by Dave Moja and Ted R. Batson, Jr.



Thank you.

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