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Safe Harbor Plan Administration: Fact or Fiction

Fact or Fiction: Is it true that safe harbor 401(k) plans do not require compliance testing?

This is FICTION and a common misconception among advisors and plan sponsors. While a 401(k) plan that provides safe harbor contributions may undergo minimal compliance testing, a safe harbor option does not guarantee there will not be any required testing for the plan. It also does not result in the plan not needing administration.

As a brief review, a safe harbor 401(k) plan is a 401(k) plan that provides participants with one of two employer contributions: either a safe harbor matching contribution in the amount of at least 4% of compensation for every 5% the participant defers, or a 3% nonelective contribution to each participant regardless of whether he or she participates through deferral. By providing a safe harbor contribution, the 401(k) plan is deemed to pass the Actual Deferral Percentage Test (ADP) and the Actual Contribution Percentage Test (ACP). In addition, if the plan sponsor provides no other contributions aside from the safe harbor contribution, including forfeitures, the plan is deemed to pass top-heavy testing. However, even in this scenario the plan is still required to perform a 410(b) coverage test.

A safe harbor 401(k) plan is a utopian scenario that requires many other cohesive pieces such as:

- The compensation definition needs to meet Internal Revenue Code (IRC) guidelines, typically meaning there are no compensation exclusions.
- If the plan is providing a profit sharing contribution, the plan is subject to the top-heavy test and the allocated contributions must be reviewed to ensure they meet the top-heavy minimum requirements, or additional employer contributions may be required.
- Review eligibility requirements for all participants to determine the appropriate plan entry date and the proper contribution and deferral opportunities.
- Review the vesting schedule to determine if participants are receiving the proper distribution percentage.
- Review distributions to plan participants to determine that only those who are eligible to take a distribution are taking one.

- Plan documents must be kept up to date, and amended as needed. Also, if a plan has an automatic enrollment feature, as was reported in the Goldleaf Partner's July 2011 issue of the Plan Sponsor Newsletter, additional administration often applies to ensure the feature is running correctly.

A safe harbor arrangement certainly can provide many benefits to plan sponsors and can ease the burden of compliance testing. It is essential to ensure a retirement plan administrator is providing comprehensive compliance services as any shortcuts in the process can lead to costly corrections in the future.

Practice Tip: Work with your plan administrator to affirm he or she is providing thorough compliance services on safe harbor plans. A plan which is not in compliance may incur costly corrections to remedy administration oversights or mistakes, and may jeopardize a sound relationship with a plan sponsor.

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