

Ask The Lawyer

401(k) SAFE HARBOR PLANS

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Despite Enron and the falling stock market, the 401(k) still remains one of the most popular forms of retirement plans. It allows employers to share the cost of providing retirement benefits with employees, getting them actively involved in planning for their own retirement. Certain changes enacted by Congress over the last several years have made a particular type of 401(k) plan, called the "401(k) Safe Harbor Plan," even more attractive.

Since 1999, sponsors (employers) have had the option of adopting a 401(k) safe harbor plan, which eliminates the need to test salary deferrals for nondiscrimination and allows highly compensated employees to maximize their savings. Recent IRS guidance has made the safe harbor plan an attractive and flexible design alternative. Our focus is on the key issues you should consider in determining if it is an appropriate design alternative for you.

In order for a plan to qualify as a 401(k) safe harbor, two basic requirements must be met. The most important is for the employer to provide contributions to the employee accounts. This requirement may be met in one of two ways: using a safe harbor matching contribution or a safe harbor fixed contribution.

Employers using the safe harbor matching contribution method must provide a fully vested matching contribution, consisting of a 100% match of an employee's elective deferrals up to the first 3% of pay and a 50% match on deferrals on the next 2% of pay. As an alternative, the employer may match 100% of deferrals up to 4% of pay.

To meet the requirements for the safe harbor fixed contribution, the employer must make a fully vested employer contribution for every non-highly compensated employee participant.

The choice between the two contribution methods should be considered carefully. The total amount of the safe harbor matching contribution depends on the employees' actual deferrals so it is more difficult to budget. In addition, the safe harbor fixed contribution is allowed to do "double duty" by being counted for the 401(k) safe harbor and the "top heavy" test. If the proportion of the plan's total fund is heavily weighted towards the account(s) of the owner(s) or key employees, it is likely to be "top heavy" and thus require a "top heavy contribution" equal to 3% of pay for each non-highly compensated participant. In this case, for the same 3% cost, both tests are met.

The second 401(k) safe harbor plan requirement is the notice requirement. Employees must be notified that the plan will be a safe harbor, describing its major provisions and providing information on a contact person they can speak to if they have additional questions. If the plan uses the 3% fixed safe harbor method, employees must be notified prior to the beginning of the plan year. If the employer is uncertain or

simply wants more flexibility, this notice may state that the plan may be a safe harbor plan, but the employer has until one month before the end of the plan year to make a final decision about amending the plan. If a decision is made to use the safe harbor at that time, an additional notice must be provided, although this can be combined with the anticipatory notice for the next plan year.

If the plan uses the matching contribution method, the plan sponsor must amend the plan and notify participants one month before the plan year begins so that the employees may make their deferral decisions based on their knowledge of the matching contributions that will be made on their behalf under the plan.

Employers should consider the 401(k) safe harbor design if their plans fall into one or more the following categories:

- The plan is already "top heavy."
- The plan experiences test failures.
- The plan benefits a large number of highly-compensated employees.
- The plan already provides generous employer contributions.
- The objective is to maximize deductions.

Use of a safe harbor plan may reduce the complexity and cost of plan administration. But the major benefit for small plans is that highly-compensated employee participants (usually the owner or owners) can defer the maximum amount allowed without considering the deferrals of non-highly compensated employee participants. In 2002, the maximum deferral allowed is \$11,000, or \$12,000 for participants 50 years of age or older. For 2003, those amounts will increase to \$12,000 and \$14,000 for participants 50 years of age or older. □

SSA offers 401(k) safe harbor plans for small business. For more information, call SSA toll-free at (800) 836-4772 (4SSA).

Small-Biz Snapshot

Working longer hours is not unique to small business. A nationwide survey finds employees are working harder and longer, largely because of the need to do the same amount of work despite layoffs.

- 39% Arrive at work early and stay late
- 30% Work late after arriving on time
- 46% Work 40 hours or more
- 50% Spent 45 minutes or less at lunch
- 35% Take 30 minutes or less at lunch
- 67% Have lunch at their worksite

Source: CareerBuilder.com

