Maximize your Executives' 401(k) Contributions

Traditional 401(k) Plans and Testing

As a result of nondiscrimination testing, which compares the amount the highly compensated employees contribute to their 401(k) in relation to the non-highly compensated employees, many executives are unable to fully contribute to their 401(k) plan. These executives generally are defined as those who are at least five percent owners of the employer, or they received compensation of more than $110,000 in the prior year.

It has become increasingly common for traditional 401(k) plans to fail the annual nondiscrimination test as many non-highly compensated employees reduce or eliminate the amount they contribute due to the uncertain economic climate. A failed test typically results in taxable refunds of 401(k) deferrals to highly compensated employees.

The Safe Harbor Design Alternative

With a Safe Harbor 401(k) plan, the annual nondiscrimination tests are deemed satisfied. This means that executives can contribute the maximum allowed by law without regard to what the other employees contribute. In order to qualify as a Safe Harbor 401(k), the plan must contain either:

- An employer matching contribution that is immediately 100% vested and equal to 100% of the first 3% of employee deferrals and 50% of the next 2% of deferrals; or
- An employer profit sharing contribution that is immediately 100% vested and equal to 3% of eligible compensation.

In addition, there is a another form of Safe Harbor 401(k) plan, called a Qualified Automatic Contribution Arrangement, that permits the use of a reduced employer matching contribution and a two-year vesting schedule if an automatic enrollment feature is utilized.

Summary

There are several plan design options available if your 401(k) plan is limiting the amount that highly compensated employees can contribute. The ideal choice will depend upon the demographics of your workforce.

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