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Retirement Plan Newsletter | Q3 2025: Safe Harbor 401(k) Plans

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Offering a 401(k) plan to employees can potentially pose challenges for many small and mid-sized businesses when it comes to nondiscrimination testing. A Safe Harbor 401(k) plan is designed to automatically satisfy nondiscrimination requirements and makes it easier for businesses to offer 401(k) plans.

401(k) plans need to be nondiscriminatory, meaning that they cannot unfairly favor highly compensated employees (HCEs) over non-highly compensated employees. Testing is performed annually to make sure that 401(k) plans are compliant with these rules. This can present a problem when only HCEs or a higher percentage of HCEs contribute to the plan vs. non-HCEs, resulting in either refunds to HCEs or additional contributions from the employer. A Safe Harbor 401(k) plan automatically satisfies these tests by requiring a standard employer contribution to all employees.

In order to benefit from this type of plan design, there are three potential employer contribution designs that will satisfy the Safe Harbor requirements under the traditional design.

Basic Match

- 100% on the first 3% of employee deferrals
- 50% match on the next 2% of deferrals
- Total match: 4% of compensation

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Enhanced Match

- 100% match on the first 4% or more of employee deferrals

Nonelective Contribution

- This is not a match. The employer contributes 3% of each eligible employee's compensation, regardless of whether the employee contributes.

Additionally, it is important to note that under a traditional Safe Harbor design, employer contributions must be 100% vested immediately.

An annual safe harbor notice must be provided to all eligible employees if using a Safe Harbor match. This notice must be provided at least 30 days (and no more than 90 days) before the start of a plan year. In general, a Safe Habor 401(k) plan must be established by Oct. 1 to be effective for that calendar year.

The Safe Habor plan design changes if the plan is using a Qualified Automatic Contribution Arrangement (QACA). QACA is a Safe Harbor 401(k) Plan that uses automatic enrollment, meaning that employees are enrolled at a set deferral rate unless they opt out. This plan design has increased in popularity because SECURE 2.0 required that starting in 2025 all new 401(k) plans must include automatic enrollment. The employer contributions under a QACA Safe Harbor differ from the traditional format in the following ways:

Basic Match

- 100% on the first 1% of employee deferrals, then 50% of the next 5%. (Total match: 3.5% of compensation)

Enhanced Match

- This must equal or be more generous than the basic formula of 3.5% of compensation.

Nonelective Contribution

- This is not a match. The employer contributes 3% of each eligible employee's compensation, regardless of whether the employee contributes.

The QACA design also differs in that the employer can impose a two-year cliff vesting schedule on employer contributions.

Both the traditional and QACA Safe Habor plan designs can benefit employers and employees by streamlining the process. Grimes has a dedicated team that specializes in providing investment advisory services to retirement plan fiduciaries and their employees. We assist clients with investment selection and monitoring, fee benchmarking, plan design and employee education, so please reach out with any questions as to how we can help you achieve your goals.

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