FisherSMB

Safe Harbor Guide

What Is Safe Harbor?

Safe Harbor is a type of employer contribution that can be added to a 401(k) plan in order to help the plan pass compliance testing.

Many owners and highly compensated employees aren't able to maximize their personal contribution to the 401(k) plan because the plan fails compliance testing. This is caused by rank-and-file employees not contributing very much to the plan. Adding a Safe Harbor provision to the 401(k) plan makes the plan automatically pass most compliance testing, allowing owners and highly compensated employees to maximize their personal contribution, thus maximizing their tax benefits in the plan.

Why Safe Harbor Is Important

Every dollar of income you save in your 401(k) reduces your taxable income today, and also grows tax-deferred. High-earning business owners can reduce today's tax bill by thousands of dollars by maximizing their 401(k) savings. Unfortunately, many business owners are not realizing the full benefit of this strategy.

As a business owner, what you save for retirement is tied to what your employees save. Plans often fail compliance testing if the high earners contribute a significantly higher percentage than the rank-and-file employees. There must be a fair balance in the benefits received through the plan. This means that in order for high earners to fully maximize their individual contribution ($23,500 if under 50 and $31,000 if 50 or older), rank-and-file employees must also contribute a significant amount. For plans where this doesn't happen, a Safe Harbor component can be added to the 401(k) in order to automatically pass most compliance testing.

Adding a Safe Harbor component to the 401(k) plan allows business owners (and other high earners) to maximize their personal contribution, thus reducing their personal taxes.

Safe Harbor Benefits and Risks

Benefits

- Enables plans to automatically pass compliance testing, allowing owners to maximize their salary deferral
- Employer contribution is a tax-reducing business expense
- Offers flexible options

Risks

- Can be expensive because of the required annual employer contribution
- Employer contributions are fully vested immediately

Compliance Testing

Annual compliance testing is required for all 401(k) plans. These tests confirm that highly compensated employees (anybody making over $160k/year for 2025, or a 5%+ owner of the company) do not receive a significantly higher benefit than non-highly compensated employees.

If a plan fails compliance testing, the company may be required to make nonelective employer contributions to eligible employees. Sometimes highly compensated employees may be subject to corrective distributions, which can be costly, and an administrative burden.

Safe Harbor can be a remedy for plans who regularly fail compliance testing.

Safe Harbor vs. No Safe Harbor

Tax-Advantaged Retirement Plan Contributions

Owners: 3
Total Employees: 10
Owner Goal: Maximize Personal Plan Contributions

- Without Safe Harbor
- With Safe Harbor

Owner's Personal Plan Contributions

	Before (without Safe Harbor)	After (with Safe Harbor)
Can owners contribute maximum contribution amount of $31,000 annually?	No	Yes
Are owners making Safe Harbor contributions to employees?	No	Yes
Does plan pass compliance testing?	No	Yes
Does plan make corrective distributions to owners?	No	Yes

Three Options for Safe Harbor Contributions:

	Nonelective Safe Harbor	Basic Safe Harbor Match	Enhanced Safe Harbor Match
	Eligible employees get an annual employer contribution of 3% of their salary. This amount is immediately fully vested and the employee gets it whether or not they contribute to the plan.	The employer matches 100% of the first 3% of each employee's contribution and 50% of the next 2%. Employees are required to contribute to their 401(k) in order to get the match.	The employer matches 100% of the first 4% of each employee's contribution. Like a Basic Safe Harbor Match, employees are required to defer money to their 401(k) in order to qualify for the match.
Consider using this type of Safe Harbor if:	Participation is high	Plan participation is low	You want to provide an enhanced benefit to participating employees
Pros:	• Simple • All employees receive a benefit • Contribution is limited to 3%	• Encourages plan participation • Can be most cost-effective if the plan has low participation	• Encourages plan participation • Provides an enhanced benefit to participating employees
Cons:	Can be expensive because all employees must get contributions, even those who don't participate	Can be expensive if plan participation is high	Can be expensive if plan participation is high

When to Consider Safe Harbor

Your 401(k) plan has recently failed annual compliance testing.

You and your highly compensated employees are not able to contribute the maximum to your 401(k) account due to the risk of failing compliance testing.

You have been forced to make employer contributions in the past.

Many of your non-highly compensated employees don't contribute to the 401(k) plan.

Sample Scenarios for Safe Harbor

1

Businesses with Fewer Than 10 Employees

If you have 10 employees, including owners, and two highly compensated employees want to contribute the maximum to their 401(k), but the rest of the employees aren't contributing, then Safe Harbor will help. Adding Safe Harbor will allow the two employees to contribute the maximum and the plan will pass compliance testing.

2

Businesses with 50 to 80 Employees

If your business has 50 to 80 employees and those who are highly compensated want to max out their 401(k) contributions, while others are not contributing at all, then a Safe Harbor provision can help. This way your employees who want to contribute the maximum can, and you can even add a Profit Sharing component—and still pass compliance testing.

3

Businesses with "Top-Heavy" 401(k) Plans

If your 401(k) plan is "top heavy," which means that the portion of 401(k) assets allocated to owners and other key employee is greater than 60% of the total assets in the plan, then the employer Safe Harbor contribution will allow key employees to maximize 401(k) contributions.

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Optimizing a 401(k) with a Safe Harbor component can allow business owners (and other high earning employees) to maximize their 401(k) contribution (up to $31,000 per year) without fear of compliance testing.

Safe Harbor — Key Takeaways

- Often, the most efficient way for a business owner to maximize their personal 401(k) contribution is to add a Safe Harbor component to the 401(k) plan.
- Adding a Safe Harbor component to the 401(k) plan allows business owners (and other high earners) to maximize their personal 401(k) contribution: $23,500/year ($31,000 if over age 50).
- A 401(k) with a Safe Harbor component will automatically pass compliance testing.

Helpful Resources

Safe Harbor Case Study

Check out this case study and find out how to increase your personal annual retirement contribution with a Safe Harbor 401(k).

Safe Harbor 401(k) 101

Everything you need to know about starting a Safe Harbor 401(k), all on one helpful page.

Does Your Business Have a Top-Heavy Plan?

In this article, we lay out the challenges and solutions for "top heavy" retirement plans.

Schedule a Consultation

Give us fifteen minutes and we'll consult on an actionable plan to optimize your retirement program for your specific goals.

Contact Us

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