Safe Harbor 401(k): A Retirement Plan for Your Businesses

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Introduction to Safe Harbor 401(k)s

The Safe Harbor 401(k) plan is an employer-sponsored, defined-contribution investment account, often backed by private businesses, that helps employees save and prepare for retirement. Developed by the Small Business Job Protection Act of 1996, the Safe Harbor was designed to increase plan adoption among businesses by simplifying the administration associated with such plans. By electing for a Safe Harbor 401(k) plan, businesses can offer employees a retirement plan with significant tax benefits while avoid costly testing requirements of a regular 401(k) plan.

Why Should I Consider a Safe Harbor 401(k) for My Business?

There are many reasons you should consider a Safe Harbor 401(k) retirement plan for your business. Depending on the profile of your business, the Safe Harbor 401(k) rules may be the most beneficial to you and your employees.

Tax-Deferred Growth for Employee Portfolios

Like other retirement account types, the Safe Harbor 401(k) allows assets invested in the account to grow on a **tax-deferred** basis. This means account owners won't incur any tax liability until withdrawing the assets in retirement, at which point the withdrawals are taxed as ordinary income. The impact of **tax-deferred** growth is massive in the long-term.

Tax Deductibility of Contributions for Your Business and Employees

Contributions to Safe Harbor 401(k) are **tax deductible** for both the business and the employee. Employer contributions are tax deductible for the business, while employee contributions are tax deductible to the employee.

Reduced Compliance Testing

Safe Harbor 401(k) plans are not subject to the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) annual nondiscrimination tests that traditional 401(k) plans are. By committing to mandatory employer contributions, either as a match or a non-elective contribution, Safe Harbor plans satisfy these tests automatically, reducing administrative hassle.

Who Can Own a Safe Harbor 401(k)?

Only employees of employers that offer a Safe Harbor 401(k) plan can contribute to such a plan. Employees of companies without a Safe Harbor 401(k) plan cannot create and contribute to their own account of this type (although other retirement account options, such as IRAs, do exist).

To be eligible, the employee must also meet all of the requirements of the employer, which can include minimum age, tenure, and number of hours worked throughout the year (applicable to part-time employees). Employer requirements must be applied uniformly across all employees.

There are no age limits for contributing to a Safe Harbor 401(k)—people of all ages can contribute—and no income restrictions either.

What are the Rules for Safe Harbor 401(k) Contributions?

Employers and employees, alike, can contribute to a Safe Harbor 401(k).

Employees have the option to contribute as much of their earnings as they would like to their Safe Harbor 401(k), up to the annual limit. Contributions are typically made through payroll deductions every pay period, but if the plan allows it, employees can make a lump sum contribution.

Employers can choose to make either a non-elective flat contribution of 3% of compensation to employee accounts, or match 100% of the first 3% of employee contributions plus 50% of the next 2%. If the latter is chosen, the employer will only contribute if the employee contributes. Employer contributions must be deposited by the federal income tax return due date for your business, including any extensions. While all employees need to be provided with the same terms, the employer can switch between matching and non-elective contributions from one year to the next.

All contributions—both employer and employee—to a Safe Harbor 401(k) are immediately vested to the employee.

How Much Can Be Contributed to a Safe Harbor 401(k)?

In 2025, the maximum contribution an employee can make to a Safe Harbor 401(k) plan is $23,500. When combined with employer contributions, the maximum contribution to any one 401(k) account each year is $70,000 (the split between employee and employer contributions does not matter).

Those who are at least 50 years old are eligible for a bonus contribution amount of $7,500, and those who are between 60 and 63 years old can contribute a bonus amount of $11,250. These "catch-up" contribution amounts increase the maximum contribution for both the employee and combined limits, alike. The employee limit, combined limit, and catch-up contribution amount are occasionally revised in order to adjust for cost of living and inflation.

Additionally, Safe Harbor 401(k) contributions are restricted to the income earned with a given employer, only. Income generated outside the compensation of your employer (such as investments or a second job) cannot be contributed to a Safe Harbor 401(k).

What is a QACA Safe Harbor 401(k)?

A Qualified Automatic Contribution Arrangement (QACA) Safe Harbor 401(k) is a variation of a Safe Harbor 401(k) that allows employers to implement a vesting schedule for all employer contributions. While a vesting schedule may help retain key employees that participate, the vesting schedule cannot go beyond two years.

In order to pursue a QACA, your business must automatically enroll participants in the plan and have automatic escalation features in employee contribution rates. Employees can opt out of the escalation feature or employee contributions entirely.

Employer contributions are potentially lower than in a regular Safe Harbor 401(k), as well. Minimum initial employer contributions are either a non-elective flat contribution of 3% of compensation to employee accounts, or match 100% of the first 1% of employee contributions plus 50% of the next 5%.

How Can My Business Deduct Contributions to Safe Harbor 401(k) Accounts?

The deadline for taking a tax deduction on Safe Harbor 401(k) contributions is the federal income tax return due date for your business, including any extensions. The tax document on which contributions can be deducted depends on how your business is legally organized.

What are the Employer Requirements for a Safe Harbor 401(k) Plan?

Businesses that offer a Safe Harbor 401(k) plan to employees must adhere to the rules set forth by the Employee Retirement Income Security Act (ERISA), although the safe harbor nature does protect the business from certain administrative burdens. Unlike traditional 401(k) plans, Safe Harbor 401(k) plans do not need to administer and pass an **annual nondiscrimination test**.

Most Safe Harbor 401(k) plans are required to file an annual **Form 5500** with the Department of Labor (DOL) and IRS to report plan activities and financial condition. Small plans with fewer than 100 participants may be eligible to file a shorter version, Form 5500-SF.

What are the Withdrawal Rules of a Safe Harbor 401(k)?

Safe Harbor 401(k) plans are subject to specific withdrawal rules that, when not followed, could result in a substantial penalty. Starting at age 59½, you may take distributions from your Safe Harbor 401(k) at any time and in any amount without incurring a penalty. These distributions are included in your taxable income for the year in which you take them.

Those who withdraw funds before age 59½ are subject to penalty in an amount of 10% of the distribution, unless the distribution qualifies for an exception. The most common exceptions include distributions related to birth or adoption expenses (up to $5,000 per child), emergency personal expenses (up to $1,000 per year), federally declared disasters (up to $22,000), certain unreimbursed medical expenses, death or disability of the Safe Harbor 401(k) account owner and separation from service for those aged 55 and older.

Separately, Safe Harbor 401(k) account owners must abide by **required minimum distribution (RMD)** rules. Starting at age 73, account owners are required to withdraw a certain amount from their account each year to avoid a penalty (up to 25% of the value) on the missed RMD. The amount of the RMD is calculated based on life expectancy and account balance.

Can Account Owners Borrow Against the Balance of Their Safe Harbor 401(k)?

Yes, if the plan allows loans. If loans are permitted, participants can typically borrow up to 50% of their vested account balance, with a maximum limit of $50,000. Loans must generally be repaid within five years, unless the loan is used to purchase a primary residence, in which case the repayment period may be longer.

What Types of Assets Can Be Invested in with a Safe Harbor 401(k)?

A Safe Harbor 401(k) allows its account owner to invest in a fairly broad spectrum of assets. Stocks, exchange-traded funds (ETFs), mutual funds, bonds, money market funds, and certificates of deposit (CDs) are all permitted assets in an 401(k). Examples of investments that are prohibited in a Safe Harbor 401(k) include life insurance, artwork and collectibles, S corporation stock, and real estate for personal use, among others.

However, the actual investment options any Safe Harbor 401(k) plan offers is dependent on the choices of the Safe Harbor 401(k) plan administrator. It is not uncommon for Safe Harbor 401(k) plans to have a limited set of preselected stock and bond funds that participants can invest in.

What Other Forms of Retirement Plans Exist for Businesses Like Mine?

There are many other forms of retirement plans that may be a fit for your business, including:

- 401(k) / Roth 401(k) – A tax-deferred retirement plan commonly offered to the employees of large, private employers.
- Solo 401(k) / Roth Solo 401(k) – A 401(k) for self-employed individuals that allows for higher contribution limits.
- SIMPLE 401(k) – A 401(k) plan with more flexibility and less administrative burden for self-employed individuals or small business owners.
- SEP IRA – An IRA with special perks for self-employed individuals or small business owners.
- SIMPLE IRA – Another IRA with special perks for self-employed individuals or small business owners.
- Payroll Deduction IRA – The easiest retirement plan to establish with the least financial and legal requirements for the sponsoring business.

How Can I Start a Safe Harbor 401(k) for my Business?

To get started with a Safe Harbor 401(k) plan for your business, reach out to us at **FreeMind Financial Advisory** and we would be happy to provide a **free strategy session** personalized for your business. We can help determine if a Safe Harbor 401(k) is the best retirement plan for your business, and if it is, we can assist in setting up accounts and onboarding employees.

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