Retirement plans

Knowing when one – or both – is better for your employees

Comparing nonqualified deferred compensation and Safe Harbor plans

Options are good, especially when it comes to saving for retirement. You want to help your key employees save more, while providing a benefit that helps you recruit and keep them for the long term. So selecting the right plan – the right benefit – is important. You can't go wrong with deferred comp and Safe Harbor plans.

Both are good options – and valued benefits – for helping your employees save more than they can in a 401(k) plan. But which plan – or a combination of both – is right for your organization and key employees? Understanding how each works can help you decide.

	Safe Harbor	Deferred comp
Type of plan	Defined contribution	Defined contribution
Nondiscrimination testing	No	No
Employer is fiduciary	Yes	No
Income tax	Pre-tax	Pre-tax
Employer tax deduction	Yes for matching contributions	Yes when benefits are paid
Contribution limits	Up to qualified plan limits	Up to 100% of annual compensation
Employer contributions	Employer match requirements	Optional
Eligibility	Key employees and non-key employees	Key employees the employer chooses
Vesting	Employee contributions immediately vested	Employee contributions always 100% vested, flexibility with employer contributions
IRS reporting	Form 5500 reporting	No Form 5500 reporting[1]
Loans available	Yes	No
ERISA[2] protection	Yes	Limited, plan benefits aren't protected in the event of company bankruptcy
Early withdrawal penalty	10% penalty for withdrawals before age 59½	No age restrictions

[1] Based on the employer setting up the deferred comp plan as required.

[2] Employee Retirement Income Security Act of 1974 (ERISA)

Safe Harbor Plus – when two plans are better than one

Depending on the needs and goals of your organization, you may decide that adding a deferred comp plan to your existing Safe Harbor plan is right for you. With a Safe Harbor plan, you're already allowing your key employees to contribute up to qualified plan limits. By adding a deferred comp plan, they can save even more (up to 100% of their annual compensation).

Some questions to consider

As you work with your financial representative to select the retirement plan that's right for you, consider:

› **Is your organization a pass-through tax entity: S corporation, partnership, limited liability partnership (LLP) or limited liability corporation (LLC)?**

If so, then Safe Harbor and deferred comp plans can be good solutions for your organization. They both can help you recruit, retain and reward key employees.

With deferred comp plans, you can use company contributions with vesting schedules based on service or performance to help in rewarding key employees and making sure they stay with your organization.

But for pass-through entity owners, there are considerations with deferred comp. Owners typically don't take advantage of the benefits because they only get a tax deduction when benefits are paid to key employees. So any increase in taxable income from employer deferrals at the entity level flows directly to the owners. Any decrease in taxable income due to a deferral is offset by the increase in pass-through (K-1) income.

› **What's right for you?**

Both plans are popular retirement plans that help key employees address common issues with traditional retirement plans. But there are differences, and the answer can vary based on organizational goals.

Do you want to allow your key employees to contribute the same amount as all the other employees? If so, a Safe Harbor plan works well – and is why it's the most popular type of 401(k) plan used by small businesses. It can be ideal for a top-heavy plan with low participation and where the organization is fine making the required employer contributions. A Safe Harbor plan allows all employees to save up to qualified plan limits, and you avoid failed plan testing and refunds.

If you're looking to allow the key employees you select to save more (up to 100% of their annual compensation) and want more vesting and plan design flexibility, a deferred comp plan may be what you're looking for. You can choose who to reward, what, if any, employer contributions you provide and what the vesting schedules are to help achieve your organizational goals.