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Safe Harbor 401(k) **Establishment Deadlines**

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Safe Harbor 401(k) Establishment Deadlines

Elective deferrals and associated matching contributions made to a 401(k) plan must satisfy certain non-discrimination rules known as the actual deferral percentage (“ADP”) and the actual contribution percentage (“ACP”) tests. The ADP and ACP tests restrict the amount of elective deferral and matching contributions that highly compensated employees (“HCEs”) may receive under a tax-qualified retirement plan. However, the Internal Revenue code of 1986, as amended, also provides a method for a plan sponsor to “buy its way out” of the ADP and ACP tests. This exception to the ADP and ACP tests is known as a “safe harbor” 401(k) plan and, in exchange for contributing on behalf of non-highly compensated employees as little as a fully-vested three percent of compensation profit sharing contribution or a four percent of compensation matching contribution, HCEs are generally permitted to contribute the maximum deferral amount and receive an associated match exempt from the restrictions normally imposed by the ADP and ACP tests.

Although the greatest burden imposed on a plan sponsor who elects a safe harbor 401(k) plan design feature is usually perceived to be the funding of the safe harbor contribution, there are many other administrative requirements that must be satisfied in order to qualify for the ADP / ACP exemption. One such requirement relates to the plan year of a safe harbor 401(k) plan.

In general, a safe harbor 401(k) plan must be adopted before the beginning of the plan year and maintained throughout a full 12-month plan year. However, in the context of the first year that the plan or 401(k) feature is established, a plan is permitted to have a no shorter than three month plan year for purposes of the safe harbor 401(k) feature. Therefore, it is possible to establish a calendar year, safe harbor 401(k) plan as late as October 1st and still obtain the exemption from the ADP and ACP tests in relation to the remainder of the year.

In that manner, it is possible for a new 401(k) plan to be established or for an existing profit sharing plan without a 401(k) feature to be amended to incorporate 401(k) and safe harbor features for as little as three months while still potentially allowing an HCE to contribute the maximum deferral contribution amount to such plan. In addition, if designed correctly, the profit sharing feature associated with such plan may be effective for the full 12 month plan year allowing the maximum possible total contribution to the plan.

As you might expect, advance preparation and planning is always necessary in order to establish a new tax-qualified plan or redesign an existing one. The same holds true for safe harbor plan design. Therefore, now is the time to consider whether a safe harbor feature is right for your company or your client’s plan in order to ensure that it can be fully operational in advance of the October 1st deadline. For more information about this issue please contact our marketing department at 484-483-1044 or your administrator at Legacy.



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