



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

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Safe Harbor 401(k) Establishment Deadline

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. However, the Internal Revenue Code of 1986, as amended, also allows a plan sponsor to “buy its way out” of the ADP and ACP tests. This design exception to the ADP and ACP tests is known as a “safe harbor” 401(k) plan (“SH Plan”).

In a SH Plan, HCEs generally are permitted to contribute the maximum deferral amount and receive an associated match that is exempt from the restrictions normally imposed by the ADP and ACP tests. This is permitted so long as each non-highly compensated employee (“NHCE”) receives a fully-vested employer contribution of as little as three percent of compensation if provided in the form of a non-elective profit sharing contribution (“SH PS”) or four percent of compensation if provided in the form of a matching contribution (“SH Match”).

Although the greatest burden imposed on a plan sponsor who implements a SH Plan is usually perceived to be funding the mandatory 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 SH Plan.

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

In addition, effective under the Setting Every Community Up for Retirement Enhancement (“SECURE”) Act for plan years beginning after December 31, 2019, a SH Plan employing a SH PS feature can be adopted as late as 30 days *prior* to the end of the full plan year to which it would relate. Also, in the alternative, if a fully vested contribution of at least four percent of compensation is allocated to each NHCE as a non-elective safe harbor contribution, a SH Plan can be established as late as the last day for distributing excess contributions in relation to such full plan year. Generally, this means that a plan that employs a



calendar year plan year will have until December 31st of the year *after* the year to which the safe harbor feature relates to adopt a SH Plan so long as the amount of the non-elective safe harbor contribution is at least 4% of compensation. However, to reiterate, the adoption timing flexibility described within this paragraph is limited to only SH Plans employing a SH PS feature, not a SH Match feature.

As described above, a SH Plan generally has to be implemented before the first day of the plan year to which it relates. However, the exceptions to this rule described above provide significant design flexibility to plan sponsors. This is important because, if employing a SH PS design feature, it can allow a plan sponsor to wait until the year is almost over before determining whether a SH Plan design is necessary to avoid refunds that might otherwise occur as a result of failed ADP/ ACP testing. In addition, if the plan sponsor is willing to give a slightly larger safe harbor contribution, it can now wait until after the end of the plan year before deciding to make a safe harbor election.

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 a SH Plan. Therefore, even with the new SH Plan establishment timing flexibility under the SECURE Act, now is the time to begin 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 applicable 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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