SH101: Safe Harbor 401(k) Overview

Key Points for Decision Makers Post SECURE Act

The last few months of the year are punctuated by a number of important new plan milestones or deadlines. While the SECURE Act did extend the new plan adoption deadline from the last day of plan year up to the tax return due date of the employer, including extensions, this new rule applies only to employer contributions. Salary deferral provisions still have to be in place before a retirement plan can accept employee contributions which requires their adoption during the year. What's more, to take advantage of the safe harbor design in a new 401(k) plan, the salary deferral feature must be effective for at least three months. This requirement did not go away with the passage of the SECURE Act. Therefore, the October 1 deadline remains an important date for calendar-year businesses that wish to establish a new safe harbor 401(k) plan or add a safe harbor 401(k) feature to an existing profit-sharing plan.

A new option added by the SECURE Act is available for current non-safe-harbor 401(k) plans. Employers now have until December 1 to add a 3% safe harbor contribution feature to an existing 401(k) plan retroactive to the first day of the plan year. This option, however, is not available for a safe harbor match feature. Safe harbor match may be added only prospectively, and action continues to be required at least 30 days prior to start of a new plan year, i.e. December 1 for calendar year plans.

For those who miss the December 1 deadline to add the 3% safe harbor contribution feature to their existing 401(k) program, the SECURE Act offers a reprieve. They can elect a safe harbor 401(k) status retroactive to January 1, 2021, if they (1) increase the safe harbor contribution from 3% to 4%, and (2) sign a plan amendment to that effect by December 31, 2021. This option is not available for a safe harbor match feature.

What Is A Safe Harbor 401(k)

In order to retain its tax advantages, a 401(k) plan has to pass a few non-discrimination tests. These tests compare salary deferral and matching contribution amounts allocated to the highly compensated employees (HCEs) and the nonhighly compensated employees (NHCEs). If the ratios fall within the parameters specified by the Internal Revenue Code, the plan is deemed to satisfy these tests. When the ratios are out of line, the tests fail. To remedy the failures, 401(k) plans have a few prescribed methods, which include refunding some (and sometimes all) of the deferrals made by the HCEs, and/or making a special fully vested contribution to the NHCE participants.

A special safe harbor contribution can make a significant difference. A 401(k) plan with a safe harbor provision will satisfy these tests automatically*.* As a result, highly compensated employees are able to maximize their deferrals regardless of the deferral behavior of the rank-and-file participants. The tests will pass even if the rank-and-file participants do not make any salary deferral contributions. Thus, safe harbor often becomes a deciding factor in making a 401(k) plan viable for a business.

How It Works

Plans with a safe harbor feature promise a special contribution. Typically, it is either:

- *A match only for those who contribute a portion of their earnings into the plan*: for instance, a dollar-for-dollar match up to 4 percent of compensation, **or**

- *A contribution to all:* at least 3 percent of pay to all eligible participants, whether or not they send a portion of their earnings into the plan.

Other Benefits

The safe harbor feature brings a variety of other important benefits:

- **Predictability:** Testing failures require a cumbersome refund process or mandate additional contributions by the employer. Safe harbor plans automatically pass these tests, alleviating these concerns: the test in a properly designed and operated safe harbor 401(k) will always pass.
- **A Higher Contribution for Key Players:** Safe harbor plans allow the highly compensated employees, typically the key players in a business, to defer the maximum amount regardless of the rank-and-file employee participation levels.
- **Benefit Cost Management:** By adding a safe harbor 401(k) feature to an existing profit-sharing plan, the employer may be able to reduce the total cost of mandatory contributions to the rank-and-file participants, while maximizing contributions to key players. Since no complex deferral/match testing and corrections are required for a safe harbor 401(k), this feature may significantly reduce plan expenses.
- **Top-Heavy Requirement:** Since a large number of small plans are top-heavy (i.e., more than 60 percent of plan assets belong to key participants), a safe harbor becomes a very helpful design feature: it helps satisfy the minimum contribution requirement for most top-heavy plans.
- **Reduce Profit-Sharing Minimum:** The 3 percent safe harbor contribution can be counted to satisfy the minimum contribution requirement for cross-tested profit-sharing plans, reducing the mandatory funding component for non-owner employees while maximizing contributions for key players.

Read this case study for an illustration of the many advantages of the safe harbor feature.

Rules of Engagement

To benefit from the safe harbor provision, a plan must follow a few rules:

- **Notify Employees:** The IRS requires employers to provide a safe harbor notice to each eligible participant no less than 30 days and no more than 90 days prior to the beginning of the plan year (SECURE Act relaxed this requirement for certain safe harbor plans, but safe harbor 401(k) plans that also use a discretionary match will likely continue to provide this notice to use the testing safe harbor).
- **Fund for All Eligible Employees:** Safe harbor 401(k) plans cannot require that an eligible participant be employed on the last day of the plan year or work a certain number of hours to receive a safe harbor contribution.
- **Use Correct Vesting:** Safe harbor contributions are usually 100 percent vested. Plans that utilize auto-enrollment may include a safe harbor match vested over a two-year period.

Who Should Consider a Safe Harbor 401(k) Plan?

Business owners with at least one rank-and-file employee may be good candidates for a safe harbor 401(k) if they:

- Are interested in a new 401(k) plan;
- Are setting up a defined benefit/cash balance and a 401(k) combination plan;
- Have an existing profit-sharing plan and want to find alternatives to managing benefit costs; or
- Have an existing defined benefit/cash balance plan and are interested in adding a supplemental 401(k) plan to improve their plan or increase their tax-deductible savings.

We're Here to Help

Your Retirement Plan Solutions consultants are available to assist. We will help with discovery, qualifying opportunities, plan design and timely implementation. Please call 844.881.PLAN, email retirementplans@cetera.com or start a conversation here.

NOTE: Individual results will vary based on plan design, census data, earnings history, actuarial calculations, and governing regulations. The figures quoted are statutory maximums based on compensation as illustrated; lower compensation will result in lower contributions. IRS regulations limit the combined contribution to certain plans. The illustration provided is for informational and educational purposes. It is not intended to provide, and should not be construed as ERISA, tax, investment, legal or financial advice or guidance.

Distributions from traditional IRAs and employer sponsored retirement plans are taxed as ordinary income and, if taken prior to reaching age 59½, may be subject to an additional 10% IRS tax penalty.

Affiliated Entities
Cetera® Retirement Plan Specialists may provide third-party administrative services (TPA) to clients of financial professionals who are affiliated with its family of broker-dealers and registered investment advisers. Cetera Retirement Plan Specialists is part of Cetera Financial Group.® Cetera Retirement Plan Specialists and its related entities operate independently and there is no requirement for retirement plan clients of Cetera Financial Group firms to engage with Cetera Retirement Plan Specialists.

About Cetera Financial Group®
Cetera Financial Group (Cetera) is a leading financial advice firm. It empowers the delivery of an Advice-Centric Experience® to individuals, families and businesses across the country through independent financial professionals as well as trusted tax professionals and banks and credit unions. It's headquartered at 200 N. Pacific Coast Highway, Suite 1200, El Segundo, CA 90245-5670.

Comprehensive services include: wealth management solutions, retirement plan solutions, advisory services, practice management support, innovative technology, marketing guidance, regulatory support, and market research.

Individuals affiliated with Cetera firms are either Registered Representatives who offer only brokerage services and receive transaction-based compensation (commissions), Investment Adviser Representatives who offer only investment advisory services and receive fees based on assets, or both Registered Representatives and Investment Adviser Representatives, who can offer both types of services.

"Cetera Financial Group" refers to the network of independent retail firms encompassing, among others, Cetera Advisors LLC, Cetera Advisor Networks LLC, Cetera Investment Services LLC (marketed as Cetera Financial Institutions or Cetera Investors), Cetera Financial Specialists LLC, and First Allied Securities, Inc. All firms are members FINRA / SIPC