

# Retirement Plan Insights

## The 5% That Makes a Difference

### *Missed the Safe Harbor 401(k) Deadline for New Safe Harbor Plans? There Is a Way*

Compared to simplified retirement programs such as SEP and SIMPLE IRAs, 401(k) plans may bring a host of additional benefits and features. They offer tax diversification by way of the Roth 401(k), a mechanism to convert pre-tax balances to Roth (internal conversions), access in pre-retirement via loans in cases of emergency, and creditor protection under Title I of ERISA without having to rely on provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act. To encourage retention, an employer can attach a vesting schedule to contributions made by the company, such as a match or profit sharing.

### Special Handling

To enjoy their tax-preferred status, 401(k) plans perform annual testing, known as an ADP test, in which salary deferral amounts of the non-highly compensated employees (NHCEs) are compared to those of the highly compensated employees (HCEs). Too great a disparity requires a special contribution to NHCEs or reversal of a share of HCE deferrals to bring the plan in balance. A similar test, known as an ACP test, applies to matching contributions.

### A Safe Harbor Approach

To break through the limits often imposed by these two tests, retirement plans often utilize safe harbor provisions. [Safe harbor 401\(k\) plans](#) require the employer to make either a 3 percent contribution for all eligible employees or a match for those who choose to defer. Safe harbor 401(k)s automatically pass the ADP and ACP tests.

### Missed the Deadline?

If a business wants to start a 401(k) plan but missed the October 1 implementation deadline\* for new safe harbor 401(k) plans, there is a solution. A special rule available only for new 401(k) plans comes to the rescue. This rule allows the HCEs to defer 5 percent of their salary and receive a match without fear of ADP or ACP test failure. From a practical perspective, a 401(k) plan should be established no later December 1 to take advantage of this opportunity and allow sufficient time for implementation of salary deferral features.

\*Absent the IRS guidance to the contrary, the salary deferral feature must be effective for at least three months for a new 401(k) plan to take advantage of the safe harbor design. This requirement did not go away with the passage of the SECURE Act.

### Case Study\*\*

Here's how it worked for one of the companies we recently helped:

#### Facts

- Consulting business
- S-corporation with two owners
- Four employees

- No retirement plan
- Contribution objective: \$60,000 – \$80,000 plus employee contribution

### First Plan Year

Recommendation: establish a 401(k) plan with a discretionary match and profit sharing.

	Age	Comp.	Salary Deferral	Discretionary Match	Profit Sharing	Total \$	% of Total
<b>Owner 1</b>	54	\$160,000	\$6,000	\$6,000	\$51,500	\$63,500	
<b>Owner 2</b>	48	\$43,808	\$4,187	\$2,190	\$3,395	\$9,772	
			<b>\$10,187</b>	<b>\$8,190</b>	<b>\$54,895</b>	<b>\$73,272</b>	<b>95%</b>
<b>Employee 1</b>	50	\$37,850	\$0	\$0	\$1,893	\$1,892	
<b>Employee 2</b>	23	\$1,999	\$0	\$0	\$100	\$100	
<b>Employee 3</b>	36	\$25,863	\$0	\$0	\$1,293	\$1,293	
<b>Employee 4</b>	26	\$18,064	\$0	\$0	\$903	\$903	
			<b>\$0</b>	<b>\$0</b>	<b>\$4,189</b>	<b>\$4,188</b>	<b>5%</b>

### Second Plan Year

Since the 5 percent rule is available only in the first plan year, add a safe harbor match to protect the deferral and matching contribution opportunity for the HCEs (even if other participants choose to defer little or not to make salary deferral contributions at all).

	Age	W-2	Salary Deferral	Safe Harbor Match	Discretionary Match	Profit Sharing	Total \$	% of Total
<b>Owner 1</b>	54	\$160,000	\$26,000	\$6,400	\$6,400	\$24,700	\$63,500	
<b>Owner 2</b>	48	\$43,808	\$19,500	\$1,752	\$1,752	\$1,314	\$24,319	
			<b>\$45,500</b>	<b>\$8,152</b>	<b>\$8,152</b>	<b>\$26,014</b>	<b>\$87,819</b>	<b>95%</b>
<b>Employee 1</b>	50	\$37,850	\$0	\$0	\$0	\$1,893	\$1,893	
<b>Employee 2</b>	23	\$1,999	\$0	\$0	\$0	\$100	\$100	
<b>Employee 3</b>	36	\$25,863	\$0	\$0	\$0	\$1,293	\$1,293	
<b>Employee 4</b>	26	\$18,064	\$0	\$0	\$0	\$903	\$903	
			<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$4,189</b>	<b>\$4,189</b>	<b>5%</b>

\*\*Individual results may vary based on specifics of a client situation, business facts and employee demographics.

In the first year, the plan will allow the owners to save a little over \$73,000 with employee contributions of about forty-two hundred dollars. In year two, with implementation of the safe harbor match provision, their contribution opportunity will increase to close to \$88,000 with the required minimum contribution for employees remaining at the same level as in year one assuming stable employee population and compensation levels.

### Who May Benefit from This Approach

- Businesses that missed the safe harbor deadline but want to start a 401(k) plan in the current year
- Businesses with profit-sharing plans that would like to add a 401(k) feature in the current year
- Businesses with a SEP IRA that want to benefit from the flexibility and efficiency available in a 401(k) plan



For use with plan sponsors only. This information is provided for discussion purposes only and in no way represents legal or tax advice. A qualified retirement plan may not be appropriate in all cases. For advice regarding specific circumstances, the services of an appropriate legal or tax advisor should be sought. Cetera® Retirement Plan Specialists.

- Businesses in [states with retirement plan mandates](#)

Retirement Plan Solutions consultants are ready to help every step of the way, from discovery to proposal preparation and implementation. Please call 844.881.PLAN, email [retirementplans@cetera.com](mailto:retirementplans@cetera.com) or [start a conversation here](#).

“Cetera Financial Group” refers to the network of independent retail firms encompassing, among others, Cetera Advisors, Cetera Advisor Networks, Cetera Investment Services (marketed as Cetera Financial Institutions or Cetera Investors), Cetera Financial Specialists, and First Allied Securities. All firms are members FINRA/SIPC. Cetera Financial Group is located at 200 N. Pacific Coast Highway, Suite 1200, El Segundo, CA 90245-5670.

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.



For use with plan sponsors only. This information is provided for discussion purposes only and in no way represents legal or tax advice. A qualified retirement plan may not be appropriate in all cases. For advice regarding specific circumstances, the services of an appropriate legal or tax advisor should be sought. Cetera® Retirement Plan Specialists.