RETIREMENT PLANS THAT ARE RIGHT FOR YOUR BUSINESS

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I. 401(K) PLANS

A. There are approximately 730,000 401(k) plans in the U.S. covering about 70 million active participants and managing $10 trillion in assets.

B. A 401(k) is a feature of a qualified profit-sharing plan that allows employees to contribute a portion of their wages to individual accounts.

C. Elective salary deferrals are excluded from the employee's taxable income (except for designated Roth deferrals).

II. 401(K) DESIGN OPTIONS

A. Roth 401(k)

1. A Roth 401(k) allows employees to make after-tax contributions, offering tax-free qualified withdrawals of both contributions and earnings in retirement.

2. Withdrawals in retirement are 100% tax-free, provided you are at least 59½ and have held the account for at least five years.

3. Unlike Roth IRAs, anyone can contribute to a Roth 401(k) regardless of income level.

4. Under the SECURE 2.0 Act, required minimum distributions (RMDs) are no longer required for Roth 401(k)s.

5. Employer matching and nonelective contributions have traditionally been deposited into a traditional 401(k) account and are taxable upon withdrawal. However, under SECURE 2.0 Act section 604, plans may now permit participants to elect to receive employer matching and nonelective contributions on a Roth basis. Traditional pre-tax treatment remains the default unless the plan is amended to offer this Roth option. Roth employer contributions are taxable when contributed, but qualify for tax-free distribution if the Roth requirements are met. (SECURE 2.0 Act section 604; IRC section 402A.)

6. In-Plan Roth Conversion

a. An in-plan Roth conversion (or rollover) allows you to move pre-tax or after-tax 401(k) funds into a Roth account within the same plan, creating a taxable event now for tax-free growth and withdrawals later.

b. Converted pre-tax money is treated as ordinary income in the year of conversion.

c. You can only convert funds you are fully vested in, or amounts that are otherwise permitted to be distributed (e.g., age 59½, separation from service).

d. The 5-year clock for qualified Roth distributions begins January 1 of the first year any Roth contribution is made to the plan, not the date of the conversion. Converted amounts withdrawn within five years and before age 59 1/2 may still trigger the 10% early distribution penalty on taxable portions. (IRC section 402A(d)(2)(B); Treas. Reg. section 1.402A-1, Q&A-4.)

e. Your employer's plan document must specifically permit in-plan Roth conversions.

B. Safe Harbor 401(k)

1. 401(k) Plans are subject to annual discrimination tests known as the Actual Deferral Percentage (ADP) Test and the Actual Contribution Percentage (ACP) Test.

2. The ADP Test ensures highly compensated employees (HCEs) do not contribute at a significantly higher rate than non-highly compensated employees (NHCEs). It compares the average employee salary deferrals of both groups, with failure leading to required refunds to HCEs.

3. The ACP Test works the same way but compares matching contributions received by the HCEs and NHCEs.

4. Safe Harbor 401(k) Plans are generally exempt from ADP testing if specific employer matching or non-elective contributions are made.

5. Safe Harbor Design Options

a. 3% Nonelective Contribution: The employer contributes at least 3% of compensation to all eligible employees, regardless of whether they contribute their own money.

b. Basic Match: The employer matches 100% of the first 3% of compensation deferred, plus 50% of the next 2% (totaling 4% if the employee contributes 5%).

c. Enhanced Match: A more generous formula that equals or exceeds the basic match (e.g., a 100% match on the first 4% of deferrals).

d. Qualified Automatic Contribution Arrangement (QACA): Combines safe harbor with automatic enrollment, allowing for a 2-year cliff vesting schedule and a lower matching formula (100% on first 1% + 50% on next 5%).

e. <u>Deadline to Adopt</u>: To adopt a 3% non-elective safe harbor, it can often be added mid-year, but most safe harbor designs require advanced notice and adoption prior to the plan year.

f. Top-Heavy Exemption: Plans with only safe harbor contributions are generally exempt from top-heavy testing.

C. Qualified Automatic Contribution Arrangements

1. Default Enrollment & Escalation

a. Initial Default Rate: Minimum of 3% of compensation, max of 10%. A Qualified Automatic Contribution Arrangement (QACA) is a safe harbor 401(k) design that requires automatic enrollment starting at 3% to 10% of pay.

b. Automatic Escalation: Must increase by 1% annually until it reaches at least 6% (max of 10% or 15% depending on interpretation).

c. Alternative: Set initial default at 6% or higher to avoid yearly increases.

2. Employer Contribution Options (Choose One)

a. QACA Match: 100% match on the first 1% of deferred compensation, plus 50% match on the next 5% of deferred compensation (3.5% total).

b. QACA Enhanced Match: A more generous formula than the basic match, still subject to specific limitations.

c. QACA Nonelective: A minimum 3% contribution of compensation to all eligible employees, regardless of whether they contribute.

3. Must include a qualified default investment alternative (QDIA) for employees who do not make an election.

4. QACA plans are generally exempt from annual ADP/ACP non-discrimination testing and top-heavy testing.

5. SECURE 2.0:

a. SECURE 2.0 Act requires most new 401(k) and 403(b) plans established after December 29, 2022, to implement an Eligible Automatic Contribution Arrangement (EACA) starting in 2025.

b. Initial default contribution must be between 3% and 10% of compensation, increasing by 1% annually to at least 10%, but not exceeding 15%.

c. Plans created before Dec. 29, 2022, small businesses (10 or fewer employees), new businesses (<3 years), church plans, and governmental plans are exempt.

d. Employees have a 90-day window to withdraw automatically contributed funds without penalties.

III. DEFINED BENEFIT PLANS

A. A defined benefit (DB) plan is an employer-sponsored retirement plan, commonly known as a traditional pension, which promises a specific, guaranteed monthly income upon retirement. Benefits are typically calculated based on a formula considering salary history and years of service, rather than investment performance.

B. Unlike 401(k) Plan (a defined contribution plan) where there is no guaranty of the value at retirement, a defined benefit plan requires sufficient funds in the plan at the time participants' retirement.

C. The employer, not the employee, is responsible for managing the plan's investment risk and ensuring enough funds are available to pay the promised benefits.

D. Defined benefit plans have disadvantages like high costs and complexity for employers, lack of investment control and portability for employees, and financial risk if the employer underfunds the plan, often leading to less flexibility and potential benefit reduction if the company faces financial trouble, making them less popular than defined contribution plans such as a 401(k) Plan.

E. A cash balance plan is a defined benefit plan that functions like a defined contribution plan (such as a 401(k)) by offering individual, hypothetical account balances. Employers guarantee a specific benefit (pay credits + interest credits) and bear all investment risk, making it popular for accelerating retirement savings and reducing taxes.

IV. COMBINING - COMBO PLANS

A. A defined contribution plan can include what is known as a new comparability formula or cross testing.

B. A defined contribution plan defines the amount that will be contributed currently with no guaranty as to the amount of the benefit at the time of retirement. A defined benefit plan specifies the benefit at retirement without a predetermined annual contribution.

C. The underlying principle determining the funding of a defined benefit plan is the time value of money. For example, a participant who is age 60 needs to have a larger contribution made to a retirement plan today to have that amount grow to $100 at retirement compared to the contribution required for a participant who is age 20 to have their benefit grow to $100 at retirement.

D. Each year, a defined benefit plan is required to have an actuary calculate the required contribution by projecting the retirement benefit to be funded.

E. In simple terms, cross testing works by looking at the contribution made to each participant currently and demonstrating that although each participant may receive a different contribution percentage compared to the other participants, the amount received is projected to be the same benefit at retirement.

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F. Key technical requirements must be satisfied to demonstrate that the cross-tested plan does not discriminate in favor of HCEs.

G. Cross-tested plans must also satisfy one of two minimum contribution requirements, in addition to the technical requirements described above:

1. A minimum 5% allocation rate to each non-highly compensated employee (NHCE); or

2. A minimum allocation rate to the NHCEs equal to 1/3 of the highest allocation rate for any highly compensated employee (HCE).

H. What it may look like:

NAME	AGE	PLAN COMP.	ASSUMED DEFERRALS	3% SAFE HARBOR	PROFIT SHARING	CASH BALANCE	TOTAL AMOUNT
Owner	50	$360,000.00	$32,500.00	$0.00	$20,282.00	$200,000.00	$252,984.00
NHCE #1	37	$52,300.00	$0.00	$1,569.00	$2,144.30	$1,830.50	$5,543.80
NHCE #2	29	$18,800.00	$0.00	$564.00	$770.80	$658.00	$1,992.80
NHCE #3	34	$28,600.00	$0.00	$858.00	$2,030.60	$1,001.00	$3,031.60
GRAND TOTAL							$263,552.20

96% of the total contributions to the owner.

V. <u>RETIREMENT PLAN DOLLAR LIMITATIONS</u>

A. The elective deferral limits under IRC §402(g) for 401(k) plans are $24,500 in 2026, with cost-of-living increases in $500 multiples.

B. The dollar limit under IRC §415(c)(1)(A) for annual additions with respect to defined contribution plans is the lesser of $72,000 or 100% of compensation for 2026, with cost-of-living increases in $1,000 multiples.

C. The compensation dollar limit under IRC §401(a)(17) is $ 360,000 for 2026, with cost-of-living increases in $5,000 multiples.

D. The deductible contribution under IRC §404(a)(3) is 25% of aggregated participant compensation.

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E. Deferrals for 401(k) plans are separately deductible with regard to the 25% limit and do not count toward the 25% limit applicable to other employer contributions (e.g., matching contributions, non-elective contributions).

F. Participant compensation used to calculate the 25% limit under IRC §404(a)(3) is based on IRC §415 compensation, which means it is "grossed up" for elective deferrals made by participants under 401(k) plans, cafeteria plans, etc.

G. Catch-Up Contributions for Individuals Age 50 and Older. Ages 50–59 & 64+: is an additional $8,000. Ages 60–63: is an additional $11,250.

H. Roth Catch-Up Mandate for High Earners. For participants 50+ with prior-year wages exceeding $150,000, enrolled in 401(k), 403(b), or 457(b) plan - all catch-up contributions must be made on a Roth basis. This requirement is effective for taxable years beginning after December 31, 2025. (SECURE 2.0 section 603; IRC section 402A(a); IRS Notice 2024-02.)

VI. THE NEED FOR LOANS AND IN-SERVICE DISTRIBUTIONS

A. Provided a retirement plan allows for loans, a participant can avoid being taxed on the receipt of funds as a distribution if a loan is made pursuant to an enforceable agreement, and the agreement meets certain requirements with respect to the term of the loan, the repayment schedule, and the dollar amount loaned.

B. The specific requirements for a loan are as follows:

1. A loan must be evidenced by a legally enforceable agreement, which may be composed of more than one document.

2. Generally, the term of the loan must be no longer than 5 years. An exception to the 5-year rule exists for principal residence loans. A principal residence loan is used to acquire a dwelling unit which is to be, within a reasonable time, the principal residence of the participant.

3. The loan must provide for level amortization over the term of the loan with payments not less frequently than quarterly.

4. The loan must bear a reasonable rate of interest.

5. Generally, the amount of the loan (when added to the outstanding balance of all other loans, whenever made, from all plans of the employer) may not exceed the lesser of (i) $50,000 (reduced by the excess of the highest outstanding balance of plan loans during the one year period ending on the day before the date when the loan is made over the outstanding balance of plan loans, the date when the loan is made), or (ii) one-half of the present value of the employees non-forfeitable accrued benefit under such plan. A plan may provide that a minimum loan amount of up to $10,000 may be borrowed, even if it is more than one-half of the present value of the employee's non-forfeitable accrued benefit.

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C. In-Service Distributions

1. Pre-tax contributions to 401(k) plans may not be distributed prior to the occurrence of certain distributable events: severance of employment, death, disability, attainment of age 59 ½, hardship, and termination of the plan.

2. In-service distributions may be made from a qualified profit-sharing plan to participants who have not separated from service upon attainment of a stated age (usually age 59½) and for emergency purposes.

3. Even if a plan does allow for in-service distributions prior to age 59 ½, the distribution may be subject to a 10% premature distribution penalty.

VII. COMMON PROBLEM AREAS

A. Depositing Contributions

1. The making of late deposits of contributions (or forgetting to make them) is an issue for both salary deferral and employer contributions.

2. The U.S. Department of Labor (DOL) rules emphasize that deposits should be made as soon as administratively feasible, not just by the 15th-day deadline.

3. Employers with fewer than 100 participants are considered to have complied if they deposit contributions within 7 business days of withholding.

4. Late deposits are considered prohibited transactions, which may require filing with the DOL's Voluntary Fiduciary Correction Program (VFCP) and paying excise taxes to the IRS.

B. Top-Heavy Violations

1. A plan is top-heavy with respect to a plan year if the aggregate account balances (or the present value of the cumulative benefits) for the key employees exceed 60% of the aggregate account balances (or the present value of the cumulative accrued benefits) of all employees.

2. A common problem found in a top-heavy defined contribution plan is that the required top-heavy minimum contribution is not provided to the non-key participating employees. The employer must provide each non-key employee participant with a contribution equal to 3% of his or her annual compensation or such lower percentage as is provided to the key employee who receives the highest percentage of compensation for the plan year.

3. Another problem occurs in top-heavy 401(k) plans. Elective contributions under a 401(k) plan on behalf of key employees are taken into account in determining the top-heavy minimum contribution. However, elective contributions on behalf of employees other than key employees may not be treated as employer contributions for purposes of satisfying the top-heavy contribution. Regulation Section 1.416-1 (M-20). Many employers are not aware of their

requirement to make a top-heavy minimum contribution when only elective deferrals are made to a plan.

C. Loans - The most common problems relate to the loans not being repaid within five years, loan payments not being made quarterly, and the plan not containing language that allows for plan loans.

D. Others

1. Inadequate documentation from the employee that a hardship or emergency exists for hardship and emergency distributions.

2. Failing to follow the terms of the plan.

VIII. WE MADE A MISTAKE, WHAT DO WE DO?

A. The Employee Plans Compliance Resolution System (EPCRS) permits plan sponsors to correct these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis.

B. Key terminology used within the Revenue Procedure includes the Self-Correction Program (SCP), the Voluntary Correction Program (VCP), and the Audit Closing Agreement Program (Audit CAP).

C. Under SCP, a plan sponsor that has established compliance practices and procedures may, at any time without paying any fee or sanction, correct insignificant operational failures of a qualified plan, a 403(b), a SEP or a Simple IRA plan, provided the SEP or the Simple IRA is established and maintained under a document approved by the Internal Revenue Service. SECURE 2.0 section 305 significantly expanded the SCP to permit self-correction of most eligible inadvertent failures, whether significant or insignificant, and removed the prior time limitation for correcting significant failures, provided correction occurs within a reasonable period after discovery and the failure was not first identified by the IRS (i.e. The plan is not under audit). (SECURE 2.0 section 305; Rev. Proc. 2021-30 as modified; Rev. Proc. 2024-15.)

D. VCP provides that a plan sponsor, at any time before audit, may pay a limited fee and receive the Internal Revenue Service's approval for correction of a qualified plan, 403(b) plan, SEP, or Simple IRA plan. Under VCP, there are special procedures for anonymous submissions and group submissions.

E. Audit CAP occurs when a failure (other than a failure corrected through SCP or VCP) is identified on audit. The plan sponsor may correct the failure and pay a sanction. The sanction imposed will bear a reasonable relationship to the nature, extent, and severity of the failure, taking into account the extent to which correction occurred before audit.

IX. STATE-MANDATED RETIREMENT PROGRAMS

A. As of early 2026, 17 states have active, mandatory state-sponsored retirement programs, with more than 20 states in total having enacted legislation to require private-sector employers to offer retirement plans.

B. These programs are designed to cover employees without access to employer-sponsored plans, often forcing employers to choose between the state plan or setting up a private 401(k).

C. The state of Michigan is actively considering a mandated state-facilitated retirement program, with legislation (HB 5336 and formerly HB 5461) introduced in late 2025 to create the "Michigan Secure Retirement Savings Program".

D. This plan would require employers with 5 or more employees who do not offer a retirement plan to automatically enroll employees into a state-administered IRA via payroll deductions, allowing employees to opt-out.

X. SOCIALLY RESPONSIBLE INVESTING (SRI)

A. Socially Responsible Investing (SRI) is an investment strategy that aims to generate financial returns while supporting positive environmental, social, and governance (ESG) outcomes.

B. It involves investing in companies with strong sustainability practices, ethical labor, and transparent management, often excluding industries like tobacco or weapons.

C. Impact Investing is a proactive subset of SRI focused on generating specific, beneficial social or environmental effects, such as funding renewable energy or affordable housing. Under the DOL 2022 final ESG rule, ERISA fiduciaries may consider ESG factors when such factors are relevant to the risk-return analysis of an investment. (29 CFR section 2550.404a-1; 87 Fed. Reg. 73822 (Dec. 1, 2022)).

D. Fiduciary Responsibilities Under ERISA. ERISA imposes core fiduciary duties on those who manage retirement plans: (1) Prudence, acting with the care, skill, and diligence of a prudent person; (2) Loyalty, acting solely in the interest of plan participants and beneficiaries; (3) Diversification, diversifying plan investments to minimize the risk of large losses; and (4) Adherence to Plan Documents, following the terms of the plan documents to the extent consistent with ERISA. (ERISA section 404(a)(1)).