

New 401(k) Plans – Things To Consider

Things to consider when establishing a new 401(k) Plan

Plan Provision Highlights

Eligibility: Service & Hours

Length of employment before becoming eligible for the plan. Examples:

- 12 months / at least 1,000 hours
- 3 months / no hours
- Eligible immediately when hired

1,000+ hours (about ½ time) is treated the same as full-time employment.

Entry Dates

Once an employee satisfies the plan's eligibility requirements, they enter on the next entry date. Examples:

- Twice annually (Jan. 1 & July 1)
- First of the next quarter
- First of the next month

Safe Harbor Provisions

Required Employer contributions, but avoids limits on deferrals for owners and other highly-paid employees.

Plans without Safe Harbor provisions are subject to non-discrimination testing and in some cases still have required contributions.

Automatic Enrollment

Participants are automatically enrolled at a specific deferral rate unless they make a positive election to not defer or defer at a different rate. Example:

- Initial auto-enrollment: 3%
- Auto-increase: 1% each year (capped at 10%).

The SECURE Act requires auto-enrollment for most new 401(k) Plans beginning in 2025.

Loans & Distributions

The plan may allow loans, but is not required to do so. Some examples of optional provisions are:

- Participant loans
- Hardship distributions
- In-service distributions (at 59 ½)

Provisions in your 401(k) Plan's adoption agreement describe how the plan should be operated. For this reason, it is important that the adoption agreement be drafted in a way that matches how you intend to operate the plan. The following are some important features to consider when starting a new 401(k) Plan.

Eligibility provisions describe the age (usually age 21) and length of service an employee must attain before they become eligible for the plan. The plan may require up to 12 months of service in which the employee works at least 1,000 hours, but this term may be shorter. Generally, if the term is less than 12 months, no hours requirement is used.

Entry dates define when the employee actually becomes a participant in the plan after the eligibility requirements are satisfied. This can be as few as twice a year (e.g., January 1 and July, 1), or could be more often (e.g., the first of the next quarter or the first of the next month).

Safe Harbor provisions are designed to allow owners and other "Highly Compensated Employees" ("HCEs") to defer at the maximum rate without regard to the deferral rate of the other plan participants. Safe Harbor provisions require the Employer to make contributions; however, without Safe Harbor provisions, the deferral rate of owners and other HCEs may be limited by annual non-discrimination testing, and the company may still be required to make contributions to employees in certain situations.

New With SECURE 1.0 & 2.0

A **new** 401(k) Plan must use **Eligible Automatic Contribution Arrangement ("EACA")** provisions. Participants are automatically enrolled at a specific deferral rate unless they make a voluntary election to not defer, or to defer at a different rate. The initial deferral rate must be at least 3% of the participant's compensation and increased 1% annually until the rate reaches 10% (see next page for more information).

Exceptions to the EACA requirement include:

- Companies that normally employ 10 or fewer employees
- New businesses during their first 3 years of existence.
- 401(k) Plans established on or before 12/29/2022.

Long-term Part-time (LTPT) employees: The SECURE Act has effectively created a new category of employees for 401(k) Plans called "Long-term Part-time (LTPT) Employees". These are employees that have worked at least 500 hours but less than 1,000 hours in two consecutive years. LTPT employees must be given an opportunity to defer under the 401(k) Plan. However, LTPT employees do not qualify for employer contributions or affect non-discrimination testing.

Note: LTPT rules only apply to plans that require 1,000 hours of service for eligibility, or plans that require lessor eligibility for full-time employees, but at least 1,000 hours for part-time employees. Service prior to 2021 is excluded.

New 401(k) Plan Considerations (cont.)

Automatic Enrollment Requirement (“EACA”)

The SECURE Act now requires that new 401(k) plans use an Eligible Automatic Enrollment Arrangement (aka “EACA”, or “auto-enrollment”).

At minimum the EACA provision must auto-enroll participants at 3% (if they don’t make a voluntary election otherwise, including an election to defer \$0), and “auto-increase” the deferral withholding each year by 1% until it reaches 10%.

90-Day Withdrawal: For a participant’s initial auto-enrollment period, they can request a withdrawal of the amount withheld with no penalty. This is to allow those who failed to provide the employer with a positive deferral election of “\$0” to request a return of the auto-enrollment amount withheld. This is only allowed for the participant’s first auto-enrollment period.

QACA Safe Harbor: 401(k) Plans electing to use Safe Harbor provisions might consider using the auto-enrollment version of the Safe Harbor Match (aka, “Qualified Automatic Contribution Arrangement”, or “QACA”). It’s capped at 3.5% (rather than 4%) and subject to a 2-year cliff vesting schedule. The QACA match formula is: 100% of the first 1% deferred, then 50% on the next 5% deferred (so, a participant would have to defer at least 6% to get the full 3.5% match).

Exceptions: Exceptions to the EACA requirement for new 401(k) Plans include:

- Companies that normally employ 10 or fewer employees
- New businesses during their first 3 years of existence.
- 401(k) Plans established on or before 12/29/2022.

Safe Harbor 401(k) Provisions

In exchange for committing to one of the Safe Harbor provisions, the employer can avoid the ADP (deferral) Test and, if no other company contributions are made, required Top Heavy contributions. This allows owners and other Highly Compensated Employees (“HCEs”) to defer the maximum without regard to the deferral rate of the other employees.

New 401(k) Plans with Safe Harbor provisions must be established at least 90 days prior to the plan-year end (e.g., for plan years ending 12/31, the deadline is October 2).

Safe Harbor contributions are always 100% vested. However, a vesting schedule may be used for other company contributions.

Without Safe Harbor provisions

- The owners and other HCEs may receive a return of their deferrals if the ADP deferral (non-discrimination) test fails.
- The employer may be required to make a 3% “Top Heavy Minimum” contribution to all eligible non-owner participants, including those who do not defer.

Roth Catch-up for Highly Paid Individuals (HPIs)

Beginning January 1, 2026, all catch-up contributions for catch-up eligible participants (those aged 50 or older) earning more than \$150,000 in FICA wages in the 2025 calendar year must be made as Roth deferrals. These participants are referred to as HPIs.

- FICA wages can be found in Box 3 of Form W-2 to determine HPI status
- Self-Employed Participants with no W-2 FICA wages are NOT HPIs

Tax Credits for Start-up 401(k) Plans: Available to New 401(k) Plans

Tax credits for 401(k) Plans may be available for companies with 50 or fewer employees (credits may be phased out for companies with more than 50 employees). Plan sponsors should consult with their tax advisors for advice on applying these tax credits to their particular situation.

Start-up Cost Tax Credit: For new 401(k) Plans, a tax credit of 100% of start-up/annual operational costs, capped at the lesser of \$250 per “Non-Highly Compensated Employee” or \$5,000 (minimum \$500) for each of the first 3 years.

Company Contribution Tax Credit: For new 401(k) Plans, a tax credit of 100% of company contributions up to \$1,000 per participant for the first 2 years (phased out over the next 3 years). This credit only applies to participants making \$100,000 or less.

Automatic Enrollment Tax Credit: A tax credit of \$500 when adding an auto-enrollment feature. This credit applies for the first 3 years this feature is used. This applies to any 401(k) Plan that adds an auto-enrollment feature with 100 or fewer employees (Note: this credit also applies to existing 401(k) Plans adding this feature).

To claim these tax credits, the client would work with their CPA to file Form 8881. They can go to www.irs.gov/Form8881 for instructions.

Other Considerations:

Potential Top Heavy Contribution: Plans with more than 60% of trust assets (including deferrals) held in accounts of “Key Employees” (owners, most immediate relatives of owners, etc.) are considered “Top Heavy.” A Top Heavy plan may require a 3% “Top Heavy Minimum” employer contribution to all eligible employees who are not Key Employees. Safe Harbor Plans may be exempt from this contribution requirement if no contributions are made other than Safe Harbor and employee deferrals.

Highly Compensated (“HCE”) Definition: Employees with compensation over a certain amount in the prior year (e.g., for 2026, employees who made more than \$160,000 in 2025) are HCEs. Allocation to HCEs (including deferrals) may be limited by non-discrimination testing. “Key Employees” are also HCEs.

ADP (deferral) Test: Plans without Safe Harbor provisions are subject to non-discrimination testing that compares the average deferral rate of HCEs to the average deferral rate of the other employees. If the test fails, corrective action is required, which generally includes a taxable distribution of deferrals to HCEs. There are certain deadlines by which such a correction must be completed.

Large Plan Audit: Plans with over 100 participants with an account balance must retain an outside CPA to perform an annual audit of the plan and the audit report must be attached to the annual IRS Form 5500.

Bonding Requirement: Plans with eligible non-owner employees must obtain a fidelity bond covering at least 10% of the plan’s assets, or more if the plan holds non-qualifying assets