Ensuring Compliance and Mitigating Risks in Retirement Plan Management

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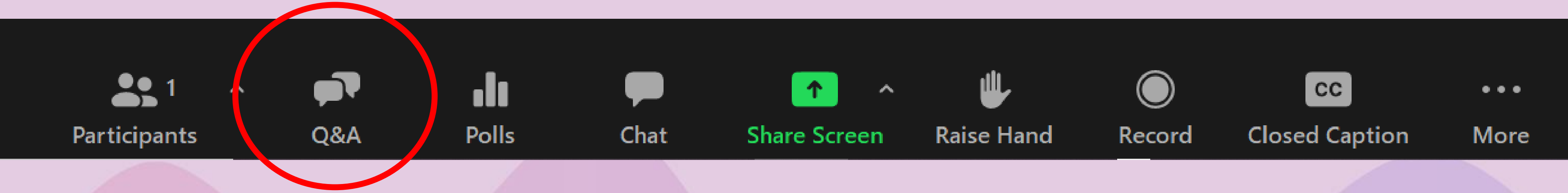

Speaker Bio

Lena Gionnette

Lena focuses her practice on creating, reviewing, and implementing benefit programs designed to meet the needs of for-profit and nonprofit entities of all sizes. She helps employers navigate the complex and evolving legal landscape surrounding benefit plans to ensure that their offerings are well designed and properly maintained. She regularly advises employers, executives, and third-party administrators on a wide range of issues relating to defined contribution and defined benefit plans, church plans, nonqualified deferred compensation arrangements, health and welfare plans, and fringe benefits. She also assists with day-to-day plan administration issues and is heavily involved in drafting plan documents, amendments, required notices, and participant communications. Lena also helps resolve plan errors under the IRS and DOL correction programs and guides clients through governmental audits. In addition, she counsels clients on benefits issues in connection with their corporate transactions. Lena received her B.A. degree in English, history and modern Greek from the University of Michigan and her J.D. degree from the University of Cincinnati College of Law.

Speaker Bio

Eric Paley

Eric Paley is the leader of the firm's employee benefits team. He advises clients on how to comply with the laws governing their employee benefits programs. He works primarily (though not exclusively) with a wide range of nonprofit organizations—hospitals and health systems, colleges and universities, iconic arts and cultural institutions, trade associations, social service agencies, and governmental organizations. His vast experience in these sectors gives him a unique perspective on the issues his clients are facing. Eric currently works with clients on fiduciary compliance, helping them establish or reconstitute their retirement plan committees; advising them on whether to engage a third-party investment consultant or conduct an RFP for a new recordkeeper; and educating boards, officers, and committee members on the rapidly changing legal landscape in which they operate. Eric is a member of the Monroe County Bar Association and the American Bar Association (Section of Taxation, Employee Benefits Committee). He received his B.A. degree from Cornell University and his J.D. degree from the Syracuse University College of Law.

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February 26, 2025

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Agenda

1. Step Up Your Game: Roth Contributions for Savvy Admins
2. The Road to Benefits Administration Hell is Paved With Good Intentions: Optional Provisions Under SECURE 2.0
3. IRS Audit and DOL Investigation Insights
4. Playing It Smart: Avoiding ERISA Litigation Over Forfeitures
5. Q&A

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Roth Contributions in Retirement Plans

A deep dive into Roth

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A quick history lesson

Roth contributions in defined contribution retirement plans

Roth IRAs were introduced in the 1990s.

Roth contributions in defined contribution retirement plans were first effective for taxable years beginning on or after January 1, 2006, under the Pension Protection Act of 2006.

Final regulations under Code section 402A were issued thereafter and became applicable for taxable years beginning on or after January 1, 2007. Addressed distribution, taxation, rollover, and recordkeeping of Roth contributions.

Do you have Roth as an option in your plan?

Please take part in the Zoom Poll!

Yes

No

No, but strongly considering it

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Roth vs. Pre-Tax Contributions

Pre-Tax Contributions

- Excludable from gross income in the year of deferral
- Includable in gross income at time of distribution
- Required in plan design (if Roth offered, must also offer pre-tax)

Roth Contributions

- Includable in gross income in the year of deferral; subject to all withholding requirements
- Contributions and earnings are excludable from gross income at time of distribution if certain conditions are met
- Optional plan design feature

Roth and Pre-Tax Contribution Similarities

- Subject to IRS annual deferral limits
- Subject to IRS in-service distribution restrictions
- Can be subject to automatic enrollment
- Must satisfy ADP nondiscrimination requirements
- Take into account in satisfying top-heavy rules
- Subject to IRS overall limit on plan contributions
- 100% vesting required

…not to be confused with after-tax contributions

After-tax contributions are:

- Not considered salary deferrals
- Not subject to deferral limits.
- Subject to overall limit on plan contributions.
- Subject to ACP testing.

When are earnings on Roth tax-free?

When funds are withdrawn in a “Qualified Distribution”

A Qualified Distribution:

- Must be made after a five-taxable-year period of participation is completed.
- Distribution must be made on or after age 59.5, made to a beneficiary or estate after participant’s death, or on account of participant’s disability.
- What about hardship distributions?
  - Earnings portion of distribution will be taxable unless five-taxable year period of participation is completed, and participant is either disabled or over 59.5.
- Roth distributions must be reported on Form 1099-R.

When are earnings on Roth tax-free?

When funds are withdrawn in a "Qualified Distribution"

How to Count Five-Taxable-Year Period in Various Scenarios

- Counted from the first day of the first taxable year (generally, January 1st) in which participant makes a Roth contribution (even if contribution is made on December 31st).
- Start date applies to all Roth contributions, even if participant "takes a break" from making Roth contributions and then starts making them again.
- Ends when five consecutive taxable years have been completed.
- Direct rollover from a Roth account under another retirement plan:
  - Counted starting with the year participant first made a contribution to the Roth account under the other plan.

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Recordkeeping Considerations

- Contributions and withdrawals must be credited and debited to a designated Roth account.
- Gains and losses must be separately allocated on a reasonable and consistent basis to the designated Roth account and other accounts under the plan.
- Forfeitures may not be allocated to the designated Roth account.
- Matching contributions may not be allocated to the designated Roth account.

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Recordkeeping Considerations

- Separate accounting requirement applies until complete distribution.
- Plan administrator is generally responsible for keeping track of 5-taxable-year period of participation as well as basis in account.
  - Must share this information with a plan receiving a direct rollover of Roth amounts and
  - To a participant requesting it in connection with a distribution.

Tax Impact of Roth Contributions

EXAMPLE

John, age 42, is in a 22% tax bracket and contributes $10,000 to his employer's 401(k) plan in 2025. Assume John retires at age 62 and the investment grows 10x in 20 years.

If $10,000 is made on pre-tax basis:

- John reduces his 2025 taxable income by $10,000, which grows to $100,000 by 2045.
- If his tax rate in **2045 is 12%**, John pays $12,000 in taxes and is left with **$88,000.**
- If his tax rate in **2045 is 32%**, John pays $32,000 in taxes and is left with **$68,000**.

If $10,000 is made on Roth basis:

- John pays 22% in taxes and invests $7,800, which grows to $78,000 by 2045.
- John withdraws **$78,000** tax-free, regardless of his tax rate in 2045.

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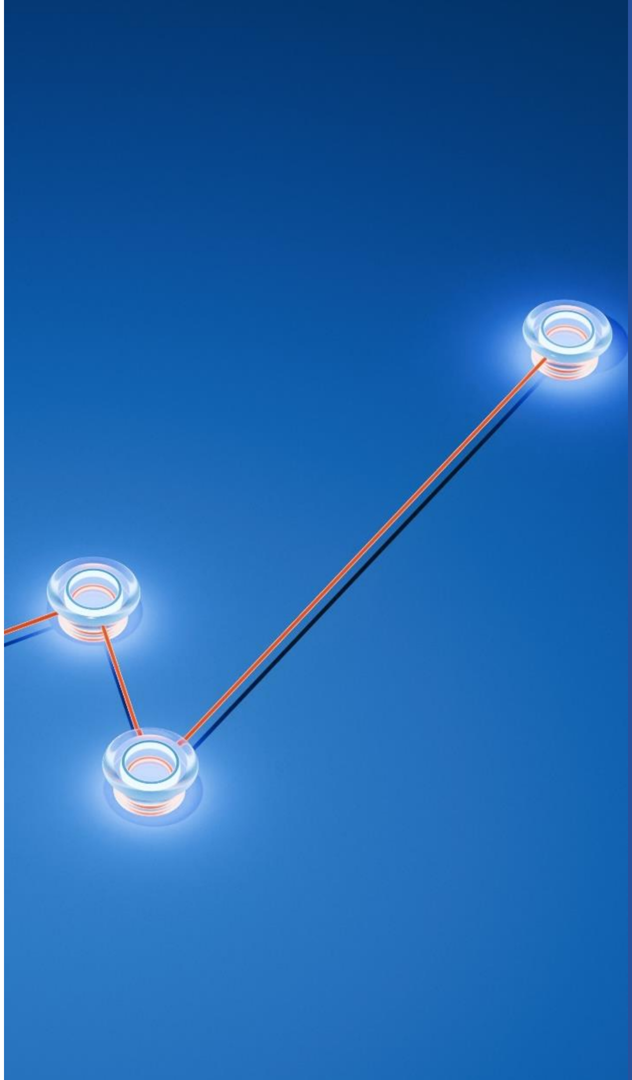
Considerations in Adding Roth Contributions

- May benefit higher earners who can't make Roth IRA contributions
- May benefit participants who think their income tax rate will be higher at retirement
- Provides new employees the opportunity to roll in money from a former Roth plan and keep the earnings on Roth contributions tax free.
- Administratively more complex to accurately recordkeep
- Educating participants can be challenging and can result in confusion.
- Plans can be amended midyear to add Roth (even safe harbor plans)



Roth In-Plan Rollovers/Conversions

An optional plan design feature

Mechanics:

- Individual's non-Roth plan account (e.g., pre-tax, matching, nonelective, rollover, after-tax, and earnings on same) is rolled over to participant's designated Roth account in the same plan.
- May be accomplished by a direct rollover or by a distribution of funds to the participant, who then rolls the funds into their designated Roth account within 60 days.
- Doesn't work the other way around!

/ Generally not subject to 10% additional tax on early distributions.

/ Generally taxable to participant; participant may want to increase tax withholding when they make an in-plan Roth rollover to avoid an underpayment penalty.

/ Spousal consent not required.

Roth In-Plan Rollovers/Conversions

An optional plan design feature

Recapture rule

If taxable amount of in-plan rollover/conversion is distributed before the end of five-taxable-year period and participant is under age 59.5, 10% penalty can apply.

Doesn’t apply to subsequent rollover to another designated Roth account.

Applies to subsequent distributions made from those other designated Roth accounts within five-year period.

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Correcting Roth Contribution Errors

So you inadvertently treated a Roth election as pre-tax…now what?

- Transfer the contributions, plus earnings, to the participant’s Roth account.
- If you don’t catch it until a later year, either:
  - Issue a corrected W-2 and instruct the participant to file an amended Form 1040 for the year in which the mistake occurred, or
  - Include the transferred amount in compensation for the year in which the transfer is made.

What if you instead treated a pre-tax election as Roth?

- Transfer the contributions, plus earnings, to the participant’s pre-tax account.
- If you don’t catch it until a later year:
  - Issue a corrected W-2 and instruct the participant to file an amended Form 1040 for the year in which the mistake occurred.

Correcting Roth Contribution Errors

So a participant made Roth contributions in excess of the annual limit…now what?

- Distribute the excess contributions by April 15th of the following plan year.
- Excess is not includible in gross income.
- Income allocable to corrective distribution is includible in gross income.
- If distribution occurs later than April 15th, the entire distribution is taxable. In other words, excess Roth contributions that aren't timely distributed are taxed twice.

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ADP Nondiscrimination Testing Failures and Roth

- ADP testing failures can be corrected by making corrective distributions to highly compensated employees
- Plans may permit participants to elect whether the corrective distribution is made from Roth or pre-tax contributions, or may mandate the ordering.
- If corrective distributions of Roth contributions are made, earnings must be included in highly compensated employee’s income

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SECURE 2.0 Considerations

Catch-up contributions for high earners starting in 2026:

- Catch-up contributions made by participants with FICA wages >$145,000 (as indexed) in the prior calendar year must be made to a designated Roth contribution account.
- FICA wage threshold isn’t prorated for year of hire.
- If implemented, all catch-up eligible participants must be permitted to make Roth catch-up contributions.
- Plans aren’t required to add Roth to accommodate this rule, but if Roth isn’t in the plan, then high earners are precluded from making catch-up contributions.
  - Plans are stuck tracking high earners either way.

SECURE 2.0 Considerations

Designation of employer contributions as designated Roth contributions, if plan so permits.

- Participant election is irrevocable, but participant must be permitted to change designation at least 1x/year.
- Only fully vested contributions can be designated as Roth.
- Includable in taxable income when made.
- Must be held in a separate designated Roth account.

Roth contributions aren’t subject to pre-death RMD rules beginning January 1, 2024.

- Aligns rules with Roth IRAs.

The Road to Employee Benefits Administration Hell is Paved With Good Intentions

Optional Provisions Under SECURE 2.0

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The Optional Features Dilemma

They sound good, but is the climb worth the view?

- Pension-Linked Emergency Savings Accounts (PLESAs)
- Student Loan Matching
- Emergency Withdrawals
- Roth Employer Contributions
- Domestic Violence Distributions
- QLACs Expansion
- De Minimis Financial Incentives

Optional changes introduce complexity, cost and compliance challenges

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Case Study – PLESAs: A Cautionary Tale

What are PLESAs?

- Emergency savings tied to retirement plans.
- Roth contributions.
- Quasi-hardship withdrawals but create challenges.

Major employer concerns:

- High admin burden (e.g., payroll, tracking, compliance)
- Confusing rules for employees
- Minimal employer ROI – costs may outweigh benefits

PLESAs – The Reality of Implementation

Employer choices:

- Optional but require payroll integration and plan updates.
- Can be terminated but may create participant confusion.

Employee participation:

- Only NHCEs can contribute.
- Once an NHCE becomes an HCE, contributions stop, but withdrawals permitted.

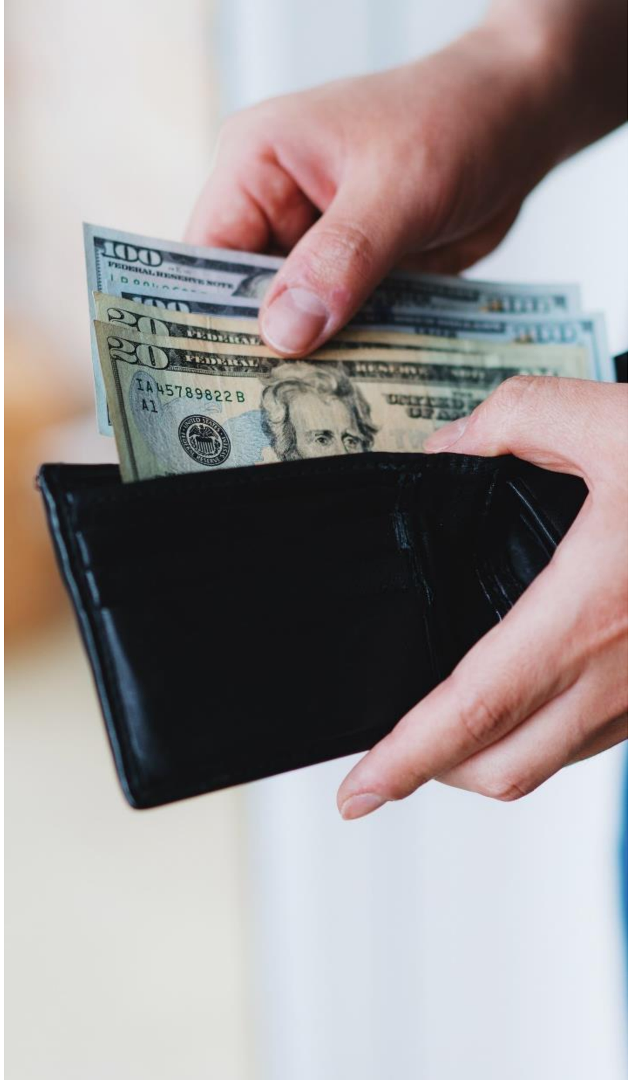
PLESA Contributions – More Complexity, Less Benefit

Contribution Limits:

- Lesser of $2,500 or employer-defined lower limit.
- Payroll deduction required.

Withdrawal Rules:

- Monthly withdrawals allowed, no hardship proof needed.
- First four withdrawals free; fees may apply after.



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Employer Burdens – What's the Catch?

Recordkeeping and Accounting Headaches:

- Separate accounting required.
- Limited investment options (cash, interest-bearing, stable value).

Compliance Risks:

- Contributions count toward IRS deferral limits (i.e., 402(g)).
- Matching contributions go to retirement plan, not PLESA.

Auto-Enrollment & Notice Requirements

Automatic Enrollment:

- Employers can auto-enroll but must provide opt-out.

Required Notices:

- 30-90 days before first contribution.
- Annual notices required to detail contributions and withdrawals.

Plan Sponsors Beware – Regulatory & Fiduciary Risks

Potential Issues:

- Tracking contribution limits properly to avoid IRS penalties.
- Employees may misunderstand withdrawals and blame employer.
- Possible future rule changes requiring plan updates.

My PLEA:
PLEASE Avoid PLESAs

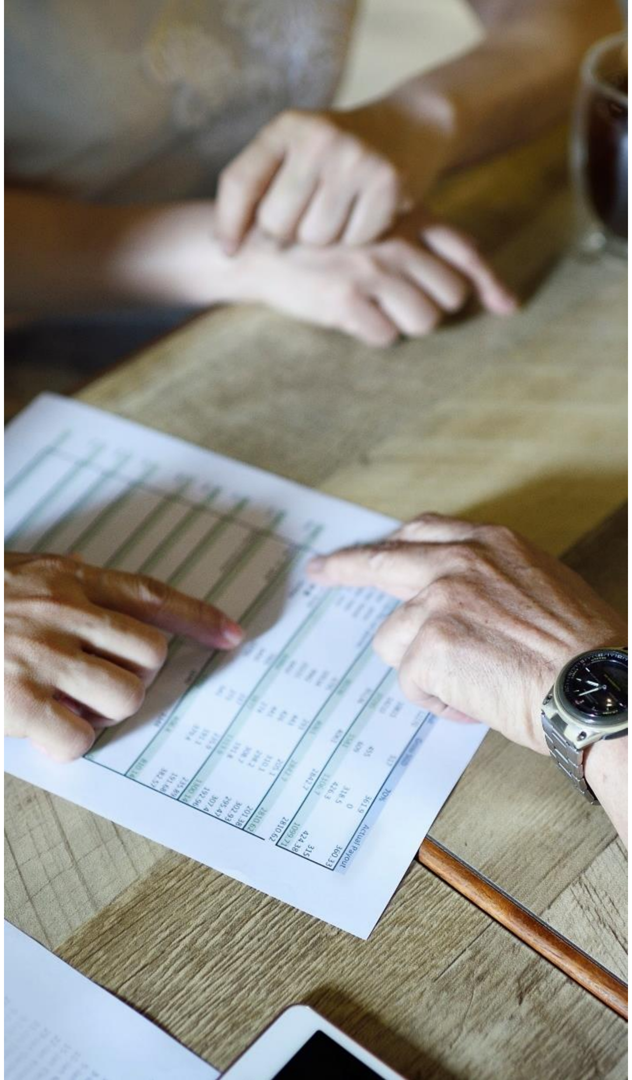
Why Employers Should Avoid PLESAs:

- Payroll & recordkeeping complexity.
- Compliance risks with IRS limits.
- Employees may confuse withdrawals and create tax issues.
- No meaningful employer benefit – costs outweigh value.

Better Ways to Help Employees

Instead of PLESAs, consider:

- Direct deposit to savings accounts.
- Financial wellness programs and coaching.
- Existing hardship withdrawals and loans.
- Employer-funded savings incentives (outside retirement plans).



The Road to Benefits Administration Hell

SECURE 2.0’s optional features may look helpful, but…

- Increase administrative burden.
- Introduce compliance headaches.
- May not significantly improve employee outcomes.

Just because the law allows it, doesn’t mean it’s a good idea.

IRS Audit and DOL Investigation Insights

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Trends We (Were) Seeing

- DOL limited-scope requests to assess untimely remittances
- IRS audits and requests to extend statute of limitations
- IRS audit “self-declaration”
- Preemptively approach DOL as a technique for “unauditable” plans
- DOL’s VFCP changes
- IRS pre-submission conference
- Level of audit and investigation activity under new administration remains to be seen

Playing It Smart: Avoiding ERISA Litigation Over Forfeitures

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Introduction

Forfeitures:

Unvested employer contributions that revert to the plan.

ERISA permits forfeitures to be used for:

1. Reducing employer contributions
2. Paying plan administrative expenses

Legal Controversy:

Are employers misusing forfeitures to benefit themselves instead of participants?

Recent litigation has tested how courts interpret forfeiture allocations.

Key Cases in Forfeiture Litigation

Charter Communications (Pending)

- Alleged misuse of $158M in forfeitures for employer contributions.

Amazon (Pending)

- Alleged improper use of $86.8M in forfeitures, violating ERISA's exclusive benefit rule.

Capital One (Pending)

- $42.65M in forfeitures allegedly used improperly.

Key Cases in Forfeiture Litigation

Honeywell (Dismissed)

- Court ruled that ERISA does not require forfeitures to be used in a specific way.

Thermo Fisher (Dismissed, with leave to amend)

- Court found no clear violation but allowed case to be amended.

Hutchins v. HP (Dismissed without leave to amend)

- A significant ruling favoring employers.

Hutchins v. HP: A Pivotal Decision

Ruling:

Case dismissed, reinforcing employer discretion over forfeitures.

Plaintiff's Allegations:

- HP violated ERISA by using forfeitures to offset employer contributions instead of reducing participant expenses.

Court's Reasoning:

- Plan explicitly allowed forfeiture discretion.
- ERISA does not require maximizing participant benefits.
- Using forfeitures for employer contributions is not prohibited self-dealing.

Impact of *Hutchins v. HP*

Strengthens legal protection for employers who grant discretion over forfeitures.

Raises the bar for plaintiffs to challenge forfeiture use.

May lead to dismissals in similar cases (*Amazon*, *Capital One*).

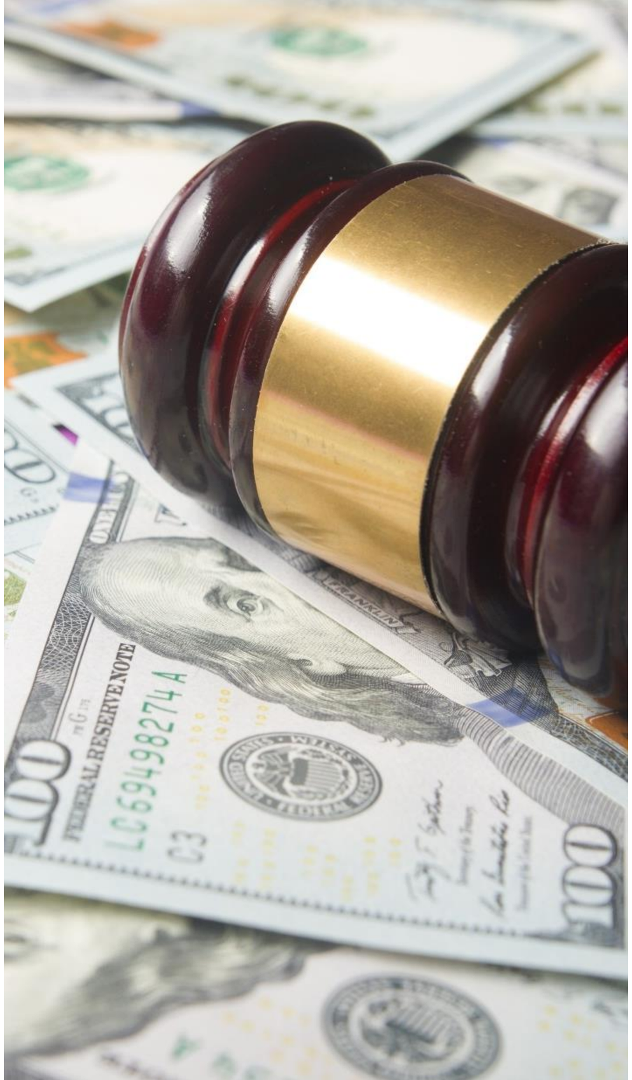
Aligns with Treasury Department's 2024 proposed regulations allowing forfeitures for employer contributions.

Discretion vs. Hardwiring: Strategic Plan Design

Two approaches to forfeitures:

- Grant Discretion: Employer decides how to allocate forfeitures.
- Hardwired Rules: The plan mandates how forfeitures must be used.

Each has benefits and risks.



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Why Granting Discretion Reduces Litigation Risk

Courts defer to plan terms if they grant clear discretion (Hutchins v. HP).

Harder for plaintiffs to claim breach of fiduciary duty.

Flexibility to adjust forfeiture use over time.

Avoids unintended conflicts when administrative costs are low.

When Hardwiring Forfeiture Use is Beneficial

Prevents allegations of employer self-dealing.

Ensures predictability and consistency in forfeiture application.

Reduces discretionary decision-making burden on plan administrators.

May reduce litigation risk if employer prefers a fixed approach.

Choosing the Right Approach: A Balanced Strategy

Hybrid Model:

- Grant discretion but provide a priority order (e.g., forfeitures may first reduce expenses, then employer contributions).
- Ensures flexibility while reducing potential litigation risk.

Key Takeaway:

Plan sponsors must align forfeiture rules with business goals and risk tolerance.

Conclusion

Hutchins v. HP strengthens employer discretion over forfeitures.

Plan sponsors must decide whether to grant discretion or hardwire rules.

Discretion provides flexibility and legal protection but requires clear documentation.

Hardwiring forfeiture use eliminates discretionary challenges but limits flexibility.

The best strategy depends on business needs, risk tolerance, and plan design objectives.

Thank you!

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Thank you!

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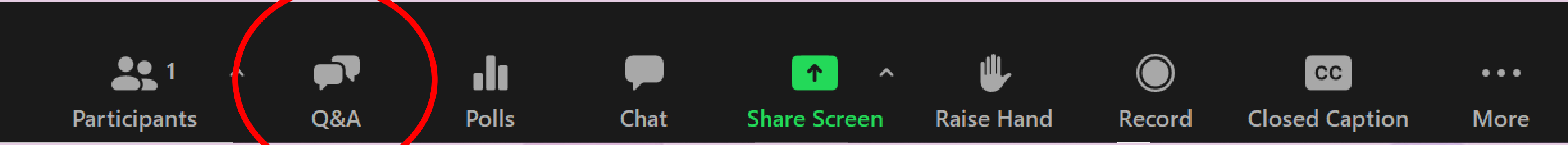

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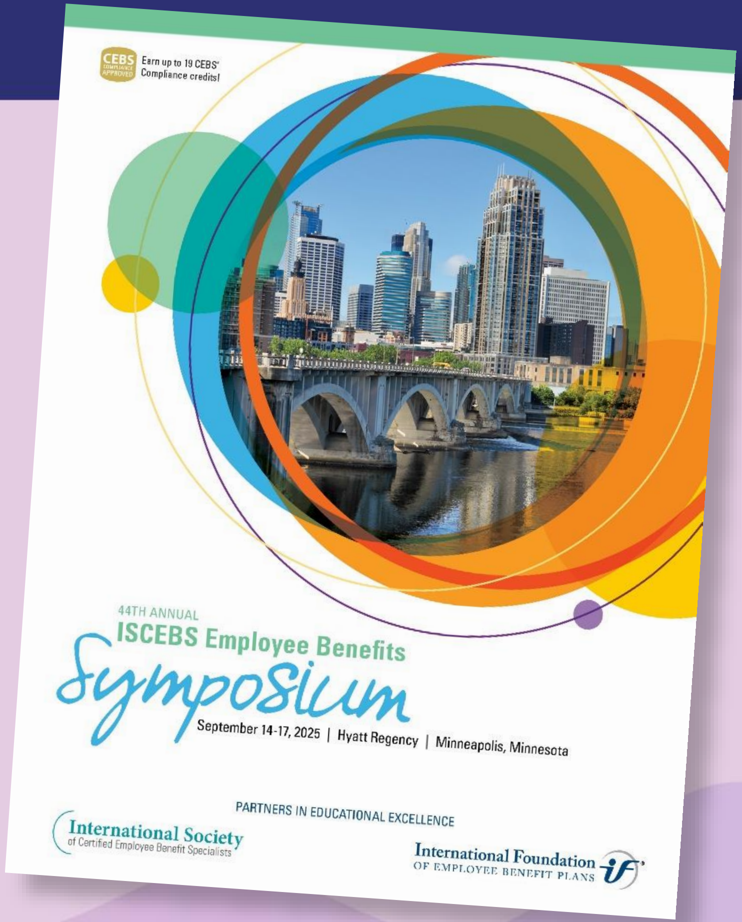

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