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AT WORK

Retirement Solutions

The Right Plan for Your Business

Thinking of providing a retirement plan for your business?

We can help you determine which plan makes sense.

Setting up a retirement plan for your company is one of the most effective ways for you and your employees to save for the future. It can also have a material impact on your business goals, driving employee acquisition, retention, productivity and loyalty.[1]

If you are thinking of offering a retirement plan for your business but are unsure where to start, this guide provides a high-level overview of various plans. When you are ready to dive into more detail, a Morgan Stanley Financial Advisor can help you navigate the features and benefits of each option, so you can decide which plan makes sense for your business. Also, make sure to discuss options with your legal and tax advisors.

Retirement Plans at a Glance

Here are three types of retirement plans for your business to consider. Each offers tax advantages, higher contribution limits than a non-employer sponsored plan and the ability for employers to contribute to plans on behalf of employees. We've identified the top-of-mind benefits for employers, benefits to employees and key considerations to ask your Financial Advisor about.

401(k) Plans

401(k) plans are the most common retirement plans offered by companies of all sizes because of their flexibility and array of customizable features. They are defined contribution plans that permit both employers and employees to make contributions to an employee's retirement savings account on a pre-tax basis, or if a Roth option is offered, on an after-tax basis. A Financial Advisor can work with the business owner to ease administrative responsibilities and concerns such as fiduciary responsibility, IRS compliance, minimum enrollment requirements and investments.

SIMPLE/SEP IRA Plans

SIMPLE/SEP IRAs are retirement plans that allow employees to save for retirement on a pre-tax basis. In comparison to a 401(k), SIMPLE/SEP IRAs have fewer plan design options and features, but are easier to set up and administer and offer a cost-effective way for a business to start a retirement plan. However, employees are responsible for managing their own investments in a SIMPLE/SEP IRA, so it may be a good idea for them to work with a Financial Advisor who can discuss investment choices as well as savings strategies.

Defined Benefit Plan: Cash Balance

Defined benefit plans, such as a cash balance plan, promise a preset benefit at retirement and can provide employees with lifetime income. They have the highest contribution limits of any plan and allow business owners and employees to save large amounts of their income in a short amount of time. However, defined benefit plans can be complex to manage and administer with many considerations requiring a view of the long-term growth of the company.

The description of the following plans are not comprehensive and should be considered a high-level overview only. Please consult with your legal and tax advisor when considering the various plans.

Traditional 401(k) Plan

A traditional 401(k) is an employer-sponsored plan set up by a business that allows employees to save money for retirement on a tax-deferred basis. 401(k)s offer high contribution limits and are favored by companies for their customizable and flexible features, such as employer matching, optional Roth deferral add-on, tailored vesting schedules, auto-enrollment and profit-sharing contributions, to name a few.

A **traditional 401(k)** plan may work well for companies of all sizes and offers options that will accommodate the needs of both employees and employers alike.

Why employers like them

- Employee matching contributions are discretionary and flexible
- Contributions made to employee retirement accounts are tax deductible
- Business owners may maximize their contributions, setting aside up to $61,000 tax-deferred in their 401(k). This includes the $20,500 employee contribution and the owner-employee contribution of up to 20% of the net earnings.[2]
- Employer contributions are tax deductible[3]
- Business owners may be eligible for up to $5,000 in tax credits for startup and administration costs in the first three years[4]
- Offering a retirement plan can help attract and retain top talent[5]
- Retirement benefits can help employees attain financial security, fostering loyalty and productivity

Key employee benefits

- Plans allow for higher employee contribution levels than non-employer-sponsored plans
- The limit on employee elective deferrals for a traditional 401(k) plan is $20,500[6]
- Companies can offer an employer match, which is typically set up in one of two ways:
  - a partial match, such as a 50% match up to 6% of an employee's salary
  - a full match, such as a 100% match up to 4% of an employee's salary
- Employers can make elective contributions whether an employee contributes to their own account or not on a pre-tax basis (or if a Roth option is offered, on an after-tax basis)
- Utilizing automated features, such as auto-enroll or auto-increase, can help simplify employee participation
- Access to a preselected list of investments

Things to consider

- There are options available to tailor a 401(k) plan to serve short and long-term business goals
- A Financial Advisor can work with business owners to ease administrative burdens and concerns such as fiduciary responsibilities, plan management, investment selection and performance management
- If 60% or more of the plan's assets are in the accounts of owners and other Key Employees, a 3% top heavy contribution may be required. Discuss with your Financial Advisor the varying plan types and which may be the best fit for a small business team. Also, make sure to discuss options with your legal and tax advisors.

401(k) Profit-Sharing Plan

Profit-sharing is an optional addition for traditional 401(k) plans. A 401(k) plan with profit-sharing allows business owners to make discretionary employee contributions and is often based on how profitable the company was in a particular year. Contributions are fully funded by the employer and businesses decide how much to share annually, with no minimum contribution requirements. A profit-sharing plan can be a good strategy for any high-growth business looking to retain talent.

A **401(k) with profit-sharing** plan may be good for companies that want an option to reward employees when their business has a lucrative year.

Plans can be structured in a way that is appropriate for the business. For instance, owners can:

- Split profits evenly, with every employee receiving the same contribution
- Distribute profits based on a percentage of an employee's salary
- Use an age-weighted or comparability method, both of which give larger contributions to older and higher-paid employees

Why employers like them

- Business owners may maximize their contributions, setting aside up to $61,000 tax-deferred in their 401(k).[7]
- Contribution amounts are flexible and discretionary, which can work well for companies whose profits are more unpredictable
- Vesting can be over time so employees have an incentive to remain with the company
- Employer contributions are tax deductible[8]

Key employee benefits

- Additional contributions may be made by the employer, although owners are not required to make such contributions

Things to consider

- Plans are subject to nondiscrimination testing, which is required by the IRS to ensure that plans are not benefitting business owners and highly compensated employees (HCEs) unfairly at the expense of other employees

Safe Harbor 401(k) Plan

Safe harbor is an optional addition for traditional 401(k) plans. A 401(k) plan with safe harbor requires employers to make fully vested annual contributions to all employees using one of three preset formulas:

- Employer contributes 3% of employee salary regardless of employee contribution
- Employer matches the first 3% of each employee's contribution and 50% of the next 2%
- Employer matches 100% of the first 4% of each employee's contribution

Once these requirements are met, owners and their highly compensated employees (HCEs) can contribute the maximum limit to their own accounts without the added burden of conducting annual nondiscrimination IRS testing.

A **401(k) with safe harbor** plan may be a good choice for high growth small businesses, by offering the maximum amount of flexibility while minimizing administrative responsibilities.

Why employers like them

- Business owners may maximize their contributions, setting aside up to $61,000 tax-deferred in their 401(k). This includes the $20,500 employee contribution and the owner-employee contribution of up to 20% of the net earnings.[9]
- Business owners can compensate higher paid employees to help retain talent
- No annual IRS nondiscrimination testing is required
- Employer contributions are tax deductible[10]

Key employee benefits

- Contributions are fully funded and guaranteed by the employer each year
- Contributions are immediately vested
- Roth option is available

Things to consider

- Businesses must have sufficient income to fund mandatory annual contributions
- Employers sponsoring safe harbor 401(k) plans must satisfy certain notice requirements. The notice requirements are satisfied if each eligible employee for the plan year is given written notice of the employee's rights and obligations under the plan and the notice satisfies the content and timing requirements.[11]
- The safe harbor 401(k) plan is not subject to the complex annual nondiscrimination tests that apply to traditional 401(k) plans.[12]
- A safe harbor 401(k) plan must provide for employer contributions that are fully vested when made. These contributions may be employer matching contributions, limited to employees who defer, or employer contributions made on behalf of all eligible employees, regardless of whether they make elective deferrals.[13]

SIMPLE 401(k) Plan

A SIMPLE 401(k) is a plan for companies with fewer than 100 employees. As the name indicates, it is simple to setup and requires some administration.

SIMPLE 401(k) plans may be good options for companies looking for a cost-effective way to offer a plan to their employees.

Why employers like them

- Low set-up fees
- Plans do not require the same compliance and reporting requirements as a traditional 401(k).
- Employer contributions are tax deductible
- Business owners may be eligible for up to $5,000 in tax credits for startup and administration costs in the first three years[14]

Key employee benefits

- Mandatory employer contributions
- Contributions are vested immediately

Things to consider

- Contribution limits are lower than other plans – $14,000 plus $3,000 catch-up contributions for employees who are 50+ years old

SIMPLE IRA Plan

A SIMPLE IRA (Savings Incentive Match Plan for Employers) is a way to offer a retirement plan to employees without the administrative complexity present in other plan types. However, the plan doesn't offer much flexibility. For example, lower contribution limits means less savings. Once a company selects SIMPLE IRA, there is a two-year waiting period before they can switch plan types, limiting options in the case of company growth.

SIMPLE IRAs may be a good options for smaller companies looking for a cost-effective way to offer a plan to their employees.

Why employers like them

- Low set-up fees
- Plans aren't subject to the same compliance and reporting requirements of a 401(k)
- Employer contributions are tax deductible
- Business owners may be eligible for up to $5,000 in tax credits for start up and administration costs in the first three years[15]

Key employee benefits

- Mandatory employer contributions
- Contributions are vested immediately

Things to consider

- Contribution limits are lower than other plans – $14,000 plus $3,000 catch-up contributions for employees who are 50+ years old
- Employees are responsible for managing their own investments
- Once a company rolls out a SIMPLE IRA they must wait two years before switching to a 401(k) or another IRA plan[16]
- Onboarding new employees can be cumbersome
- Payroll could be more difficult due to lack of integrations
- Does not offer loan provisions
- Does not offer automated features in plan design

SEP IRA Plan

SEP IRAs (Simplified Employee Pension Plan) are different than SIMPLE or individual IRAs in that contribution limits are much higher and employees can't make any contributions to their own accounts. The company owner is required to make contributions on behalf of employees. Although employers are not required to make contributions every year, when they do make contributions each eligible employee must receive the same amount.

A **SEP IRA** plan may be a cost-effective way for sole proprietors, entrepreneurs and small business owners to save for retirement.

Why employers like them

- Higher contribution limits than SIMPLE and individual IRAs
- Easier to set up and administer than most other plan types
- Employers are not required to make annual contributions, but when they do, all employees must receive the same amount
- Total contributions to each employee's SEP-IRA cannot exceed the lesser of $61,000 for 2022 or 25% of compensation.
- Each employee is always 100% vested in (or, has ownership of) all contributions to his or her SEP-IRA.[17]
- Employer contributions are tax deductible[18]
- Business owners may be eligible for up to $5,000 in tax credits for start up and administration costs in the first three years[19]

Key employee benefits

- Contributions limits are high and are fully funded by employers (although not required)

Things to consider

- Business owners must make equal contributions to all employees in years when they contribute to the plan
- Employees are responsible for managing their own investments
- Employees cannot contribute to their own plan
- Payroll could be more difficult due to lack of integrations
- Does not offer loan provisions
- Does not offer automated features in plan design

Defined Benefit Plan: Cash Balance

A cash balance plan is a defined benefit plan that allows large contributions, with higher amounts of available to those who are closest to retirement. Contributions are based on what is needed to provide determinable benefits to the participant. Actuarial assumptions and computations are required to figure these contributions.

In general, the annual benefit for a participant cannot exceed the lesser of 100% of the participant's average compensation for his or her highest three consecutive calendar years, or $245,000 for 2022.

Cash balance plans can be appealing to doctors, lawyers, entrepreneurs, or any small business with a limited number of non-targeted high earners.

Why employers like them

- They offer the highest contribution rates of any plan, allowing business owners and their employees to save large amounts in a short period
- Contributions are tax deductible

Key employee benefits

- Employers are required to make mandatory annual contributions
- Participants can choose to take either a lump sum of their hypothetical account balance at retirement or an annuity based on the balance that will provide lifetime income
- Plan participants can contribute the maximum limit to their 401(k) profit-sharing account on top of cash balance contributions

Things to consider

- Requires hands-on management by a third-party administrator (TPA)
- Businesses must have sufficient income to fund mandatory annual contributions
- Must consider the long-term growth trajectory of the business

Comparison at a Glance

	MANDATORY EMPLOYER CONTRIBUTIONS?	CONTRIBUTION LIMITS	VESTING	LOANS	ROTH OPTION?
Traditional 401(k)	No	– Employees can make tax-deferred contributions up to $20,500 – Employer and employee maximum tax-deferred contributions combined are $61,000 or 100% of the employee's total compensation (whichever is less) – $6,500 catch-up amount for those who are 50+	Vesting can be immediate or over time using a vesting schedule (to a maximum of six years)	Yes	Yes. The contribution limit is the same as a traditional 401(k) plan. Contributions can be split between traditional and Roth plans in any way an individual chooses as long as the combined total does not exceed the $20,500 (plus $6,500 catch-up for those who are 50+).
401(k) with Profit-Sharing	No	Plans can be structured in whichever way suits the business. For instance, owners can: – Split profits evenly, with every employee receiving the same contribution – Distribute profits base on a percentage of an employee's salary – Use an age weighted or comparability method, both of which give larger contributions to older and higher-paid employees	Contributions can be vested over time	Yes	No. Company match and profit sharing contributions cannot be made as an after-tax Roth contribution. However, employees may elect to make their deferral contributions as Roth in the same manner as a traditional 401(k).
401(k) with Safe Harbor	Yes; employers must use one of the following options: – Employer contributes 3% of employee salary regardless of employee contribution – Employer matches the first 3% of each employee's contribution and 50% of the next 2% – Employer matches 100% of the first 4% of each employee's contribution	– Employees can make tax-deferred contributions up to $20,500 – Employer and employee maximum contributions combined are $61,000 or 100% of the employee's total compensation (whichever is less) – $6,500 catch-up amount for those who are 50+ – Employer can deduct contributions that do not exceed 25% of employees' compensation	Employer contributions are 100% vested immediately	Yes	Yes. The employee contribution options are the same as a traditional 401(k) plan. Contributions can be split between pre-tax and Roth deferrals in any way an individual chooses as long as the combined total does not exceed the $20,500 (plus $6,500 catch-up for those who are 50+)
SIMPLE 401(k)	Yes; employers can choose to make a 2% fixed contribution (regardless of whether employees contribute) or match employee contributions up to 3% of their total compensation. This can be reduced to 1% in 2 out of 5 years.	Tax-deferred contributions of $14,000 plus $3,000 catch-up contributions for employees who are 50+	Employer contributions are 100% vested immediately	Yes	No
SIMPLE IRA	Yes; employers can choose to make a 2% fixed contribution (regardless of whether employees contribute) or match employee contributions up to 3% of their total compensation. This can be reduced to 1% in 2 out of 5 years.	Tax-deferred contributions of $14,000 plus $3,000 catch-up contributions for employees who are 50+	Employer contributions are 100% vested immediately	No	No
SEP IRA	No	25% of an employee's compensation, or $61,000, whichever is less. Employees who are 50+ cannot make catch-up contributions within the SEP but can make them in their regular non-employer-sponsored IRA, if eligible.	Employer contributions are 100% vested immediately	No	No
Defined Benefit: Cash Balance	Yes; employer contributes an amount annually on behalf of owners and participants. The contribution is deposited the following year prior to taxes being filed. The owners and other participants can have different contribution credits, as long as it passes compliance testing.	The annual benefit for a participant cannot exceed the lesser of 100% of the participant's average compensation for his or her highest three consecutive calendar years, or $245,000 for 2022.	Employer contributions must be fully 100% vested in three years	Yes	No

Conclusion

No matter what plan you choose, it's important to talk to an expert as well as consult with legal and tax advisors to discuss which plan makes the most sense for your business, now and as you grow.

When you are ready to take the next step, a Morgan Stanley Financial Advisor is here to help simplify the process of putting a retirement plan to work for your business and employees, from selecting and implementing a plan, to guiding through administrative concerns and ongoing plan management.

[1] https://www.accenture.com/us-en/services/public-service/pensions (acquisition and retention)
https://www.pwc.com/us/en/services/consulting/workforce-of-the-future/library/employee-financial-wellness-survey.html (productivity)
https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2019/05/24163214/FHN-MorganStanley-Infographic-FINAL.pdf (loyalty)

[2] https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

[3] Employers can deduct 1. amounts that do not exceed 25% of aggregate compensation for all participants and 2. all salary reduction contributions (maximum compensation on which contributions can be based is $305,000 for 2022)

[4] https://www.irs.gov/retirement-plans/retirement-plans-startup-costs-tax-credit

[5] https://content.schwab.com/web/retail/public/about-schwab/Schwab_401k_Participant_Survey_deck_2018.pdf
https://www.accenture.com/us-en/services/public-service/pensions

[6] https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

[7] https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

[8] Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants (maximum compensation on which contributions can be based is $305,000 for 2022)

[9] https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits

[10] Employers can deduct 1. amounts that do not exceed 25% of aggregate compensation for all participants and 2. all salary reduction contributions (maximum compensation on which contributions can be based is $305,000 for 2022)

[11] https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview

[12] https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview

[13] https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview

[14] https://www.irs.gov/retirement-plans/retirement-plans-startup-costs-tax-credit

[15] https://www.irs.gov/retirement-plans/retirement-plans-startup-costs-tax-credit

[16] https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/simple-ira-plans-for-small-businesses.pdf

[17] https://www.irs.gov/retirement-plans/sep-fix-it-guide-sep-plan-overview

[18] Employer can deduct amounts that do not exceed 25% of compensation (maximum compensation on which contributions can be based is $305,000 for 2022)

[19] https://www.irs.gov/retirement-plans/retirement-plans-startup-costs-tax-credit

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