Morgan Stanley

Choosing a Plan for Your Business

Thinking of providing a retirement plan for your business? We can help you determine which plan type 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 common types of retirement 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. Discuss these options with your legal and tax advisors as well.

Retirement Plans at a Glance

Below 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.

1. 401(k) Plans

401(k) plans are the most common type of 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 pretax basis, or if a designated Roth plan account feature is offered, on an after-tax basis. Once a plan has been established, a Financial Advisor can work with plan fiduciaries to help reduce certain of their fiduciary responsibilities related to plan investment decisions.

2. SIMPLE IRA Plans/SEP IRAs

SIMPLE IRA Plans/SEP IRAs are retirement solutions where a SIMPLE or SEP IRA is established for the benefit of each eligible employee that allows employers (and employees solely with respect to SIMPLE IRAs) to contribute to those IRAs established for their employees to assist them in saving for retirement. In comparison to a 401(k plan, 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 offer a retirement solution to their eligible employees.

3. Defined Benefit Plans

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 participating employees may accrue substantial benefits 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 descriptions of the plans are not comprehensive and should be considered a high-level overview provided for educational and informational purposes only. Please consult with your legal and tax advisors when considering the various plan options.

Traditional 401(k) Plan

A traditional 401(k) plan 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) plans 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 $69,000 tax-deferred in their 401(k). This includes the $23,000 employee contribution and the owner-employee contribution of up to 25% of the net earnings.[2]
- Employer contributions are tax deductible.[3]
- Employers 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.[1]
- 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 $23,000.[2]
- 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 pretax 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.

Profit-Sharing Plan

A profit-sharing plan may be a plan type to consider for companies that want an option to reward employees when their business has a lucrative year.

A profit-sharing plan is similar to a traditional 401(k) plan as both plan types allow employers to make discretionary employee contributions. A profit-sharing plan provides eligible employees with a share in the employer's profits. Contributions are fully funded by the employer, and employers 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.

Plans can be structured in a way that is appropriate for the business. For instance, employers can structure their profit-sharing plan as follows:

- 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

- Employers may maximize their contributions, setting aside up to $69,000 tax-deferred in their profit-sharing plan accounts.[2]
- Employer contribution amounts are flexible and discretionary, which can work well for companies that have variable profit patterns.
- Tailored vesting schedules available.
- Employer contributions are tax deductible.[4]

Key employee benefits

- Additional contributions may be made by the employer, although employers 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 benefiting business owners and highly compensated employees unfairly at the expense ofother employees.

Safe Harbor 401(k) Plan

A safe harbor 401(k) plan is similar to a traditional 401(k) plan that 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, employers and participating employees can contribute the annual maximum limit to their safe harbor 401(k) plan accounts without the added burden of conducting annual nondiscrimination IRS testing.

A safe harbor 401(k) plan may be a plan type to consider for high-growth small businesses, by offering the maximum amount of flexibility while minimizing administrative responsibilities.

Why employers like them

- Employers may maximize their annual contribution limits, contributing up to $69,000 on a tax-deferred basis in their safe harbor 401(k) plan.
- Employers can compensate higher-paid employees to help retain talent.
- No annual IRS nondiscrimination testing is required.
- Employers may be eligible for up to $5,000 in tax credits for startup and administration costs in the first three years of a new safe harbor 401(k) plan.[4]
- Employer contributions are tax deductible.[4]

Key employee benefits

- Contributions are fully funded and guaranteed by the employer each year.
- Contributions are vested immediately.
- Roth designated account option may be available.

Things to consider

- Employers 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.[3]
- The safe harbor 401(k) plan is not subject to the complex annual nondiscrimination tests that apply to traditional 401(k) plans.[3]
- 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, oremployer contributions made on behalf of all eligible employees, regardless of whether they make elective deferrals.[3]

SIMPLE 401(k) Plan

A SIMPLE 401(k) plan is a plan for companies with 100 or fewer employees that do not offer any other employer-sponsor plan to their employees. As the name indicates, it is simple to set up and requires some administration.

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

Why employers like them

- Low setup fees.
- Plans do not require the same nondiscrimination testing requirements as a traditional 401(k)plan.
- Employer contributions are tax deductible.
- Employers may be eligible for up to $5,000 in tax credits for startup and administration costsin the first three years of a new SIMPLE 401(k) plan.[4]

Key employee benefits

- Mandatory employer contributions.
- Contributions are vested immediately.

Things to consider

- Contribution limits are lower than other plans; annual limit of $16,000 plus $3,500 catch-up contributions for employees age 50 or older.[2]

SIMPLE IRA Plan

A SIMPLE IRA (Savings Incentive Match Plan for Employers) plan is a way to offer a retirement savings solution to employees without the administrative complexity present in other plan types. However, the SIMPLE IRA plan doesn't offer much flexibility. For example, lower contribution limits mean less savings. Once a company selects a SIMPLE IRA plan, there is a two-year waiting period (beginning when an employee first participates in such SIMPLE IRA plan) during which an employee may only transfer money to another SIMPLE IRA.

SIMPLE IRA plans may be a retirement option to consider for smaller companies looking for a cost-effective way to offer retirement savings to their employees.

Why employers like them

- Low setup fees.
- Plans aren't subject to the same nondiscrimination testing requirements as atraditional 401(k) plan.
- Employer contributions are tax deductible.
- Employers may be eligible for up to $5,000 in tax credits for startup andadministration costs in the first three years of a new SIMPLE IRA plan.[4]

Key employee benefits

- Mandatory employer contributions.
- Contributions are vested immediately.

Things to consider

- Contribution limits are lower than other plans; annual limit of $16,000 plus $3,500 catch-up contributions for employees age 50 or older.[2]
- Employees may be able to make tax-free rollovers from a SIMPLE IRA to another type of IRA or to another employer's qualified plan after two years of participation in the SIMPLE IRA plan.[6]
- Onboarding new employees can be cumbersome.
- Does not offer loan provisions.

SEP IRA Plan

SEP (Simplified Employee Pension) IRA plans are different than SIMPLE or traditional IRAs in that contribution limits are much higher and employees can't make any contributions to their own accounts. The employer is required to make contributions to the IRA established for the benefit of each participating employee. 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 help their employees save for retirement.

Why employers like them

- Higher contribution limits than SIMPLE and traditional IRAs.
- Easier to set up and administer than other plan types.
- Employers are not required to make annual contributions, but when they do, all eligible employees must receive the same amount.
- Total contributions to each employee's SEP IRA cannot exceed the lesser of $69,000 or 25% of compensation.[2]
- Each employee is always 100% vested in (or has ownership of) all contributions to the SEP IRA.[7]
- Employer contributions are tax deductible.[4]
- Employers may be eligible for up to $5,000 in tax credits for startup and administration costs in the first three years of a new SEP IRA.[4]

Key employee benefits

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

Things to consider

- Employers must make equal contributions to all eligible employees participating in the plan.
- Employees cannot make contributions.
- Does not offer loan provisions.

Defined Benefit Plan

Defined Benefit plans may be appealing to small businesses to take advantage of the larger tax-deductible contribution limits.

A defined benefit plan provides a specific benefit at retirement age for each eligible employee. Contributions are based on what is needed to provide determinable benefits to the participant. Actuarial assumptions and computations are required to calculate these contributions.

In general, the annual benefit for a participant cannot exceed the lesser of 100% of the average compensation for the participant's three consecutive calendar years, or $275,000.[7]

Why employers like them

- They offer the highest contribution rates of any plan, allowing eligible employees to save large amounts in a short time 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.

Things to consider

- Defined benefit plans can be more administratively complex.
- Employers should consider whether they have sufficient income to fund mandatory annual contributions.
- Employers may want to consider the long-term growth trajectory of the business.

Comparison at a Glance

	MANDATORY EMPLOYER CONTRIBUTIONS	CONTRIBUTION LIMITS	VESTING	LOANS	ROTH-DESIGNATED ACCOUNT PLAN OPTION
Traditional 401(k) Plan	No	• Employer: 25% of compensation or $69,000, whichever is less, for incorporated businesses; lesser of 20% of net earnings from self-employment or $69,000 for self-employed business owners/partners. Subject to $345,000 cap on compensation/net earnings. • Employees: Salary deferral contributions of 100% of earned income up to $23,000. Individuals 50 and older may contribute up to $30,500.	Tailored vesting schedules may be available.	Yes. If permitted under the terms of the plan.	Yes. If a plan includes a designated Roth feature, employees can designate some or all of their elective deferrals as designated Roth contributions.
Profit-Sharing Plan	No	• Employer: 25% of compensation or $69,000, whichever is less, for incorporated businesses; lesser of 20% of net earnings from self-employment or $69,000 for self-employed business owners/partners. Subject to $345,000 cap on compensation/net earnings. • Employee: No pretax employee contributions. Individuals may receive up to 100% of compensation or $69,000, whichever is less. Other limits may apply.	Deferred vesting for up to six years of service.	Yes. If permitted under the terms of the plan.	No.
Safe Harbor 401(k) Plan	Yes	• Employer: 25% of compensation or $69,000, whichever is less, for incorporated businesses; lesser of 20% of net earnings from self-employment or $69,000 for self-employed business owners/partners. Subject to $345,000 cap on compensation/net earnings. • Employees: Salary deferral contributions of 100% of earned income up to $23,000. Individuals 50 and older may contribute up to $30,500.	Full and immediate for employer matching and nonelective contributions. Tailored vesting schedules may be available for other contributions.	Yes. If permitted under the terms of the plan.	Yes. If a plan includes a designated Roth feature, employees can designate some or all of their elective deferrals as designated Roth contributions.
SIMPLE 401(k) Plan	Yes	• Employer: Dollar-for-dollar match up to 3% (lesser percentage may be elected under certain circumstances) of employee compensation or net earnings from self-employment or 2% nonelective contribution for each eligible employee (subject to $345,000 cap on compensation/net earnings). • Employee: Salary deferral contributions of 100% of earned income up to $16,000. Individuals 50 and older may contribute up to $19,500.	Full and immediate.	Yes. If permitted under the terms of the plan.	Yes. If a plan includes a designated Roth feature, employees can designate some or all of their elective deferrals as designated Roth contributions.
SIMPLE IRA	Yes	• Employer: Dollar-for-dollar match up to 3% (lesser percentage may be elected under certain circumstances) of employee compensation or net earnings from self-employment or 2% nonelective contribution for each eligible employee (subject to $345,000 cap on compensation/net earnings). • Employees: Salary deferral contributions of 100% of earned income up to $16,000. Individuals 50 and older may contribute up to $19,500. (No Traditional or Roth IRA contributions are permitted into a SIMPLE IRA).	Full and immediate.	No.	No.
SEP IRA	No	• Employer Only: 25% of compensation or $69,000, whichever is less, for incorporated businesses; lesser of 20% of net earnings from self-employment or $69,000 for self-employed business owners/partners. Subject to $345,000 cap on compensation/net earnings.	Full and immediate.	No.	No.
Defined Benefit Plan	Yes	• Employer: Complex limits apply, which take into account actuarial assumptions (e.g., age, compensation, etc.). Subject to $345,000 cap on compensation/net earnings. • Employees: No pretax employee contributions to traditional defined benefit plans. (After-tax contributions may be permitted). Certain limits may apply.	Deferred vesting for up to seven years of service.	Yes. If permitted under the terms of the plan.	No.

Conclusion

No matter what plan you choose, it's important to consult with your legal and tax advisors to discuss which retirement solution makes the most sense for your business, now and as your business grows.

When you are ready to take the next step, after consulting with your legal and tax advisors, your Morgan Stanley Financial Advisor is here to help simplify the process of putting your selected retirement plan to work for your business and employees.

[1] https://www.morganstanley.com/content/dam/msdotcom/atwork/state-of-workplace-financial-benefits-study-2023/state-of-workplace-study.pdf

[2] https://www.irs.gov/pub/irs-drop/n-23-75.pdf

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

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

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

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

[7] https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-defined-benefit-plan-benefit-limits

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