Qualified Plans

What When and How

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September 30, 2025

What is a Qualified Plan?

- Retirement plan that provides tax benefits to the employer and to participants
- Subject to IRS requirements
- Unless an exception applies, subject to the Employee Retirement Income Security Act (ERISA)
  - Exceptions for governmental and church plans

Types of Qualified Plans

- Defined Contribution Plans
  - Profit Sharing Plans
  - 401(k) Plans
  - Money Purchase Plans
  - Employee Stock Ownership Plans
- Defined Benefit Plans
  - Traditional Pension Plans
  - Cash Balance Plans

DEFINED CONTRIBUTION PLANS

Profit Sharing Plans

Individual Account Plan that enables employer to make a discretionary profit sharing contribution that may or may not be based on company profit

401(k) Plans

Individual Account Plan that enables participants to defer a portion of their salary on either a pre-tax or after-tax (“Roth”) basis

Often includes a matching contribution

May also include a profit sharing component

Money Purchase Plans

Individual Account Plan to which employer contributions are made in a stated amount based on a percentage of participant's compensation

Example: The employer contributes on behalf of each participant 5% of the participant's compensation.

These plans are now somewhat rare and are subject to mandatory spousal annuity requirements, unless waived.

Employee Stock Purchase Plans (“ESOPs”)

Individual Account Plan that is designed to invest primarily in employer stock

May be leveraged or non—leveraged

Leveraged ESOPs are subject to additional compliance requirements if the loan to the ESOP is from a disqualified person, e.g., the employer or a current shareholder.

Special non-allocation rules apply to S corporation ESOPs

DEFINED BENEFIT PLANS

Traditional Pension Plans

- Plan that provides a benefit payable at normal retirement age
- Plan may provide a reduced early retirement benefit
- Benefit may be a fixed amount
- Benefit may be a formula that is calculated as the product of a participant's compensation for a certain period and the participant's years of service
- Employer must fund the plan on an ongoing basis based on actuarial assumptions

Cash Balance Plans

- Pension Plan that is a hybrid between traditional pension plan and an individual account plan
- Normal retirement benefit is calculated by reference to a notional account balance credited with employer contributions and a fixed or variable rate of interest, based on the formula in the plan.
- Employer must fund the benefit and bears the risk of investment performance

Defined Benefit Plan Unique Issues

- Need an actuary to determine required contributions consistent with IRS funding requirements
- Pension Benefit Guaranty Corporation (PBGC) filings and premiums
  - Exception for governmental and church plans (not subject to ERISA) and plans of professional service employers who have never covered more than 25 active participants
- Annual funding notice to participants and beneficiaries
- Annuity notices and spousal consent requirements for distributions

IMPORTANT ROLES

- Plan Sponsor—the employer who sponsors the plan
- Plan Administrator—does the plan document name the plan sponsor as the administrator?
- Outside Recordkeeper/TPA/Actuary
- Who is a fiduciary?
  - Discretionary control over plan administration or investment of plan assets
- Am I a fiduciary?

TERMINATE OR CONTINUE A CUSTOMER'S PLAN

Should the company continue to maintain the plan?

- Is the business ongoing with continuing employees?
- Has the plan document been timely updated for current legal requirements?
- Do the executives demand it as a condition of continued tenure?
- Is there a good support system with qualified professionals in place?
  - Outside recordkeeper
  - Actuary for defined benefit plans
  - ERISA counsel

ONGOING ADMINISTRATION

- Annual returns (Form 5500)
- Annual compliance testing (nondiscrimination and coverage)
- Plan Sponsor concerns
  - Who is updating the plan for statutory and regulatory changes
    - Prototype or customized plan
- Fiduciary concerns
  - Who is making investment decisions for investment of plan assets?
  - Who is updating the summary plan description?
  - Who is providing required annual notices?

Should the company terminate the plan?

- Is the business winding down?
- Is ongoing administration a challenge?
- If a defined benefit plan, is the funding status adequate to pay benefits upon termination of the plan?
- If you terminate a 401(k) plan and make distributions, cannot put another defined contribution plan in place within 12 months if more than 2% of the current participants would be covered under the replacement plan

STEPS TO TERMINATE A PLAN

- Board resolution to terminate the plan and set the date of termination
- Must amend the plan for any statutory or regulatory provisions in place and make required employer contributions prior to the termination date
- Must fully vest all participants
- Should I file IRS Form 5310?
- If a defined benefit plan, must follow procedures to terminate with the PBGC—the plan should be fully funded
- Notice requirements

PROBLEM SOLVING

How Do I Fix It?

My customer has a 401(k) Plan that has not filed a 5500 in 3 years

- Department of Labor Delinquent Filer Program (DFVCP)
  - Must file before receiving notice from DOL of late filing
  - Penalty for small plans (fewer than 100 participants)
    - $750 maximum for single late filing (or $10/day if less)
    - $1,500 for multiple years (or $10/day per filing if less)
  - Penalty for large plans
    - $2,000 maximum for single late filing (or $10/day if less)
    - $4,000 for multiple years (or $10/day per filing if less)

How Do I Fix It?

- Penalties for Late Filing Outside the Delinquent Filer Program
  - IRS Penalties--$250/day with maximum of $150,000 for each late 5500
    - IRS will generally waive this penalty for DFVCP filers
  - DOL Late filing-Up to $2,739/day with no limit (and not considering any filing extensions)

How Do I Fix It?

My customer has a 401(k) Plan that has delinquent contributions

- Amounts were withheld from payroll for employee deferrals and loan payments but were not timely contributed to the plan.
- DOL Voluntary Fiduciary Correction Program (VFCP)
  - Must not be "under investigation"
  - Must pay missed deferrals/loan payments with interest
  - No excise tax if certain conditions are met

How Do I Fix It?

My customer acquired another company with a 401(k) Plan that is still in existence until the end of the year and my customer didn't amend their plan to exclude the acquired employees for that period of time.

- IRS Voluntary Correction Program (VCP)
  - Retroactive Amendment through Self-Correction if excluding the employees wouldn't reduce their benefit

How Do I Fix It?

My customer inadvertently excluded some eligible employees from participation in the plan or used an incorrect definition of compensation when determining plan contributions

- IRS Voluntary Correction Program (VCP)
  - Contribute a portion of the missed contributions with calculated earnings through self-correction or a VCP filing

How Do I Fix It?

Qualified Plans have many requirements and many things can go wrong. Unless the company is acting in bad faith, most violations can be corrected.

When in doubt, contact qualified ERISA counsel.

Questions?

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