ANNUAL LIMITS, DEFINITIONS, AND GUIDANCE - 2025

This is a summary of important plan issues – updates to the limits, some information about new regulations, etc. Please review this and keep these items in mind while administering your plan. If you have any questions, please contact a member of your CPC team.

<u>Catch-up Contributions for 401(k) and 403(b) Plans</u>

Catch-up contributions, if allowed by your plan, may be made by participants who are age 50 by the end of the calendar year. A participant whose 50th birthday occurs anytime during a calendar year is considered to be age 50 as of January 1st of that year.

Starting in 2025, an additional catch-up is available for employees attaining the ages of 60, 61, 62, or 63 during the year: their catch-up limit is increased by 50% of the applicable limit (for 2025, it goes from $7,500 to $11,250.) The participant ages out of this in the calendar year in which they attain age 64. Be sure to communicate this to applicable participants; they should complete an election if they want to defer the higher amount.

Starting 1/1/26, all catch-up deferrals for "High Earner" participants (currently defined as having compensation greater than $145,000 in the prior year) must be made as Roth deferrals. We will be reviewing plans and sending you more information on this later in 2025.

As discussed in an email sent to 401(k) and 403(b) plan contacts, catch-up contributions are optional; you can choose to eliminate them entirely. If interested, you should discuss this with your tax and financial advisors.

Annual Plan Limits

Each year the U.S. government adjusts the limits for qualified plans and Social Security to reflect cost-of-living adjustments and changes in the law. This is a list of the ones that will affect your plan the most. Many of these limits are based on the "plan year" as defined in the plan document. The elective deferral and catch-up limits are always based on the calendar year.

	2025	2024	2023	2022
Compensation	$350,000	$345,000	$330,000	$305,000
Limits on benefits and contributions:				
Defined contribution plans	$70,000	$69,000	$66,000	$61,000
Defined benefit plans	$280,000	$275,000	$265,000	$245,000
401(k), 403(b) and 457 plan elective deferrals	$23,500	$23,000	$22,500	$20,500
SIMPLE plan elective deferrals	$16,500	$16,000	$15,500	$14,000
IRA	$7,000	$7,000	$6,500	$6,000
Catch-up contributions:				
Basic for 401(k), 403(b) and 457 plans (ages 50-59 or 64+)	$7,500	$7,500	$7,500	$6,500
Supplemental for 401(k), 403(b) and 457 plans (ages 60-63)	$3,750	N/A	N/A	N/A
Basic for SIMPLE plans (ages 50-59 or 64+)	$3,500	$3,500	$3,500	$3,000
Supplemental for SIMPLE plans (ages 60-63)	$5,250	N/A	N/A	N/A
IRA	$1,000	$1,000	$1,000	$1,000
"Highly Compensated" definition	$160,000	$155,000	$150,000	$135,000
"Key Employee" definition:				
Officer	$230,000	$220,000	$215,000	$200,000
1% owner	$150,000	$150,000	$150,000	$150,000
Social Security taxable wage base	$176,100	$168,600	$160,200	$147,000

Annual Additions Limit (Internal Revenue Code Section 415)

The total of all contributions and forfeitures allocated (excluding catch-up contributions) for a participant may not exceed the lesser of 100% of gross compensation or the annual additions limit for the plan year. (See “Limits on benefits and contributions” above.)

Long-Term, Part-Time Employees UPDATED

The SECURE Act enacted at the end of 2019 requires that 401(k) plans allow employees who are not already eligible and are employed for at least three consecutive years with at least 500 hours, but less than 1,000 hours, per year ("long-term, part-time employees" or "LTPTEs") to defer into the plan. Plan Sponsors had to start tracking hours worked for these employees beginning January 1, 2021, as pre-2021 service is disregarded. However, due to the three-year determination period, the first time these employees must be able to defer is January 1, 2024 (this may be different if your plan is not calendar-year based.) In addition to tracking the hours, the exact hours worked need to be provided as part of the year end census collection for the plan. If full census is being provided each pay period to a recordkeeper so that they can determine eligibility and/or vesting, make sure it has ALL employees and complete data, including hours worked.

The SECURE 2.0 Act enacted at the end of 2022 now requires that 401(k) AND 403(b) plans allow employees who are not already eligible and are employed for at least two consecutive years with at least 500 hours, but less than 1,000 hours, per year ("long-term, part-time employees" or "LTPTEs") to defer into the plan. For 401(k) plans, pre-2021 service continues to be disregarded. For 403(b) plans, pre-2023 service is disregarded. The first time the employees that meet these criteria must be able to defer is January 1, 2025 (non-calendar year plans may have a different starting date.)

Refer to our SECURE 2.0 documents (posted under Client Resources on our website) and the Winter 2022 and Winter 2023 newsletters (posted under Newsletters on our website) for more information, examples and recommendations of how to change your eligibility provisions to avoid these rules if warranted.

Highly Compensated Employees

Highly compensated employees must be identified to apply the various nondiscrimination tests for qualified plans.

In general, an employee is a highly compensated employee if the employee meets one of two tests:

1. 5% Owner Test - The owner owns more than 5% of the employer (or more than 5% of a related employer) at any time during the current or prior plan year. An individual is treated as owning any interest that is owned by the individual's spouse, children, grandchildren or parents.

2. Compensation Test - In determining the highly compensated status for the current year, you are looking back to the prior year. Therefore, use the limit in effect for the prior year (e.g., for 2024 HCE determination, 2023 compensation must be in excess of $155,000.00).

The employer may elect to limit the number of employees included in the compensation test to the top 20% of employees for the prior year, if permitted by the plan.

S-Corp Shareholder Health Insurance Premium

The health insurance premiums paid by greater-than-2%-shareholders in an S-Corp are counted as compensation for employer contribution purposes, but only if reported in Box 1 on the shareholder's W-2. Reporting these amounts incorrectly may be a nondiscrimination issue. If this applies to you, please review your year-end reporting to avoid potential issues and delays in your annual calculations.

Loan Defaults

A participant's loan that is defaulted due to non-payment or late payment is taxable to the participant. A Form 1099-R must be issued. Please refer to the plan's loan procedure to determine if any loans are in default. Please let us know immediately when a loan is in default.

Hardship Self-Certification

If the plan allows hardship distributions, you may choose to allow participants to 'self certify' their hardship distribution requests, as opposed to collecting detailed information to determine if it meets the IRS standards. Participants have to attest it meets an IRS standard and agree to keep relevant documentation for three years (so they can provide it in the case of an audit); this will indemnify the plan from any misdeed unless it can be shown the plan knew of the misrepresentation.

There are pros and cons to this (which we have outlined in previous eblasts), but it seems that the retirement plan industry is moving in this direction in general. If you get any communication saying that your recordkeeper WILL add it by default, please let us know. We can add this feature to your plan at any time.

Top Heavy

The definition of Key Employee used to determine if a plan is top heavy is as follows:

1. an officer with compensation in excess of $230,000 (for 2025). However, in determining the key employees for the current year (2024), you are looking back to the threshold in effect for the prior year ($220,000 for 2024); or

2. a more than 5% owner*; or

3. a more than 1% owner* with compensation in excess of $150,000.

* An individual is treated as owning any interest that is owned by the individual's spouse, children, grandchildren or parents.

An employee is a Key Employee if he or she satisfies the definition during the preceding plan year.

A retirement plan is determined to be top heavy when the account balances of key employees exceed 60% of the total plan balance. **In general**, a plan determined to be top heavy must ensure that all eligible participants receive a minimum contribution (in most cases equal to 3% of compensation). If the only contributions made to the plan for the year are deferrals and a safe harbor allocation, this test may be ignored for the year.

This test looks at the money in the plan. This is a different test than the ones that compare the contributions made for the current year.

Loan Repayments and Timing of Deposits

Please be sure that all loan repayments are made to the plan on an after-tax basis.

The Department of Labor issued final regulations establishing a safe harbor for the timely deposit of loan repayments and employee deferrals to retirement plans.

Under the safe harbor, employee deferrals and loan repayments to plans with fewer than 100 participants will be in compliance if these amounts are deposited within seven (7) business days after the amounts would have been payable to the participant or received by the employer (in the case of a participant loan repayment made outside of payroll.) This supersedes the IRS regulation and is faster than is required for SIMPLE IRA plans. To date, no proposed guidance has been issued for plans with 100 or more participants. The DOL, however, has indicated that the deposits should be made at the same time as the payroll tax deposits.

Deposits that are not made timely are subject to the following: they must be "made whole" with lost earnings paid by the plan sponsor; they may be subject to an excise tax due to the IRS; a filing may need to be submitted to the Department of Labor explaining the reason for the error, the steps taken to correct the error, and the procedures implemented to avoid future errors; and they must be reported on Form 5500-SF under penalty of perjury. We strongly recommend that you review your internal procedures to ensure you meet the applicable standard.

Deferral Election Forms

New participants should be informed, and existing participants should be reminded, to verify that the employer has properly implemented their deferral election. This should be done at the beginning of each year as well as after any requested election change.

The employer should also verify that all participants have returned a deferral election form to the employer **even if the participant is choosing to defer $0**. This will serve as proof that the plan was offered to the participant should it be audited by the IRS or DOL and is an important reference for plans with automatic enrollment.

Elective Deferrals for Partners and Sole Proprietors ("self-employed participants")

A self-employed participant's earned income is treated as currently available on the last day of their taxable year.

A deferral election must be made no later than the last day of the year and may state the deferral as a dollar amount, a percentage of the partner's earned income, or as a formula (e.g., "the maximum deferral amount that does not exceed all applicable limits").

Since the actual earned income is not determined until after the end of the taxable year, a self-employed participant who defers during the year may (i) "overshoot" a plan-imposed limit on deferrals based on compensation (earned income) or a deferral election made as a percentage; (ii) have to "true-up" the deferrals at year end to correspond to his/her election; and/or (iii) not have sufficient earned income to support the deferral. For these reasons, we recommend that self-employed participants not defer during the year, but if they do so, to defer "conservatively" (and at consistent, fixed amounts) if it is not possible to reasonably forecast earned income until late in the year.

The deferrals must be deposited at the earliest date they can reasonably be segregated from the self-employed participant's general assets, but not later than the 7th business day following the day on which the earned income is determined. The date the partner's earned income is determined is the date the partnership's accountant determines the partner's distributive share of earned income or, if deferring on a monthly draw which is paid on the last day of the month, the earned income is treated as being distributed on the last day of each month. For a sole proprietor, it is the day on which the sole proprietor's earnings are determined.

Automatic Enrollment

401(k) and 403(b) plans started after 12/28/22 are required to have an automatic enrollment feature. Any participant who does not make a deferral election (choosing zero is considered 'an election') will be subject to having a percentage of their compensation deducted from their pay and deposited into the plan. These deferrals will be invested in a default fund and can be refunded within 90 days. Automatic enrollment will require additional annual notices be provided to participants. And the automatic deferral rate must increase each year (to avoid this part, industry standard is to set the initial default rate to 10% or higher – this also encourages participants to act.)

There are some exceptions to the requirement. Businesses less than three years old are exempt (though they lose that exemption when they reach the three-year mark) as are those that 'regularly employ' ten (10) or fewer employees. "Regularly employ" is not yet fully defined by the IRS. In general, if you are going to eventually end up requiring automatic enrollment, our opinion is that it is easier to add it from the start than to change procedures later.

We recommend that participants be encouraged to make their own deferral; the fewer participants you have subject to these provisions, the simpler the administration from your side will be.

Many recordkeepers have developed eligibility tracking (and some also provide notice delivery for a fee) to help with this. We recommend that you review this with the plan's recordkeeper, if applicable, and use the tools they provide to help keep you compliant.

Fidelity Bond

Under U.S. Department of Labor regulations, anyone who has discretionary authority or control over a plan or its assets, and anyone who handles funds or other property of a plan, must be bonded. A plan administrator, officer, or employee shall be deemed to be "handling" funds or other property of a plan whenever his/her duties or activities with respect to given funds or other property could be lost in the event of fraud or dishonesty on the part of such person, acting either alone or in collusion with others. Handling does not require physical contact.

The plan(s) must be named in the bond as an insured and the bonding company must be listed on the Department of the Treasury's Listing of Certified Companies. The current version of the list can be obtained at http://www.fiscal.treasury.gov/fsreports/ref/suretyBnd/c570_a-z.htm. The bond must be in an amount of at least 10% of the plan(s) assets as of the beginning of the plan year. The bond may not be for less than $1,000 and need not be for more than $500,000 (see exception below*.) Please contact your insurance company to obtain a bond, or you may apply for a bond on-line by going to our website, http://www.crepen.com/, clicking on "Links", and then clicking on "Colonial Surety Company".

A bond is not required for a plan covering only the owner or the owner and the owner's spouse. If the plan's only participant is not the owner, this exception does not apply. Also, a bond is not required for a partnership if the plan covers only partners or partners and their spouses.

* For plans with investments in non-qualifying assets (limited partnership interests, non-marketable securities (i.e., securities that are not traded on an exchange and not readily marketable with an ascertainable value), real estate, collectibles, and mortgages or loans (other than participant loans)), DOL regulations require that the bond be increased to the value of the non-qualifying assets, even if for more than $500,000. **If the bond is not increased or there is no bond, the plan will be required to have an audit by an independent qualified public accountant.**

The Department of Labor intends to contact retirement plan sponsors who appear to have no fidelity bond, or who have an insufficient amount of bonding as reported on Form 5500/5500-SF. If so notified, plan sponsors will have fifteen (15) days to obtain sufficient bonding and provide proof of the bonding to the DOL.

Note that this is different from a "fiduciary bond". A fidelity bond is required by the DOL and protects the plan from misdeeds. A fiduciary bond is an <u>optional</u> coverage the trustees and others who handle the plan can obtain to help protect themselves from a lawsuit against them for mismanaging the plan. You should review the plan set up, size, and other plan administration aspects with your financial advisor to determine if this optional coverage is necessary.

More SECURE 2.0 Changes

There are some provisions in the SECURE laws that we do not recommend making available at this time, typically because either we are still waiting for more detailed regulations so they can be administered properly, or they are not able to be implemented at this point because the 'structure' to handle them is not fully developed yet.

Some examples are:

- Plan match based on student loan repayments;
- Distributions due to domestic abuse situations;
- Distributions to terminally ill participants; and
- Depositing employer contributions as Roth.

As more information about these become available, we will keep you updated.