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Navigating 401(k) Plan Considerations in a Corporate Transaction

In a corporate transaction, one of the many areas that must be addressed is employee benefits. From the scope of diligence review of the various employee benefits programs, to assessment of their related liability considerations, and contemplation of post-closing arrangements and integration of employees, there is no shortage of issues to tackle. Each employee benefit program is also subject to its own set of rules and compliance obligations that will require a separate analysis. The purpose of this article is to highlight some of the decision points and complex issues that can arise with regard to 401(k) plans in a transaction.

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It is no wonder that employer-sponsored 401(k) plans are a key topic to address in corporate transactions since, as of the end of 2023, there were at least 843,053 401(k) plan sponsors. {P&I Research Center 2024 U.S. Defined Contribution Record-Keeper Data Report and Analysis} These employer-sponsored 401(k) retirement plans held $9.3 trillion in plan assets as of June 30, 2025. {ICI's Statistical Report, Release: Quarterly Retirement Market Data, Second Quarter 2025 (September 18, 2025)} The likelihood of having to navigate 401(k) plan issues in a corporate transaction is quite high. While there are some issues that consistently arise, there also are evolving issues to consider. The purpose of this column is to provide employers, both buyers and sellers, with an overview of preliminary considerations to keep in mind when addressing 401(k) plans and related issues in a corporate transaction.

Compliance Status of the 401(k) Plan

On an ongoing basis, plan sponsors must maintain their tax-qualified 401(k) plans, in form and operation, in compliance with applicable law. In the normal course of plan administration, any 401(k) plan-related compliance issues, including late contributions or delinquent Form 5500 filings, must be corrected as soon as possible in the best interests of plan participants and beneficiaries. If a seller has any question that its 401(k) plan governance, status of written plan documentation and authorized signatures, or fulfillment of the reporting and disclosure obligations of the 401(k) plan has been less than stellar, they should identify the appropriate individuals who can conduct a self-audit of the 401(k) plan program to address any compliance issues and plan records long before commencing a corporate transaction process. A self-audit is a fiduciary best practice that should be periodically conducted in the normal course and can be performed without risking disclosure of a potential sale. During a self-audit exercise, any outstanding compliance issues can be identified and corrected, and plan records can also be organized so that they are in order and easily produced for buyer review when the time comes.

Certainly, a buyer in a corporate transaction would not want to inherit, assume sponsorship of, or merge a 401(k) plan with outstanding errors, compliance violations, or looming liabilities, nor would it want to be exposed to any outstanding plan-related risks. If such risk exists, a buyer would likely seek indemnification in the purchase agreement. Even if a buyer does not inherit the plan and requires a seller to terminate the plan prior to a closing of the transaction, the seller will need the plan to be compliant through the date of plan termination. In addition, the compliance status of seller's plan will affect the buyer's willingness to accept rollovers of acquired employee accounts from seller's plan into its own 401(k) plan.

Once a transaction process is underway, sellers also should seek to learn as much as they can about any buyer 401(k) plan in which their employees may participate after the closing of a transaction. While this type of discussion likely will occur later in the diligence process, the appropriate parties should confirm the benefit plan offerings that will be made to the acquired employees, and confirm 401(k) plan design and features, as well as overall state of the plan's governance and compliance with applicable law. Sellers would not want their employees to be participants in a buyer 401(k) plan that is plagued with poor governance or looming compliance issues and liabilities. Efforts should be made to address post-closing integration of employees and employee benefits offerings with qualified advisors prior to a transaction closing so that these issues can be effectively addressed and communicated to the employees at the appropriate time.

Sponsor of the 401(k) Plan

The target entity of a corporate transaction might not be the actual sponsor of the 401(k) plan in which its employees participate. Sometimes, the target entity is part of a larger controlled group of entities, and the target entity itself might be a participating employer in a plan sponsored by another entity in its controlled group. Depending on the facts of a particular transaction, there also may be reasons to transition the 401(k) plan sponsorship to the target entity, and restructure the nature of the other participating employers in such plan, or establish a separate plan for the target entity, well in advance of engaging in any potential sale process. This target entity also could be a participating employer in a 401(k) plan sponsored by a professional employer organization, a multiple employer plan provider, or a pooled plan provider, in which case it will be imperative to understand the policies, procedures, and timelines of that third-party plan provider for the entity to terminate participation in such plan, which may require a spin-out of assets from such plan into a single-employer plan that can be terminated prior to the closing of any sale of the target entity.

Buyers also may need to consider which 401(k) plan within its controlled group of entities will provide acquired employees with eligibility for participation, especially if it has a complex organizational structure. A buyer may need to amend its 401(k) plan to be a multiple employer 401(k) plan, or it may have a need to establish a new plan for the acquired target entity. Moreover, in complex structures in which a buyer has carefully balanced the coverage of employees in various plans sponsored by its greater controlled group, the acquisition of a new entity and employees could threaten that balance. It would be prudent to consider how the new entity and employees will impact the buyer's plan structure well in advance to prepare for such changes, rather than after compliance issues arise. Thus, sponsorship of a 401(k) plan at the appropriate entity level for acquired employees, and anticipation of plan coverage and testing issues, may require attention.

What Type of Transaction?

The structure of a corporate transaction will impact the considerations related to handling of the seller or target entity 401(k) plan, and provision of a 401(k) plan to acquired employees. The main options to consider include terminating the seller or target 401(k) plan immediately prior to the closing of the transaction, continuing to maintain the 401(k) plan post-closing, freezing the 401(k) plan as of the closing and merging it with a buyer plan post-closing, or continuing the 401(k) plan and merging it with a buyer plan prior to the end of Internal Revenue Code (Code) Section 410(b) transition period. In some cases, it may be desirable and possible to maintain the target plan indefinitely, particularly in groups that have widely diverse employee populations with different priorities. The desired approach may fluctuate during the diligence process of a transaction or as the structure of the transaction changes. The parties will need to be prepared to pivot as needed on the final approach and related tasks.

In a stock purchase or merger transaction, the liabilities of a seller transfer by operation of law to a buyer. Buyers typically require a target company to terminate its 401(k) plan prior to the closing of the transaction for two reasons: (1) the buyer may not want to inherit a plan with compliance issues, and (2) provisions in the 401(k) rules generally prohibit post-acquisition plan termination and asset distribution, requiring the buyer to maintain the acquired plan or merge it with its own plan post-closing. In particular, if the seller or target entity 401(k) plan is terminated post-closing and the buyer, or any of its related companies, sponsors (or adopts within 12 months) another defined contribution plan, the seller/target plan would be foreclosed from providing benefit distributions to its participants. [Code § 401(k)(10)] This so-called alternate defined contribution plan rule (also referred to as the successor plan rule) does not apply if either the plan is terminated before the transaction or if, at all times during the 24-month period beginning 12 months before the date of plan termination, fewer than 2 percent of the employees who were eligible under the seller/target 401(k) as of the date of plan termination are eligible under the other defined contribution plan of the buyer. In such a situation, the buyer's plan is not an alternative defined contribution plan, and distributions would be permitted from the seller's plan.

In an asset purchase, the buyer may purchase certain assets and assume some, but not all of, the seller's liabilities. A buyer may still request that a seller terminate its 401(k) plan prior to the closing of an asset sale, especially if it is concerned about successor liability issues, but if the seller will still have other operations and employees, it may be in a position to retain and continue its 401(k) plan operations. The employees that would be hired by a buyer in an asset sale would be terminated from employment by a seller and able to obtain 401(k) plan distributions in connection with their severance from employment. The buyer generally would inherit no plan from the seller and would require that the purchase agreement exclude it from the acquired assets and liabilities, so its potential liability may be considerably less than with a stock or merger transaction although successor liability issues can arise.

In a joint venture or a private equity deal, there may be additional nuances and considerations to weigh as to whether it would make sense to assume and continue to maintain a seller's or target entity's 401(k) plan. Organizational structure issues also may need to be addressed concerning the appropriate entity to sponsor the 401(k) plan post-closing. Applicable coverage and non-discrimination testing rules may raise additional complexities.

Due Diligence Review of the 401(k) Plan and the Purchase Agreement

The due diligence exercise in corporate transactions will involve review of the compliance status of the seller or target entity's 401(k) plan. This may entail review of the applicable plan documentation, plan design features, duly authorized plan adoption resolutions and amendments, summary plan descriptions, trust agreements, investment management agreements, Form 5500 filings, nondiscrimination testing reports, fiduciary governance structure, investment option line-up, fidelity bond, fiduciary liability insurance policy, service agreements, non-routine government correspondence, outstanding plan errors or corrections and related corrective filings, non-routine claims, pending or threatened litigation, status of plan audits, any untimely plan contributions, prohibited transactions, assessed or potential excise taxes or penalties and status of payment of same, and occurrence of partial plan termination requiring accelerated vesting for affected participants. The seller also will make certain representations regarding the compliance of the seller or target entity 401(k) plan with applicable law, in form and operation, in the purchase agreement. The diligence review will result in an assessment of the compliance status of the plan and the veracity of these purchase agreement representations.

Depending on the diligence findings, and the structure of the post-closing entities, a buyer might agree to inherit the plan and maintain it post-closing or to merge it with another existing plan in its controlled group. If there is ample time prior to consummation of a transaction, the parties might also be able to align their respective plan terms so that the seller or target entity 401(k) plan can be assumed and easily merged with a buyer 401(k) plan. In most cases, however, a buyer will seek a covenant in the purchase agreement that the seller entity will take necessary actions to terminate the 401(k) plan immediately prior to, and contingent on, the closing. The contingency wording has become common so that sellers can manage the plan termination in practice, especially if the deployment of the plan termination process needs to be halted, but the plan termination date is to be prior to closing. Sellers and target entities must ensure that they understand their plan document provisions, and their service provider procedures for terminating plans which may be addressed in plan service agreements, and should confirm with their service providers the applicable timelines and instructions that will need to be provided in order to commence, and wind up, a 401(k) plan termination.

In the event that material compliance issues are discovered with respect to a seller or target entity 401(k) plan, a buyer also may seek indemnification for liabilities or other adjustments as reflected in the purchase agreement. With the proliferation of State-run automatic payroll-IRA (individual retirement accounts) requirements for employers that do not sponsor retirement plans, a seller that does not sponsor a 401(k) plan may even have potential penalty exposures for not properly registering with the applicable State-run automatic payroll-IRA program, and buyers would need to consider if indemnification is warranted for same. Buyers also must ensure that the appropriate 401(k) plan amendments are made to their own plan to address any relevant purchase agreement covenants made by the buyer, such as commencement of plan participation eligibility, addition of related or participating employers, or crediting of service and vesting, especially for asset purchase agreements.

Termination of the Seller or Target Entity's 401(k) Plan Immediately Prior to the Closing

Once the parties have determined that the seller or target entity will need to terminate its 401(k) plan immediately prior to, and contingent on, the closing of the transaction, the applicable plan sponsor, through action of its governing body, will need to adopt resolutions accordingly, establishing the plan termination date. In addition, any required 401(k) plan amendments to maintain the plan's tax-qualified status through the date of termination must be timely adopted. A buyer will request to review these resolutions prior to the closing date, as well as seek confirmation of completion of any corrections of outstanding plan errors prior to plan termination. All participants will become fully vested in their 401(k) plan accounts. If an Internal Revenue Service (IRS) determination letter is desired in connection with the plan termination, provision must be made for preparation of the submission to the IRS for the request.

Coordination with 401(k) plan service providers will be needed to address plan termination steps, final plan contributions, treatment of outstanding plan loans, search methods for missing participants, small balance cashouts and safe harbor IRA rollovers, communications to plan participants including plan distribution and rollover packages, and action plan for wind up tasks including final plan nondiscrimination testing, plan audits, and interim and final Form 5500 filings. It is important to keep in mind that when a 401(k) Plan has a short plan year or a termination before the end of a plan year, there is a proration requirement for the Code Section 401(a)(17) compensation limit and the 415(c) contribution/forfeiture allocation limit for short plan years and terminating plans. If the plan sponsor adopts a resolution to terminate the plan before the end of the year, final allocations under the plan are based on compensation earned to date of plan termination, and the applicable IRS Section 401(a)(17) compensation limit for that year is prorated by multiplying the applicable annual compensation dollar limit for the calendar year by a fraction, the numerator of which is the number of months in the short plan year, and the denominator of which is 12. [Treas. Reg. § 1.401(a)(17)-1(b)(3)(iii)(A)] A terminating 401(k) plan is treated as having amended its limitation year if the effective date of the termination is any date other than the last day of the plan's limitation year. The short limitation year ends on the effective date of the plan termination. [Treas. Reg. § 1.415(j)-1(d)(3)] Termination of such a plan before its last day will lower the dollar limit on the maximum amount of annual additions that may be credited to a participant's account in its final year. [Treas. Reg. § 1.415(j)-1(d)(3)] This requires proration of the Code Section 415(c) dollar limitation for the termination year, and might restrict the maximum amount otherwise allocable to a participant.

An individual may need to be appointed as a fiduciary to continue to manage 401(k) plan wind-up tasks and provide authorized signatures on final reporting and disclosures. A safe harbor IRA solution also may need to be established for small balance cashouts or missing participants. If a seller or target entity 401(k) plan has an auto-portability feature in effect for small balance cash-outs, and the plan is involved in a merger or acquisition, this could impact the auto-portability program, including former employees in transit in the network. In the event that the terminating 401(k) plan has assets invested in complex investments that raise special liquidation considerations, those issues will need to be addressed before those affected participants can obtain their plan distributions or rollovers. Service agreements will need to be terminated at the appropriate time and provisions should be made for secure return and destruction of records and data. A responsible fiduciary should oversee the management of final compliance and governance tasks.

Considerations for Buyer When Assuming the Seller or Target Entity's 401(k) Plan

In the event a buyer determines that it would make sense to inherit and assume a seller or target entity's 401(k) plan, even if that plan is frozen, the buyer will need to decide between maintaining that plan as a separate plan in its controlled group and ensure that there is long-term fiduciary oversight for the separate plan, or undertaking steps toward merging that plan with its own 401(k) plan. To effect a plan merger, the buyer will need to establish a project plan with the applicable plan service providers to navigate the many steps involved, including coordination with the recordkeepers of both 401(k) plans to arrange the transfer of assets from the seller or target 401(k) plan to the buyer's 401(k) plan. There also may be plan testing or correction issues to resolve prior to establishment of the plan merger date. The buyer will need to adopt resolutions to execute a plan merger and asset transfer, and amend its plan as applicable. Reciprocal resolutions also will need to be adopted with respect to the seller or target 401(k) plan. Buyer will need to file a final Form 5500 for the seller or target 401(k) plan within seven months of the end of the month during which final distribution of benefits from that 401(k) plan occurred (that is, the date on which the assets are transferred into the buyer's 401(k) plan). The IRS may audit the seller or target 401(k) plan for up to three years after the filing of its final Form 5500. The buyer also will need to terminate any applicable service agreements with the seller or target 401(k) plan service providers and will need to address how to secure copies of records and participant data and confirm the service providers' procedures for the destruction of files. In addition, there will be many other 401(k) plan benefits, rights, and features, design, testing, and related issues to address in connection with a plan merger. For example,

1. Under the Code's 410(b) transition period rules, the successor entity can conduct separate minimum coverage testing for each of its Code Section 401(k) plans until the end of a transition period that will begin on the closing date of the transaction, and end on the last day of the first plan year beginning after the change in the controlled group, provided that both plans satisfy the minimum coverage rules under Section 410(b) of the Code immediately before the acquisition and there are no significant changes in either the terms of the plan or the coverage of the plans other than the change in the controlled group following the transaction.
2. If the assets from the seller or target entity 401(k) plan will be transferred to the buyer plan in a trust-to-trust transfer or a plan merger, this will require a protected benefits analysis to preserve any benefits, rights and features that may be required under Code Section 411(d)(6). Protected benefits that a plan sponsor cannot reduce or eliminate include benefits such as vesting, retirement age, and early retirement benefits, as well as optional forms of benefits with respect to benefits

attributable to service before the amendment. Optional forms of benefits include payment schedules (lump sum, installment, annuities), timing, distribution forms, and election features. Other benefits, such as participation eligibility, loan availability, and the right to direct investments, are not protected benefits, and so are subject to amendment to match those in the successor plan. The buyer should confirm prior to plan merger that the service providers for its plan can continue to effectively administer the plan with protected benefit features that differ from the mainstream plan features.

3. The actual deferral percentage (ADP) and actual contribution percentage (ACP) testing rules, however, do not offer any transition rule such as the transition rule for minimum coverage testing. Thus, following a corporate transaction, the tests must continue to be performed annually unless the plan satisfies a safe harbor design. Applying the nondiscrimination requirements during the transition period when two 401(k) plans are maintained separately or being merged into one plan requires a number of considerations and potential adjustments when identifying highly compensated employees (HCEs); performing coverage, ADP, and ACP testing; and applying the elective deferral limit. A transaction will often raise issues about how to perform the tests in the plan year of the transaction. The ADP and ACP tests are performed on a plan-year basis, but if merging plans do not have the same plan year or do not merge on the first day of a common plan year, there will be questions about how to proceed with testing. While Treasury regulations address how plans experiencing plan coverage changes should handle prior-year testing, they do not address short plan-year testing or current-year testing for merging plans, or how to resolve other issues that might arise in corporate transactions. Depending on the facts, it may be helpful to merge the 401(k) plans at year-end, so that any testing, or safe harbor, for each plan applies for the whole plan year.
4. Another issue that may come up in the merger and acquisition context affects the top-paid group election in relation to the determination of which employees are highly compensated. This election involves calculating the number of employees in the top-paid 20 percent of the workforce, and identifying those highest-paid individuals. To use the top-paid group election, the election must be reflected in the plan and it must be made by all plans of the employer (other than multiemployer plans). Unless any acquired plan and all of the buyer's plans make the election, none of them will be able to use it. Thus, plans may need to be amended to meet the consistency requirement. Furthermore, the top-paid group election has consistency implications for other benefits such as Section 125 cafeteria plan benefits, so the impact of whether this election is or may be made has more wide-ranging ramifications.
5. A reduction or suspension of safe harbor contributions or changes from safe harbor plan status to non-safe harbor plan status are only permitted as described in Treasury Regulation Sections 1.401(k)-3(g) and 1.401(m)-3(h)), as augmented by IRS Notice 2016-16. Midyear changes either to a safe harbor plan or to a plan's safe harbor notice do not necessarily violate the safe harbor rules, provided that applicable notice and election opportunity conditions are satisfied and the mid-year change is not prohibited by IRS Notice 2016-16. To enable a mid-year reduction or suspension of a plan with matching contributions, the plan's safe harbor notice provided at the beginning of the year would have had to include a statement that the plan could be amended to reduce or suspend safe harbor matching contributions, and such reduction or suspension cannot occur fewer than 30 days after all eligible employees are provided with a supplemental notice. That notice must explain how participants can change their deferral elections before the change goes into effect, and any safe harbor matching contributions that accrued before the amendment date would need to be made. The ADP/ACP tests would apply for the entire year.
6. When a plan merger occurs or assets are moved from the seller's plan to the buyer's plan, there may be restrictions on the normal rights of participants to direct or diversify their assets or to take loans or distributions for a certain blackout period. If a blackout period will last more than three consecutive business days, ERISA generally requires that participants be given at least 30 days' advanced notice, unless an exception applies. As part of the asset transfer, the Buyer will need to arrange for a blackout period and communication of related issues.
7. The former seller or target 401(k) plan participants may have to select new investments when they next access their accounts through the buyer 401(k) plan,

unless their funds are "mapped" to a qualified default investment alternative, or mapped to like-funds with similar risk/returns to their current investments. The participants can avoid mapping if they make affirmative elections as to where they would like to map their investments prior to the blackout period; or they can make investment selection changes after the blackout period ends. These issues should be addressed by the plan fiduciaries with the investment advisors to the plans. To the extent there are complex investments available through the seller or target 401(k) plan, or liquidity issues related to them, additional considerations may arise.

8. Mandatory automatic enrollment also has added a complexity that must be considered. If the seller or target 401(k) plan is not a plan that was established prior to enactment of Code Section 414A(a) pursuant to Section 101 of the SECURE 2.0 Act (December 29, 2022) (that is, a Pre-enactment 401(k) Plan) and it is merged with the buyer's 401(k) plan, which is a Pre-enactment 401(k) Plan, then the buyer 401(k) plan can continue to be a Pre-enactment 401(k) Plan and not be subject to mandatory automatic enrollment under an eligible automatic contribution arrangement so long as if, in connection with a transaction described in Code Section 410(b)(6)(C), the buyer 401(k) plan is the surviving plan and the merger occurs by the end of the Section 410(b)(6)(C) transition period. [IRS Notice 2024-2, Q&A 3] If this exception does not apply, it is possible that the merged plan—notwithstanding the fact that it is sponsored by the buyer—must impose mandatory automatic enrollment on all its participants without affirmative deferral elections.
9. In light of the Roth catch-up requirements for those high earners who are age 50 by the end of the plan year, earning FICA wages above the applicable IRS threshold (which is $150,000 in 2025 for 2026 plan years), consideration must be given to participant communications that may have been provided regarding the applicable approaches that would be taken with respect to these contributions and the applicable administrative practices that were developed with payroll and plan recordkeepers. If these procedures will be different in the surviving 401(k) plan, it may be necessary to address the applicable changes and develop communications to participants on this issue. It also will be necessary for the buyer to have good quality prior year FICA compensation information for the acquired employees.
10. If the seller or target 401(k) plan that is assumed has an auto-portability feature for small balance cash-outs, plan data changes may need to be sent to the automatic portability provider network so that it can be updated accordingly and it can continue to identify the correct plan when it makes its matches. New third-party contracts also may need to be executed.
11. The transfer of assets to the buyer 401(k) plan must result in the seller or target 401(k) plan participants having balances in the buyer 401(k) plan immediately post-plan merger that include amounts equal to their closing account balance under the seller or target 401(k) plan.

Concluding Thoughts

The foregoing considerations are not an exhaustive list, but rather, intended to assist plan sponsors and fiduciaries in project planning and developing their approach to navigating 401(k) plan issues in a corporate transaction. The particular facts of the transaction, and parties involved, may dictate certain post-closing integration approaches or give rise to issues not addressed herein.

Undoubtedly, all parties involved will want the employees affected by the transaction to be pleased with their ongoing 401(k) plan benefits, and efforts should be made to ensure that the resulting plan will provide a meaningful benefit. Moreover, it is important to note that the 401(k) plan is only one type of benefit program. Each employee benefit program will require its own diligence and analysis in a corporate transaction. It is advisable to engage the applicable plan advisors to assist with these matters early in the process. The successful provision of employee benefits to the acquired employees will support the integration of employees and lead to long-term success of the corporate transaction.