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Evaluating a 401(k) Plan for Your Business

It seems that 401(k) plans have become the retirement plan of choice for many businesses. While they offer many advantages for the company and the employees, there are several issues that should be considered when evaluating them.

Why have a 401(k) or any other type of retirement plan?

- Offering a retirement plan as part of an employee benefit program helps three parties - the business, the owner and the employees.
- The right type of retirement plan can become an integral part of the management of your business. It can help attract, retain and motivate your employees. In an environment where keeping good employees is becoming more difficult, a good retirement plan, and effective communication about the plan, can be powerful tools.
- The right plan, properly structured, can also help the owner of the business build a substantial retirement nest-egg.
- Finally, employees are keenly aware of the need to take control of their future financial security. Providing assistance with a company sponsored retirement plan will help them reach their retirement goals.

What is a 401(k) plan?

A 401(k) plan is a company sponsored profit-sharing plan that allows employees to defer a portion of their wages into investment options of their choice. Employers have the flexibility to make contributions and can offer some form of matching contributions to those of their employees. The employer contribution flexibility and employee contribution aspects of 401(k) plans are part of the reason so many companies have chosen this form of retirement plan. The employer match and the investment flexibility of many plans are some of the reasons that now over 40 million Americans are choosing to participate in 401(k) plans.

Why consider a 401(k) plan?

If your business has many employees, you wish to provide an attractive employee benefit and you want to retain control over some aspects of a retirement plan, a 401(k) plan may be the most attractive alternative. This form of retirement plan can also allow for larger contributions than many other types of plans.

Key aspects of a 401(k) plan.

- Any employer with one or more employees can establish a 401(k) plan. Usually, this type of plan can be economically feasible when a company has at least 25 employees.
- These plans allow for employees to contribute pre-tax dollars for their own benefit. It brings employees into the process of planning for their own retirement.

- The contribution limits are larger than those found with most other types of plans. Employees can defer up to $19,500 for 2020 into their account. The total contribution, including employee and employer contributions, is limited to 25% of compensation up to $57,000 for 2020.
- The 2001 tax law also created a "catch-up" contribution provision for participants ages 50 and older. Under this provision, in 2020, an eligible participant can contribute an additional $6,000.
- The employer can attach a vesting schedule to any company contributions. This provides a strong motivation for employees to remain as with your company. Employee contributions are immediately vested.
- The company can have control over some level of their contributions. Usually, the plan document provides a certain level of contribution matching of employee deferrals, but can allow the company to make a discretionary contribution, usually based on financial results.
- The 401(k) plan must be made available to all employees at least 21 years of age who worked at least 1000 hours and may be made available to part-time employees who have three consecutive years with 500 hours of service.
- Most 401(k) plans provide a great deal of investment flexibility. Participants choose where to invest their money among many alternatives. Usually, there are a number of mutual funds and often an option of company stock (if the company is publicly held).
- There are annual filings that must be made with the IRS and special testing to ensure the plan does not discriminate in favor of highly compensated employees.

Investigating 401(k) plans further

The key parties needed for establishing and administering a 401(k) plan are an administrator and an investment manager. Many investment managers, including banks, mutual fund companies and some investment advisors, offer special bundled programs that include administrative services as well as their investment management options. There are IRS and Department of Labor filing requirements with 401(k) plans that can be part of their services as well.