401(k) Plans

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401(k) Plans

What is a 401(k) Plan?

401(k) plans are salary deferral plans. Employees may have up to $20,500 (2022) deducted from salary and deposited to their account. Those age 50 and older may make an additional $6,500 “catch-up” contribution for a total deferral of $27,000 (2022).

Does the Employer contribute?

- The sponsoring employer may or may not contribute to the plan.
- Frequently, the employer obligates the company to a “matching” contribution. For example, the employer may match an employee’s contribution dollar-for-dollar; may promise to match employee contributions at $0.50 on the dollar, etc.
- Employers may also make additional discretionary contributions over and above the match.
- The employer and employee contributions, when combined, may not exceed $61,000 ($67,500 with the “catch-up”).

Plan Eligibility

- Any established business entity such as a Corporation, Sole Proprietor, LLC, LLP, or Partnership may establish a 401(k) plan.
- Typically, a plan benefits a mix of rank-and-file employees and owner/managers . An eligible employee is any employee who:
    - Has one year of service
    - Has attained age 21
    - Works 1,000 hours or more during a plan year
    - Has not bargained in good faith for pension benefits
- Union employees and non-resident aliens who have no U.S. source of income may generally be EXCLUDED from coverage.

Of course, an employer can establish less restrictive eligibility requirements than those listed above, but cannot be more restrictive.

Safe Harbor 401(k) Plan

A Safe Harbor 401(k) plan is similar to a traditional 401(k) plan but, among other things, must provide for employer contributions that are fully vested when made. The advantage of the safe harbor 401(k) is that it is not subject to many of the complex tax rules that are associated with a traditional 401(k) plan, including annual non-discrimination testing.

- Under a safe-harbor plan, you can match each eligible employee's contribution, dollar for dollar, up to 3 percent of the employee's compensation, and 50 cents on the dollar for the employee's contribution that exceeds 3 percent, but not 5 percent, of the employee's compensation. Alternatively, you can make a non-elective contribution equal to 3 percent of an employee's compensation to each eligible employee's account. Each year you must make either the matching contribution or the non-elective contribution.
- Both the traditional and safe harbor plans are for employers of any size and can be combined with other retirement plans.

Roth 401(k)

- The Roth 401(k) is an *optional* feature. It does not require a new document; however, one may amend an existing document.
- Employees at ANY income level can participate and their contributions are made on an *after-tax* basis .
- One advantage of the Roth feature in 401(k) plans is qualified distributions come out income tax free if taken 5 years from first deposit, attainment of age 59 ½, or due to death or disability.
- Roth 401(k) employer contributions are matched on a pre-tax basis and are therefore subject to income tax on withdrawal.
- When employees terminate they may roll over their Roth 401(k) account to a Roth IRA.
- For those age 50 and older, the catch-up contribution may go to the Roth 401(k) account.
- Contributions to the 401(k) account can be all Roth or part Roth and part traditional.
- Roth 401(k) deposits can be made *regardless* of one's income level, unlike IRA limitations.

Determining How Much to Save into a 401(k)

- The easiest way to determine one's retirement income needs is to subtract how much will come from Social Security Benefits, personal savings, any other employer plans, inheritance, if any. What is left over is the shortfall.
- After calculating the shortfall, one has to determine the amount necessary to fund that income shortfall.
- Many believe retirees can best preserve their assets if their annual withdrawal rate is 4% or less of invested assets. This assumption provides a quick and easy formula for determining the total amount necessary to save by retirement. In other words, divide your desired annual income by the withdrawal rate (100,000 / 0.04 = $2,500,000).
- This is not meant to be exhaustive or comprehensive, but a starting point in one's consideration of retirement planning.

Automatic Enrollment

- A 401(k) with automatic enrollment is one in which the employees are automatically enrolled and monies are deposited into the plan directly from their paycheck. Generally speaking, the employee’s contribution starts at 1% of gross income.
- Think about it this way: $1 per $100 of gross wages is contributed on the employee’s behalf to the 401(k) and now becomes eligible for any and all employer matches.
- The employee can withdraw from the plan at any time; there is no obligation to participate.
- The thought is that, once enrolled, the employees will continue to contribute and therefore save for the inevitable retirement.
- Automatic Enrollment is used to help employees have adequate money for saved for a comfortable retirement.

401(k) Checklist

- Have you determined which type of 401(k) plan best suits your business?
- Have you decided whether to make contributions to the plan, and, if so, whether to make non-elective and/or matching contributions? (Remember, you may design your plan so that you may change your rate of contributions if necessary).
- Have you decided to hire a financial institution or retirement plan professional to help with setting up and running the plan?
- Have you adopted a written plan that includes the features you want to offer, such as whether participants will direct the investment of their accounts?
- Have you notified eligible employees and provided them with information to help in their decision-making?
- Have you arranged a trust fund for the plan assets or will you set up the plan solely with insurance contracts?
- Are you familiar with the fiduciary responsibilities?
- Are you prepared to monitor the plan's service providers?
- Are you familiar with the reporting and disclosure of a 401(k) plan?

How do I get a 401(k) Plan illustration or more information?

Go to our web site: www.PensionSpecialist.net

Or call:

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