Consider 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.

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 can contribute to the employee's plan and may offer matching contributions if they so choose. The employer match and the investment flexibility of these plans are two of the reasons that over 40 million Americans choose to participate in 401(k) 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 a minimum of 25 employees.
- These plans allow for employees to contribute pre-tax dollars for their own benefit. It engages employees in 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 $17,500 (in 2013 and 2014) into their account. The total contribution, including employee and employer contributions, is limited to 25% of compensation up to $51,000 for 2013 and $52,000 for 2014.
- The 2001 tax law also created a "catch-up" contribution provision for participants ages 50 and older. Under this provision, in 2013, an eligible participant can contribute an additional $5,500 to his or her plan.
- The employer can attach a vesting schedule to any company contributions. This provides a strong motivation for employees to remain 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 1,000 hours in the previous year.
- 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 to establish and administer 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.