

Reasons Why You Should Sponsor A 401(k) Plan

By Ary Rosenbaum, Esq.

As an employer, a big reason for setting up a retirement plan is because it's an employee benefit and it can be used to recruit and retain top-level employees. Unlike health insurance, the costs of running a retirement plan don't increase at least 20% annually. As far as what retirement plan you should be setting up, I think the best option out there is the 401(k) plan. I'm sure you've read so many articles on how bad 401(k) plans are, but 401(k) plans are only bad if they are run badly. To steal a line from 16-time World Champion wrestler Ric Flair, as far as 401(k) plans go: "Whether you like it, or you don't like it, learn to love it! It's the best thing going today!" When it comes to retirement plans, the 401(k) plan is your best option and this article will tell you why.

For most, Pension Plans are like 8 track tapes

Prior to the introduction of 401(k) plans in the early 1980s, the retirement plan of choice was the one that even predated ERISA, and that was the good old-fashioned defined benefit plan. Many people blame 401(k) plans for the phase-out of defined benefit plans because 401(k) plans were cheaper to maintain. The reason that 401(k) plans are cheaper is that the bulk of retirement savings is funded by the employee through salary deferrals while the pension plan was a defined benefit at retirement age that was almost entirely funded by the employer. Whether the replacement vehicle was going to be a 401(k) plan or something else, the fact is that defined benefit plans were going to go the way of the 8 track. The reason they

were going to be replaced in one fashion or another was that of the cost of funding these plans. While health insurance premiums are still so uncontrollable, it was inevitable that employers would need to cut down on costs so the defined benefit plan was going to be a casualty. Luckily, there was an attractive retirement plan out there that employers could substitute because I'll always contend if something attractive

requirements that a 401(k) plan has. These plans don't have any administrative cost, no compliance requirements, they're easy to maintain, and no Form 5500 that needs to be filed. These two types of plan are SEP (Simplified Employee Pension) IRA or a SIMPLE (Savings Incentive Match Plan for Employees) IRA. A SEP is a plan that allows you to make contributions toward your own retirement and your employees'



retirement without getting involved in a more complex qualified plan. Under a SEP, you make the contributions to a traditional individual retirement arrangement (called a SEP-IRA) set up by or for each eligible employee. A SEP-IRA is owned and controlled by the employee, and you make contributions to the financial institution where the SEP-IRA is maintained. SEP-IRAs are set up for, at a minimum, each eligible employee. Unlike a 401(k) plan, an employee can't make salary deferrals to a SEP so that means all contributions are made by the employer. A SIMPLE IRA is

similar to the SEP in the sense that it is an IRA-type arrangement, but there are three major differences. First, a SIMPLE IRA can be funded with pre-tax salary deferrals, so an employee can defer up to \$13,000 or up to \$16,000 if they are aged 50 or over (those are 2019 limits). Second, an employer has to make a minimum contribution annually to a SIMPLE that they don't have to under a SEP. The plan requires a certain minimum contribution from the employer. The employer may either match the salary deferral contributions of employees dollar for dollar up to 3% of the employee's com-

SEPs and SIMPLEs aren't great if you have employees

For small business owners, there are some attractive retirement savings vehicles that are available without the cost or compliance

requirements that a 401(k) plan has. These plans don't have any administrative cost, no compliance requirements, they're easy to maintain, and no Form 5500 that needs to be filed. These two types of plan are SEP (Simplified Employee Pension) IRA or a SIMPLE (Savings Incentive Match Plan for Employees) IRA. A SEP is a plan that allows you to make contributions toward your own retirement and your employees'

pensation or the employer may contribute a flat 2% of compensation for each employee with at least \$5,000 in compensation for the year, regardless of the amount the employee contributes. Third, SIMPLE plans are only available to employers with less than 100 employees. Why are 401(k) plans better? There are three big reasons. The first reason is that under a 401(k), an employee can defer up to \$19,000 or up to \$25,000 if they are age 50 or over (those are 2019 limits). A 401(k) plan participant can defer a lot more than SIMPLE-IRA participants and certainly more than a SEP-IRA participant who can't make any salary deferrals. The second big reason is that there is absolutely no flexibility in contributions under a SEP



and SIMPLE. A SIMPLE-IRA plan requires a contribution every year and SEPs and SIMPLEs require that each employee receive the same percentage of compensation as an employer contribution. So as an owner, if you want to give yourself a 25% employer contribution, you have to give the same percentage amount of contribution to your employees. A 401(k) plan offers flexibility through plan design. A 401(k) plan can make matching contributions that are connected with an employee's salary deferrals or they can make a profit sharing contribution that doesn't necessarily have to be the same percentage of compensation required by SEPs and SIMPLEs. For example, you can give people who make over the Social Security Wage Base slightly bigger contributions, or a contribution based on age-weighting, or you can give contributions based on something called cross testing/new comparability. So while you'd be forced to give every employee a contribution of 25% of compensation if you wanted one yourself in a SEP, cross testing/new comparability in a 401(k) can give you a 25% contribution and only require you to give 5% to your employees which can be a tremendous savings. The third big reason is that SEPs and SIMPLEs require employees to make their

own investment decisions usually without the help or guidance of a financial advisor.

Limited liability for participant direction of investments

The major proliferation of 401(k) plans came at the end of the 1990s where there was a booming stock market and most mutual funds were making 30% annual returns. So the mutual fund companies started touting daily valued, participant-directed 401(k) plans. Technology finally allowed participants to direct their own investments on a daily basis and they would use ERISA §404(c) as a layer of liability protection. As long, you do the work on your end in selecting and replacing investment options and educating participants, you won't be held liable as a plan sponsor for the losses incurred by participants when they direct their own investments. You won't get that level of protection as a plan sponsor for a retirement plan where the plan trustees direct the investments and you might not get that level of protection for SEP and SIMPLE IRA investments if a court ever decided that these type of plans get ERISA treatments because they cover non-owner employees.

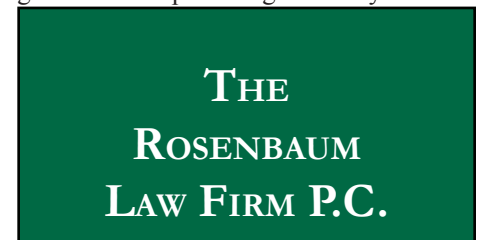
It's a 401(k) world

Since the 401(k) plan is the dominant retirement plan in the marketplace, it's load-

ed with talented retirement plan providers that can help you limit your liability as a plan sponsor. With other types of plans, you may have a tougher time in getting the help you need. If you decided to sponsor a SEP or SIMPLE IRA, you'll realize you won't get any help since there is no one to assist in the plan administration and no advisor would want to work with an IRA type plan with so little assets. We live in a 401(k) world and the amount of experts in that field is far greater.

It's the most cost-effective plan out there

Since the bulk of the contributions under a 401(k) plan belong to participant deferrals, it's safe to say when it comes to employer contributions, it's the most cost-effective retirement plan out there. Thanks to competition and fee disclosure regulations, 401(k) plans have seen their fees decrease. Sure SEPs and SIMPLEs have less cost because there is no plan administration, but they're costlier in the number of contributions that you have to provide as a plan sponsor if you want to give contributions to your highly compensated employees since you have to give the same percentage to everyone else.



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