Set Up a 401(k) for Your Small Business

A 401(k) is an employer-sponsored retirement plan for contributions that are not taxable until distribution. Employers benefit from deducting employee contributions they match on their taxes, and a retirement plan also attracts and retains the most competitive employees. According to a study conducted by the TCRS, 66% of workers want more help from employers to meet retirement goals, but only 52% of employers believe this. As the responsibility for retirement savings shifts more toward employees, small business owners can set themselves apart by offering more support.

However, many small business owners suffer the misconception that a company must have a minimum number of employees to qualify for a 401(k). In fact, a business of any size can offer a 401(k), even if the company consists of a sole proprieter. To prepare a retirement plan that is mutually advantageous for you and your employees, follow the steps below.

Step 1: Choose a Type
The IRS describes three categories of 401(k) plans: traditional, safe harbor, and SIMPLE.

A traditional 401(k) offers the most flexible contribution matching requirements for employers. These plans are subject to nondiscrimination testing to be sure benefits for all employees are proportional to those for you as the business owner or for other managers. While this annual assessment ensures balance, it can limit your savings if your employees are not contributing to their plans.

For this reason, Serenity Gibbons writes for Forbes that safe harbor 401(k) plans are the most popular among small businesses today. They require employer contributions but are not subject to annual testing. Learn more about these plans in IRS Publication 4222.

Finally, SIMPLE 401(k) plans, which have safe harbor features, are designed specifically for businesses of 100 or fewer employees with low administrative costs and simple operational requirements. IRS Publication 4334 addresses SIMPLE plans and can be accessed here. However, if you are a sole proprietor with no other employees, the IRS offers a type of traditional plan called a solo 401(k) as one retirement account option.

Step 2: Select Service Providers
Maybe you already feel overwhelmed by the many choices and administrative demands associated with sponsoring a 401(k). Luckily, there are many parties who can help facilitate your fiduciary responsibilities as a plan administrator.

Recordkeepers: This is the first responsibility you will want to delegate to track contributions, earnings, and investments of participants, among other duties.
Financial Advisors: While financial advising is an optional service that adds cost, you may choose an advisor to help you make investment choices and maintain compliance. If you aren’t confident with retirement plans, consider a 3(38) investment manager who will take on full liability for investments.

Third Party Administrators (TPAs): You can also handle administration in-house, but often a third party is the best option for small businesses because the tasks can be extensive. A TPA will prepare participant notifications, approve transactions, handle discrimination testing, and file compliance forms. Certain TPAs can also assume liability for upholding regulations set by ERISA, a 1974 federal law that established retirement plan standards to protect participants.

Does this mean you need to shop multiple parties if you want all of these services? It can, but there are also service firms that act as one-stop shops for all of these responsibilities. The Chamber of Commerce provides a list of companies (including ADP, Charles Schwab, and Fidelity) that can help small business owners navigate time-consuming duties and mitigate risk for reasonable fees.

If you do hire a provider of multiple services, inquire about cost breakdown. For instance, there could be hidden fees for compliance, recordkeeping, or investment management. Be aware of this as you search for your best match.

Step 3: Write a Plan
Now that you have your team assembled, you will adopt a plan with the desired features. The good news is that your third party administrator can draft a plan for you, considering factors like employer matching and profit sharing, when distributions are taxed, and employee participation eligibility. Even if you outsource this task, be sure you understand the plan attributes so that you can monitor compliance.

Step 4: Appoint a Custodian
Along with recordkeeping and administration, asset custody is the final component of a 401(k) investment platform. You must arrange a trust for your plan's assets to protect your employees and appoint a custodian to hold the assets and complete recordkeeping for trades and statements. A trustee, by contrast, directs the assets by choosing funds and investing. These tasks can be delegated to and by a service firm acting as plan administrator, another reason to consider the value added by hiring one for your business.

Step 5: Educate Employees
Now that your plan has been established, you must notify eligible employees with a summary plan description (SPD) and provide them the information they need for their decision-making. A survey conducted by Fisher Investments suggests that 69% of employees don't have mastery of basic 401(k) knowledge. What can you do to remedy this as a small business owner?

Provide online tools and resources that emphasize perks like tax-free contributions (or tax-free distributions for Roth plans), employer matching contributions, and compounded tax-deferred earnings
Offer one-on-one meetings with your employees to help understand their retirement goals and assess their knowledge
Allow access to retirement specialists who can advise employees
Include a retirement component at an office meeting to boost financial literacy and maximize collective benefit
Step 6: Empower Yourself
You can absolutely hire helpers to ensure you comply with IRS and ERISA regulations (like the federally mandated annual filing of Tax Form 5500, among many others). While third party administrators and advisors can complete tasks for you, it's important you understand the fiduciary hierarchy so that you know your liabilities and can determine the control you would like to have. A helpful infographic can be found here.