401(k)

Generally, any employer is eligible to set up a 401(k) plan.

All organizations, except governmental entities, are eligible to set up 401(k) plans. However, these plans may be particularly attractive to those employers who:

- Employ more than 25 employees
- Have a sufficient number of non-highly compensated employees who will defer a portion of their salaries
- Are willing to make employer matching and discretionary contributions to encourage deferrals
- Are willing to spend the time and money that a 401(k) plan requires for plan design, administration, and communication

With a 401(k) plan, an employee can elect to defer a portion of their income to the plan. The amount deferred (called and "elective contribution" or "pretax contribution") is not currently included in the employee's income, it is made with pretax dollars. Consequently, the employee's federal taxable income (and federal income tax) that year is reduced.

The deferred portion is taxed to the employee when it is withdrawn or distributed. As an example, assume Melissa is employed by a department store. She earns $30,000 annually and elects to defer $5,000 of her earnings to her employer's 401(k) plan. As a result, Melissa's taxable income is reduced to $25,000. She is not taxed on the deferred money ($5,000) until she receives a distribution or makes a withdrawal.

Tip: State tax laws may differ from federal law. Consult a tax specialist for the tax impact in your state.

Tip: Special rules apply to SIMPLE 401(k) plans and Safe Harbor 401(k) plans.

Roth 401(k) Plans

A 401(k) plan can allow employees to designate all or a part of their elective deferrals as qualified Roth 401(k) contributions. Roth 401(k) contributions are made on an after-tax basis, just like Roth IRA contributions. Unlike pretax contributions to a 401(k) plan, there is no up-front tax benefit, but if certain conditions are met, employee's Roth contributions and earnings are entirely free from federal income tax when distributed from the plan. Separate accounts must be established within a 401(k) plan (the "Roth accounts") to track each employee's Roth contributions and any gains or losses on those contributions. The taxation of distributions from the Roth account is also determined separately from any other 401(k) plan dollars. (Note: Employers do not have to allow Roth contributions to their 401(k) plans.)

Employee contributions

Whether an employee elects to make pretax contributions or Roth after-tax contributions to the 401(k) plan, careful attention must be paid to the elective deferral limits.

Employer contributions

To encourage employee participation, some employers offer to "match" employee contributions under a specific formula. For example, you might decide to match 50 cents on every dollar contributed by employees up to a maximum of 10% of each employee's salary. As an employer, you also have the option of making discretionary contributions ("nonelective contributions") to the employees' accounts. These contributions are subject to specific tests to ensure they don't discriminate in favor of highly compensated employees.

Tip: Your employer contributions to the plan are always made on a pretax basis. That is, your employees are not taxed on these contributions until they are distributed from the plan. This is true even if you choose to match employees' Roth contributions.

If you would like to discuss your plan options, contact your financial professional or Security Benefit at 800.747.5164 option 3.

Related Products

- SecurePoint Retirement Program

- SmartChoice Retirement Program
- Workplace Retirement Program for ERISA Plans