Why Employers Should Sponsor a Retirement Plan

By Ary Rosenbaum, Esq.

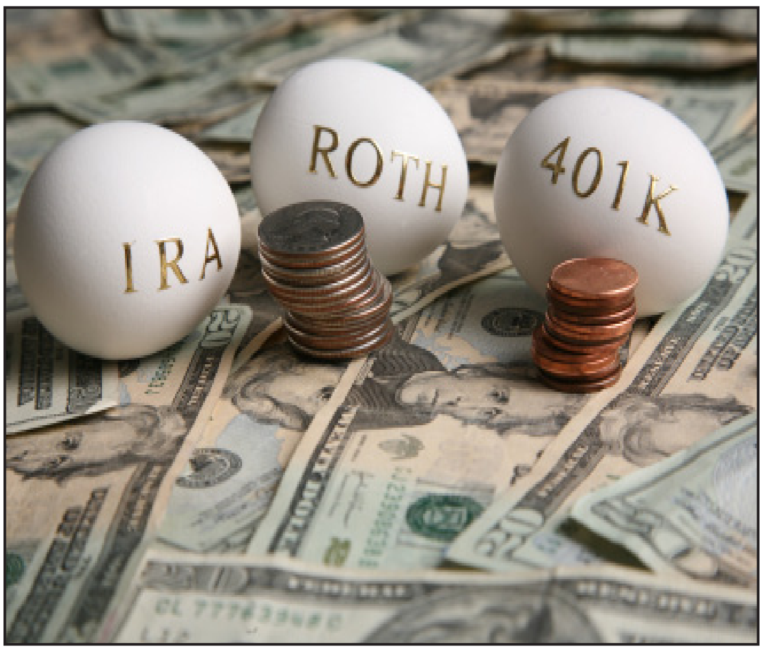
Starting and running a business is one of the hardest things out there and I know from experience in starting my own law firm. You start a business to make a living and when the need arises and when you can afford it, you need to hire employees. While employees can help grow your business, they do cost money in terms of the employer portion of Social Security, unemployment insurance, health insurance, and other benefits. One benefit that employers should offer their employees is a retirement plan and there are many good reasons why. So this article is about why employers should offer a retirement plan to their employees.

It's a great way to recruit and retain employees

I was an employee once and when it came time to interviewing with prospective employers, one of the main considerations for contemplating starting employment with one of these firms was the salary and the benefits. Cash is cash and since my wife works for government, health insurance wasn't the benefit that I was interested in. Since my career revolves around retirement plans, my interest in benefits would be there.
A retirement plan is an excellent benefit that can help recruit and retain employees because people see retirement plans as a great benefit even if an employer doesn't make contributions to their employees in a 401(k) plan. Any type of retirement plan that allows employees to save for retirement (whether the contributions are their own or through an employer) is going to be a benefit that many employees will see as something worthwhile to them. A benefit like a retirement plan can go a long way into recruiting employees and retaining them. In addition, having a retirement plan may mask a decrease in the health care benefit, lack of bonuses, or a mediocre pay. Unlike most employer provided benefits, this article will describe how a plan may not bust the employer's financial budget.

We have a retirement crisis in this country

Regardless of what their employees think, most employers do care about them. Whether you're a Republican or Democrat, one doesn't have to be a political ideologue to understand that with the questionable funding of Social Security and the curtailment of most employer-funded pension plans, there is a retirement crisis in the country. So while a retirement plan is a great tool to recruit and retain employees, it's a great way to care of employees to help them save for retirement. While most of my former colleagues at a union side law firm would suggest that employers don't care about employees, I believe that many employers actually do. So since Social Security might be insolvent the year before I'm supposed to collect (2038) and a defined benefit pension plan are reserved for union jobs, government jobs, and the few large corporations to still afford them, the only way that an employee can truly afford retirement is through savings under an employer provided retirement plan. So this retirement crisis is another reason why an employer should sponsor a retirement plan.

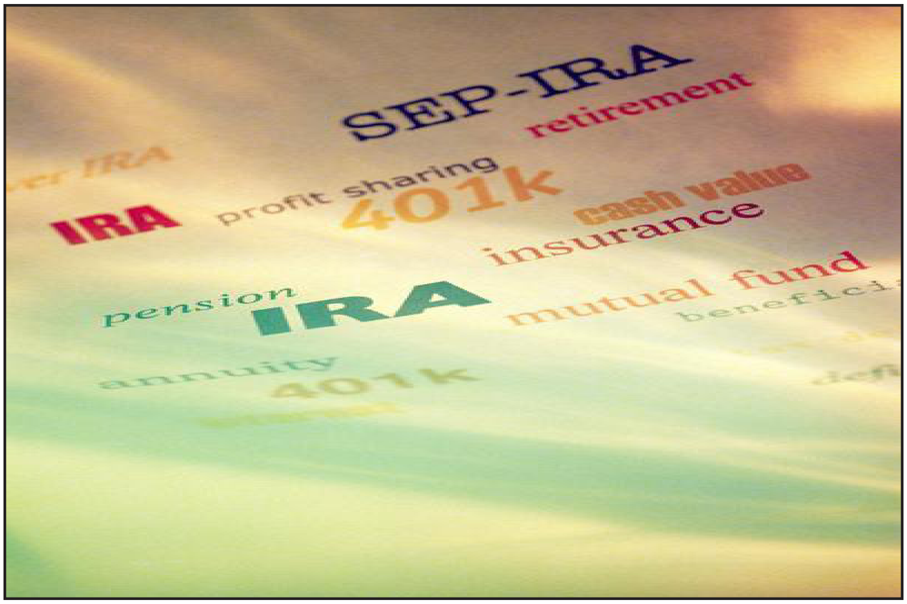


The owners and highly compensated employees can save too

One of the requirements of any qualified retirement plan is that they must not discriminate in favor of highly compensated employees (HCEs) and they have to cover at least 70% of the rank and file employees as compared to the HCEs. So an employer can't set up a retirement plan that will only benefit only the owners and the other highly paid employees. So in order for an employer to cover their highly paid employees and have a tax qualified plan where employer contributions can be deducted is to set up a plan that will also benefit the rank and file employees. Without benefiting the rank and file employees, employers won't be able to save for the highly paid and as discussed before, an employer sponsored retirement plan is a great incentive and retention tool for employees. Highly paid employees who don't own a piece of the action (stock in the employer) are a lot more mobile than rank and file employees, so a retirement plan could help them stay put. So to benefit the employer's chosen few, an employer would have to cover the bulk of their rank and file employees in order to have a qualified retirement plan.

Employer doesn't have to pay the costs of the plan

While a 401(k) plan does not require an employer contribution (unless the plan fails its compliance test(s)), there is a cost of running a retirement plan. A retirement plan needs a financial advisor, a third party administrator (TPA) and if large enough, an ERISA attorney and an auditor. Any cost that an employer incurs on their own in the implementation and administration of a retirement plan is an allowable business deduction. That deduction may give little solace to the employer who may have little to spend on a retirement plan. For the employer with limited means, a retirement plan does not require an employer to pay out of pocket for its administration. Other than implementation costs and some other costs (such penalties from the government), the expenses in running a retirement plan can be paid from the plan's assets. While the plan's (and the plan participant's) assets can pay for the administration of the plan, employers still would have the fiduciary duty to pay only reasonable expenses to the plan's service providers. So an employer won't have to spend their own assets to pay for the upkeep of their retirement plan, but will have to make sure any fees paid from the plan are reasonable for the services provided.



The problems with those small business plans

This article talks about qualified retirement plans that require a Form 5500 and the retention of a TPA. For the employers who don't think they can afford these qualified plans, there are a number of small business plans available that do not require a Form 5500 and the retention of a TPA. A simplified employed pension plan (SEP) or a SIMPLE-IRA can be started by going to the local office of a popular mutual fund company and signing a page or two to set it up. While the idea of these small plans are nice (who needs the headache of using a TPA if you don't need them?), there is a huge tradeoff by using them. A SEP allows no employee salary deferrals, so any contributions made to the plan will be made by the employer. A SIMPLE-IRA allows employees to defer a maximum of $12,000 of their owner, but only if an employer makes a matching or profit sharing contribution. While $12,000 is a nice nest egg for a retirement plan, the salary deferral limit fro an employee under a 401(k) plan is a healthier $17,500. One of the beauties of qualified retirement plans is that there can be a leeway in employer contributions between highly compensated employees and the rank and file. The smaller plans don't allow that leeway as both the SEP and SIMPLE-IRA requires all employer contribution to be uniform among all participants. Last year, I advised a small business that had a little extra cash for the owners. While the owner could afford to put 25% of his pay into this retirement plan, the SEP the owner had required him to put 25% of pay to all of his other employees if he wanted 25% for himself. That would make such a contribution to himself cost prohibitive if he had to make the same contribution to the other employees. With the new 401(k) plan that I set up for him, he was able to put away 25% of his pay while the rank and file employees got 5% of pay. So there is an absolute tradeoff for operating, these no cost, no administration needed plans. While the costs are nil in running them, they both require employer contributions and those employer contributions must be uniform. A 401(k) plan may allow for a disparity in employer contributions and won't require any employer contributions as long as the compliance tests for the plan pass.

There is a retirement plan design with the right fit for an employer

Thanks to the different plan types out there, along with different retirement plan design types, there are enough choices out there for an employer. I always compare retirement plans to suits, where they need to be custom tailored to the employer's needs. An employer with some disposable income can make greater contributions that one who is living hand to mouth, so their plans should have dissimilar plan designs. An employer with 1,000 employees has different demographic and compliance issues than an employer with two employees. So an employer working with a competent TPA will be able to select a retirement plan and plan design that will fit the employer's needs. Those needs change over time, so an employer should annually review their plan type and design to see if it still fits their fiscal needs.

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