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# Starter 401(k) plans under SECURE 2.0: Helping small employers fast-track a retirement plan

In 2024, a provision in the SECURE 2.0 legislation permits an employer that is not sponsoring a retirement plan to offer a starter 401(k) or safe harbor 403(b) plan to its employees that is exempt from certain nondiscrimination requirements.

By **Lisa A. Tavares** & By **Carol V. Calhoun** | April 19, 2024 at 10:38 AM



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In 2022, almost half of American households had no savings in retirement accounts, according to the Survey of Consumer Finances (SCF). The situation is particularly acute with employees of small employers, which may not offer retirement plans at all. For many such employers, the cost and regulatory requirements have



proved a deterrent to implementing such plans. And while employees can set up individual retirement accounts on their own, experience has shown that the likelihood of an employee saving for retirement is significantly increased if the employee has access to an employer-provided plan, particularly one with automatic enrollment.

Meanwhile, small employers are often deterred from offering retirement plans by cost and/or administrative complexity.

To try to improve this situation, the SECURE 2.0 Act included a provision for Starter 401(k) Plans. The intent was to eliminate barriers to establishment of 401(k) plans, and to encourage employees to contribute to them.

## **What are the features of a Starter 401(k)?**

In a [Starter 401\(k\) Plan](#), all eligible employees (those who have completed age and service requirements, other than collectively bargained employees) must be automatically enrolled. An employee will have automatic deferrals of between 3% and 15% of compensation unless they opt out or select a different contribution level. No employer contributions can be made. Maximum contributions are limited to the lesser of 15% of compensation or \$6,000 (\$7,000 for those 50 or older), adjusted annually for inflation.

## **What employers can have a Starter 401(k)?**

While earlier types of plans intended to reduce regulatory requirements, such as SIMPLE plans, are limited to small employers, Starter 401(k) Plans have no such limitations. While expected to be of most interest to small employers, they can be adopted by employers of any size.



## Only two groups of employers are precluded from having a Starter 401(k) Plan:

1. An employer that maintains another qualified plan, with three exceptions:
  - A plan covering only collectively bargained employees will not preclude an employer from having a Starter 401(k) plan.
  - If a company previously offered a 401(k) but they terminated it and have not offered a plan in at least 12 months, they may be eligible for a Starter 401(k).
  - A business that has previously offered a state-mandated retirement plan can replace it with a Starter 401(k).
2. A state or local governmental employer other than one that maintained a 401(k) plan on May 6, 1986. (Such employers are not permitted to maintain a 401(k) plan of any kind.) However, a state or local government can offer a section 457(b) plan, which is similar. And a public school or university may maintain a starter 403(b) plan, which has similar rules to a Starter 401(k).

In the event of a merger or acquisition in which one of the companies has a Starter 401(k) Plan and another has another type of retirement plan, one or the other plan must be closed to new contributions by the last day of the plan year following the year in which the acquisition takes place.

## What are the advantages of a Starter 401(k)?

A Starter 401(k) Plan provides many of the same advantages to the employer as any other 401(k) plan: providing a benefit that may help to attract and retain employees, FICA savings to the employer, and potential tax credits for setting up a plan. However, it provides certain advantages that may make it attractive, particularly to smaller employers:



**Simplicity and cost:** A Starter 401(k) Plan is exempt from both the automatic deferral percentage ("ADP") and top-heavy requirements applicable to other 401(k) plans. Moreover, because it covers all employees who have met age and service requirements equally, and does not provide for employer contributions, it involves fewer complications than other 401(k) plans. Given the lack of complexity, it can be expected that such plans will have a lower cost to employers than other types of plans.

**Avoidance of state mandates:** Several states require that employers that do not maintain retirement plans contribute to state-run IRAs. Typically, these are Roth IRAs. This means that employees do not get a deduction for their contributions, which diminishes their attractiveness to employees. And employees whose income exceeds certain limits are ineligible for Roth IRAs, meaning that they cannot contribute to these plans. Maintenance of a Starter 401(k) Plan, while not significantly more complex than a state-run IRA, does not have these disadvantages and eliminates the requirement to contribute to state-mandated plans.

**Ability to merge or roll over into another 401(k):** If an employer becomes ineligible to maintain a SIMPLE plan (due to an acquisition in which one employer maintains a plan other than a SIMPLE plan, or an increase in the number of employees), there are limited options for closing down the SIMPLE plan. A SIMPLE plan cannot simply be merged with a 401(k) or other qualified plan. And employees cannot roll money from a SIMPLE plan into another qualified plan until they have participated for at least two years. By contrast, a Starter 401(k) Plan can always be merged into a regular 401(k) plan.



## What are the disadvantages of a Starter 401(k)?

While a Starter 401(k) Plan has many advantages, there are some things to consider for smaller employers:

**Lower employee contribution limits:** In a normal 401(k) plan, contributions may be as high as the lower of 100% of compensation or \$23,000 (\$30,500 for those 50 or older). In a Starter 401(k) Plan, the limits are the lesser of 15% of compensation or \$6,000 (\$7,000 for those 50 or older). The dollar limits on both types of plans are adjusted annually for cost-of-living increases. Thus, a Starter 401(k) Plan provides much lower limits. A Starter 401(k) Plan cannot permit employer contributions of any kind.

**Must cover all eligible employees:** A Starter 401(k) Plan must automatically enroll all employees other than:

- Those under 21.
- Those with less than one year of service.
- Collectively bargained employees.

Moreover, a Starter 401(k) Plan must permit long-term part-time employees to participate, although such employees need not be included in automatic enrollment. For this purpose, a long-term part-time employee is one who achieves at least 500 hours of service in each of three consecutive years (two consecutive years beginning in 2025).

Thus, there is no flexibility to have different plans for different groups of employees. And accidentally omitting an employee (which sometimes happens especially with newly hired employees or more casual employees if the employer is not keeping careful track of hours) would be considered a plan error. While employers



are normally not permitted to make contributions to a Starter 401(k) Plan, it appears that they may be required to make such contributions under certain circumstances if they have improperly excluded employees.

**Definition of compensation:** One of the most common errors employers make in operating a 401(k) plan is misidentifying what compensation is eligible for deferrals. For example, the employer may neglect to include irregularly received compensation such as commissions from 401(k) deferrals. Given that a Simple 401(k) Plan must provide for deferral of a fixed percentage of compensation, errors in the calculation of compensation will result in incorrect deferrals. And while employers are normally not permitted to make contributions to a Starter 401(k) Plan, it appears that they may be required to make such contributions under certain circumstances if employee deferrals have been improperly calculated due to errors in computing compensation.

**Issues in mergers and acquisitions:** As mentioned, in the event of a merger or acquisition in which one of the companies has a Starter 401(k) Plan and another has another type of retirement plan, one or the other plan must be closed to new contributions by the last day of the plan year following the year in which the acquisition takes place. Given the employee relations issues involved in taking away benefits employees (either the group previously covered by the Starter 401(k) Plan or those previously covered by the other plan) previously had, this may well involve admitting those previously covered by the Starter 401(k) Plan into the other plan, potentially increasing employer costs.



## **Related: [Starter 401\(k\): New kid on the retirement block to help small businesses](#)**

A Starter 401(k) Plan has certain advantages, particularly for a small employer that has not previously maintained a retirement plan at all. However, it may not always be as simple as it appears. And its limitations mean that it cannot be considered a substitute for a regular 401(k) plan.



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