



## Retirement Planning

# The Starter 401(k): A New Way for Small Employers to Launch Retirement Plans

*These new plans, created under Secure Act 2.0, may help 19 million American workers access workplace-based retirement savings. Here are the details.*



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[Secure Act 2.0](#) created a new type of 401(k) plan—the “Starter 401(k)” —as an introductory option for smaller employers who do not already offer a qualified retirement plan. A Starter 401(k) is a salary-deferral-only plan and has lower employee salary-deferral limits versus a traditional 401(k) plan. An eligible employer can establish a Starter 401(k) plan effective January 1, 2024. Now, an eligible employer has three types of 401(k) plans to choose from, including traditional, Safe Harbor, and the new Starter plan.

The “Starter” plan creates a 401(k)-like product minus the burden of annual non-discrimination testing<sup>1</sup> that applies to “traditional” 401(k) plans. A Starter plan is also likely to be popular with small employers who can’t or don’t want to make a mandatory annual employer contribution that applies to a [SIMPLE IRA](#) or Safe Harbor 401(k). The Starter plan should also compete with state-run “Auto IRA” plans offered to private sector employers in several states.

The American Retirement Association estimates the Starter 401(k)—coupled with the new [Secure Act 2.0 employer plan start-up tax credit](#)—will enable 19 million additional American workers to access and participate in the workplace-based retirement system.

*The Senate Finance Committee’s summary of the relevant provision under Secure Act 2.0:*

*Section 121 permits an employer that does not sponsor a retirement plan to offer a starter 401(k) plan (or SH 403(b) plan). A starter 401(k) plan (or Safe Harbor 403(b) plan) would generally require that all employees be default enrolled in the plan at a 3% to 15% of compensation deferral rate. Section 121 is effective for plan years beginning after December 31, 2023.*

## What you need to know about the new Starter 401(k) plan

- An employer, regardless of the number of employees, that does not sponsor a retirement plan can offer a new “Starter” 401(k) or 403(b) beginning in 2024. This must be the only plan maintained by the employer.
- Eligible employees must be automatically enrolled at a 3% to 15% deferral rate.
- A Starter plan can only permit elective deferrals. Employer contributions are not permitted. Should an employer want to make an employer contribution, they would need to set up a “traditional” 401(k) or Safe Harbor plan.
- There is no Actual Deferral Percentage (ADP) or top-heavy testing.
- Form 5500 filing rules apply.
- Qualified student loan payments count as deferrals under a Starter 401(k).
- A Starter plan has less administrative burden or expense than a traditional 401(k).



## Employee Elective Deferrals

The Starter 401(k) employee-elective-deferral limit is tied to the annual IRA contribution limit in effect for that year. For example, in 2024, the IRA (traditional/Roth) contribution limit is \$7,000. Therefore, the Starter 401(k) plan employee-elective-deferral limit should reflect the same limit (i.e., \$7,000).

Secure Act 2.0, however, contains a drafting error. The legislation had a delayed effective date for the Starter 401(k) until 2024. Meanwhile, the IRA contribution limit increased due to inflation. For example, the 2023 IRA contribution limit was \$6,500, while the 2024 limit is now \$7,000, plus an additional \$1,000 in catch-up contributions for those individuals age 50 and older. The Starter 401(k) now will have a lower contribution limit when compared to an IRA. It appears the summary by the Senate Finance Committee (above) reflected an intent for the contribution limits of the Starter plan to match the IRA contribution limit. However, the provision limits contributions to \$6,000 (indexed), which is the 2022 IRA limit and lower than the (IRA) in 2024.

In May of last year (2023), Congress sent a letter to the IRS, identifying drafting errors in Secure Act 2.0, including the Starter 401(k) elective-deferral limit. “ARA [American Retirement Association] really appreciates the tremendously hard work of all the congressional committee staff in putting this package of technical corrections together,” ARA CEO Brian Graff said. “In particular, we are very pleased they agreed that the Starter 401(k) contribution limit was always intended to track with the IRA contribution limit, and that the proposal will correct this technical error. Technical correction legislation (pending) strikes the reference to \$6,000 and inserts text specifying the contribution limit is “the amount in effect under section 219(b)(1)(A) for the taxable year in which the calendar year begins,” such that the contribution limit would now be tied to the IRA contribution limit.

Questions? Please contact your Lord Abbett representative at 888-522-2388.

<sup>1</sup>Under non-discrimination testing, plan sponsors must test traditional 401(k) plans each year to ensure that the contributions made by and for rank-and-file employees (non-highly compensated employees (NHCE)) are proportional to contributions made for owners and managers (highly compensated employees (HCE)). As the NHCEs save more for retirement, the rules allow HCEs to defer more.



### Important Information

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The information presented in this section is intended for general information and is not intended to be relied upon and should not be relied upon, as financial, legal, tax, or accounting advice for any particular investor. We strongly recommend that you contact your financial, legal or tax advisor regarding your particular tax situation.

A 401(k) plan is a qualified plan that includes a feature allowing an employee to elect to have the employer contribute a portion of the employee's wages to an individual account under the plan. The underlying plan can be a profit-sharing, stock bonus, pre-ERISA money purchase pension, or a rural cooperative plan. Generally, deferred wages (elective deferrals) are not subject to federal income tax withholding at the time of deferral, and they are not reported as taxable income on the employee's individual income tax return. A safe harbor 401(k) plan is similar to a traditional 401(k) plan, but, among other things, it must provide for employer contributions that are fully vested when made.

A 403(b) plan, also known as a tax-sheltered annuity plan, is a retirement plan for certain employees of public schools, employees of certain Code Section 501(c)(3) tax-exempt organizations, and certain ministers. A 403(b) plan allows employees to contribute some of their salary to the plan. The employer may also contribute to the plan for employees. A safe harbor 403(b) plan is similar to a traditional 403(b) plan, but, among other things, it must provide for employer contributions that are fully vested when made.

A safe harbor 401(k) plan is similar to a traditional 401(k) plan, but, among other things, it must provide for employer contributions that are fully vested when made. These contributions may be employer matching contributions, limited to employees who defer, or employer contributions made on behalf of all eligible employees, regardless of whether they make elective deferrals. The safe harbor 401(k) plan is not subject to the complex annual nondiscrimination tests that apply to traditional 401(k) plans.

A SIMPLE IRA is a retirement plan that may be established by employers, including self-employed individuals. The employer is allowed a tax deduction for contributions made to the SIMPLE. The employer makes either matching or nonelective contributions to each eligible employee's SIMPLE IRA, and employees may make salary deferral contributions.

A Traditional IRA is an individual retirement account (IRA) that allows individuals to direct income, up to specific annual limits, toward investments that accumulate tax-deferred. Contributions to the traditional IRA may be tax-deductible depending on the taxpayer's income, tax-filing status, and other factors.

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