Small-business
retirement plan sponsors

A closer look at **SECURE 2.0 Act startup tax credits**

Effective for taxable years beginning in 2023, new and enhanced tax credits for smaller employers can make starting a retirement plan more affordable than ever.

To ease the burden for small businesses, **the SECURE 2.0 Act created a substantial new startup tax credit based on contributions the employer makes** on behalf of participants and **expanded the existing startup tax credit on employer plan costs.** Together, these tax credits may provide a significant benefit for small businesses that are starting a plan.

What requirements must businesses meet to qualify for either of the startup tax credits?

- No more than 100 employees who received compensation of $5,000 or more in the preceding year; and
- Employer didn't offer a plan covering substantially the same employees during the previous three tax years.

What is the new employer contribution tax credit?

The tax credit is a decreasing percentage of the amount contributed by the employer for each employee earning no more than $100,000 per year, up to $1,000 annually per employee, over the plan's first five years.

How does this contribution tax credit apply to different plan types and sizes?

- The contribution tax credit applies to defined contribution plans, such as 401(k), SEP and SIMPLE plans, that have no more than 100 employees.
- The credit percentage for smaller plans — with 50 or fewer employees — phases down over five years from plan adoption according to the schedule below.

Phase-down schedule

Year 1	Year 2	Year 3	Year 4	Year 5
100%	100%	75%	50%	25%

Note: The percentage is applied to the amount of employer contributions to determine the credit, which can be up to $1,000 per employee each year.

- The tax credit for larger plans — with 51–100 employees — also phases down according to the schedule above but is subject to additional reductions. The percentage for the applicable year is reduced by 2% for each employee in excess of 50 employees.

Example 1a at right illustrates how the credit could work for a plan with no more than 50 employees and example 2a reflects a plan with more than 50 employees.

See how the new employer contribution tax credit could work

Example 1a: Qualified employer has 12 employees, 10 making less than $100K, 9 of the 10 participate and each contributes $3,000 a year; employer match is 50%

Employer contributions: 50% × $3,000 employee contributions = **$1,500 for each of 9 employees**

Credit calculation: 100% × $1,500 = **$1,500 for each of 9 employees, but capped at $1,000 each**

The total year 1 tax credit is $9,000, based on $13,500 of total employer contributions for 9 employees

Example 2a: Qualified employer has 70 employees, 60 making less than $100K, 54 of the 60 participate and each contributes $3,000 a year; employer match is 50%

Employer contributions: 50% × $3,000 employee contributions = **$1,500 for each of 54 employees**

Credit calculation: 60% (100% – (2% × 20 employees in excess of 50)) × $1,500 = **$900 for each of 54 employees**

The total year 1 tax credit is $48,600, based on $81,000 of total employer contributions for 54 employees

As you can see in the examples, the amount of the contribution tax credit can be substantial.

Note: All references to "employees" refer to those who received compensation of at least $5,000 in the preceding year.

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What is the plan cost tax credit?

- The credit reduces the amount of federal taxes that a small business may owe during each of the first three years of its first-ever retirement plan.
- The credit covers **100%** (if 50 or fewer employees) **or 50%** (if 51 to 100 employees) of the employer's ordinary and necessary out-of-pocket plan costs up to an annual limit.
- **The annual limit is $500** or, if greater, $250 multiplied by the number of plan-eligible non-highly compensated employees (NHCEs), **up to $5,000.**

Note: To qualify for this credit, a plan must have at least one participant who is a NHCE.

What SECURE 2.0 changed:

Previously, the tax credit covered 50% of eligible employer plan costs. SECURE 2.0 increased the credit to **100% of eligible costs for employers with 50 or fewer employees** who were paid at least $5,000 in the preceding year.

What types of plan costs does this credit apply to?

The credit applies to costs **paid by the employer to set up and administer the plan,** such as financial professional and TPA compensation, recordkeeping fees and employee education expenses. The credit does not apply to plan costs paid through plan assets or investment expenses.

How does this cost credit apply to different plan types and share classes?

In general, the credit amount may be limited for SEP and SIMPLE IRA plans because of their lower administrative costs. Share classes with fees used to help pay plan costs may also have limited benefits. Plans with fee-based financial professionals may pay more plan costs out of pocket, so the credit amount may be greater.

What else should I know about the credits?

- The expanded cost credit and new contribution credit are available for taxable years beginning after 2022.
- The contribution credit and cost credit are separate and distinct. Plans may receive one or both credits.
- If a plan terminates after receiving tax credits, repayment of the credits is not required.

See how the expanded plan cost tax credit could work

Example 1b: Qualified employer pays annual plan costs of $4,500 and has 12 eligible employees, including 10 NHCEs

Credit calculation: $4,500 plan costs × 100% (fewer than 50 employees) = **$4,500**

Maximum credit: 10 NHCEs × $250 = **$2,500**

The total year 1 tax credit is $2,500 based on the maximum credit formula.

If the employer received both credits (examples 1a and 1b), **the tax credits for year 1 would total $11,500.**

Example 2b: Qualified employer pays annual plan costs of $6,000 and has 70 eligible employees, including 60 NHCEs

Credit calculation: $6,000 plan costs × 50% (more than 50 employees) = **$3,000**

Maximum credit: 60 NHCEs × $250 = **$15,000, but capped at $5,000**

The total year 1 tax credit is $3,000, 50% of employer plan costs

If the employer received both credits (examples 2a and 2b), **the tax credits for year 1 would total $51,600.**

In addition: Automatic enrollment tax credit

Employers can also earn a tax credit for adding or, in the case of a startup plan, including an automatic enrollment feature as part of their plan. **The credit is $500 per year for the first three years** the feature is included.

The credit is only available to employers who had no more than 100 employees with at least $5,000 in compensation in the preceding year. Additionally, to qualify for the credit, the feature must be structured as an eligible automatic contribution arrangement (EACA), following specific notice requirements, and uniformly apply the plan's default contribution rate.

SECURE 2.0 impact: The availability of this tax credit is even more significant due to changes made by SECURE 2.0, which requires certain plans starting after December 29, 2022, to use automatic enrollment. While the requirement is not effective until 2025, employers with plans potentially subject to the requirement may consider including automatic enrollment at the time of launch to benefit from this tax credit sooner. Employers with plans not subject to the requirement also may consider including automatic enrollment to take advantage of the credit.

Information as of December 31, 2022. Other details, rules and exceptions may apply. This material does not constitute legal or tax advice. For more information, consult your financial professional, legal or tax advisor.

Examples are hypothetical and provided for illustrative purposes only; they are not intended to represent or predict actual results.

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