VOL. 36, NO. 2 SUMMER 2023

BENEFITS LAW JOURNAL

Tax Credits for Starting Up Small Employer Plans: What You Need to Know

By Fred Reish and Joan M. Neri

In this article, the authors discuss the new tax credits available to small employers for establishing new retirement plans.

Starting with tax years beginning after December 31, 2022, a small employer can take advantage of significant tax credits under SECURE Act 2.0 (the Act) for establishing a new retirement plan. Under the Act, the tax credits are available for plan administrative and contribution costs.

The full tax credit is available to employers with 50 or fewer employees and there is a partial credit available to employers with 51 to 100 employees. There are several additional conditions for eligibility as well.

Broker-dealers and registered representatives (advisors) will want to know about these credits in order to educate small businesses and assist them in establishing plans to take advantage of the credits.

The authors, attorneys with Faegre Drinker Biddle & Reath LLP, may be contacted at fred.reish@faegredrinker.com and joan.neri@faegredrinker.com, respectively.

THE CREDIT FOR PLAN START-UP COSTS

Eligible Small Employers

Advisors should educate small employers about the available tax credit for the administrative costs of setting up and operating an eligible employer plan for the first three years in which the plan is maintained. In order to qualify for the credit, the following conditions must be met:

- *Number of Eligible Employees*: The employer must have no more than 100 eligible employees who received at least $5,000 of compensation from the employer in the preceding year.

- *Non-Highly Compensated Employee:* The plan must have at least one employee eligible to participate who is not a highly compensated employee (for 2023, generally an employee making less than $150,000).

- *Eligible Employer Plan:* The plan established by the employer must be a tax-qualified 401(a) plan (e.g., 401(k) plan, profit-sharing plan, pension plan), a 403(a) annuity plan (i.e., a tax-qualified plan funded by annuity contracts instead of a trust), a SEP or a SIMPLE-IRA.

- *No Prior Plans:* The employer did not maintain a 401(a) or 403(a) qualified plan, a SEP or a SIMPLE-IRA in the three immediately preceding taxable years that covered substantially the same employees.

Qualified Start-Up Costs

The tax credit is a percentage of the employer's qualified start-up costs. Qualified start-up costs are defined as ordinary and necessary expenses paid or incurred by the employer in establishing or administering the new plan or educating employees about the new plan. This means that, unlike the typical scenario where the plan pays for start-up costs, the employer will need to make the payments to be entitled to the credits. Such costs would include plan document, administration, and recordkeeping fees, and employee education. Although not entirely clear, it is also possible that such costs include investment advisory services regarding the plan's investment line-up.

Calculating the Credit for Start-Up Costs

The minimum credit is $500 and the maximum credit is the lesser of –

(a) $5,000, or

(b) $250 multiplied by the number of eligible non-highly compensated employees.

Employers with no more than 50 eligible employees are eligible for a tax credit of 100% of qualified start-up costs, up to the maximum credit. For employers with 51 to 100 eligible employees, the tax credit percentage is reduced to 50%.

THE CREDIT FOR CONTRIBUTION COSTS

Eligible Small Employers

Advisors should also educate small employers about the tax credit for employer contributions to a newly established defined contribution plan. Small employers who establish an eligible employer plan that is not a defined benefit plan can take advantage of a tax credit for employer contributions to the plan for the first five years in which the plan is maintained. As with the credit for start-up costs, the employer must have no more than 100 eligible employees who received at least $5,000 of compensation from the employer in the preceding year. And, the credit is not available if the employer maintained a 401(a) or 403(a) qualified plan, a SEP or a SIMPLE-IRA in the three immediately preceding taxable years that covered substantially the same employees. However, unlike the credit for start-up costs, this limit, due to the employer's maintenance of another plan, applies only to the year the plan is established and the eligible employer will still be eligible for a credit in the next four years.

Determining the Credit for Contributions Costs

The credit is only for contributions made for eligible employees who earn $100,000 or less in Social Security wages (FICA wages) in the taxable year in which the tax credit is claimed. This dollar amount will be adjusted for future cost of living increases. The maximum credit is the lesser of –

(a) The employer contribution, or

(b) $1,000 for each eligible employee earning $100,000 or less in FICA wages.

For employers with 50 or fewer eligible employees, the credit reduces over the five-year period as follows:

Year Plan is Established	100%
1st Year after Plan is Established	100%
2nd Year after Plan is Established	75%
3rd Year after Plan is Established	50%
4th Year after Plan is Established	25%

If the employer has 51 to 100 employees, the tax credit for contributions reduces pro-ratably at the rate of 2% for each employee of the employer in excess of 50 employees.

Under this formula, if an eligible employer designs its plan to contribute $1,000 to the accounts of 30 participants who make $100,000 or less, the employer can receive a $30,000 tax credit for this contribution for the first two years (reducing over the next three years) effectively offsetting the cost of the contributions for those first two years.

ACTION PLAN FOR BROKER-DEALERS

These credits provide a significant incentive for small businesses to establish and maintain retirement plans. Broker-dealers and their advisors can help small businesses understand these rules and take advantage of the economic advantages they provide by assisting employers in establishing a plan design that maximizes the benefit of these credits. Advisors can also educate employees of the small business to improve investment and financial understanding and promote retirement readiness.