SMALL BUSINESS TAX CREDITS FOR RETIREMENT PLANS

At Compass, we work hard(er) to make your job easier, and that includes keeping tabs on the industry updates that affect your business. Here is the latest on Small Business Tax Credits for Retirement Plans as enhanced by SECURE Act 2.0. These tax credits are intended to expand coverage and make it easier for Small Businesses to start retirement plans.

STARTING A NEW RETIREMENT PLAN: HOW THE TAX CREDITS WORK

Tax credit on qualified plan startup costs paid by the employer	New Employer Contribution Credit
The credit is the greater of: • $500 or • The lesser of – $250 multiplied by the number of non-highly compensated employees eligible to participate in the plan, or – $5,000 **Credit is available for each of the first 3 years:** • Less than 50 employees: – 100% tax credit • 51-100 employees: – 50% tax credit **Note:** These costs include expenses associated with the establishment or administration of a plan or the retirement-related education of employees for this new plan.	**Applies to:** • Safe Harbor contributions • Profit Sharing contributions • Regular matching contributions **Maximum of $1,000 per non-highly compensated employee with wages below $100,000.** **Applies to businesses with fewer than 100 employees.** **Tax credit equals:** • Year 1: 100% • Year 2: 100% • Year 3: 75% • Year 4: 50% • Year 5: 25% **Full tax credit for employers with less than 50 employees.** **Tax credit is phased out for employers with 51 – 100 employees.**

To be eligible for the tax credit:

- Your business must have 100 or fewer employees who received at least $5,000 in compensation the preceding year
- Your business must have at least one plan participant who was a non-highlycompensated employee (NHCE)
- In the three tax years preceding, your employees were not substantially the same employees who were covered by another retirement plan sponsored by you

PLUS...

There is an additional tax credit of $500 — annually, for 3 years — for small businesses that start a new plan with automatic enrollment, or add it to their existing plan. Please note: Subject to change, as automatic enrollment will be mandatory for most new plans starting in 2025.

FAQs REGARDING THE SMALL BUSINESS TAX CREDITS FOR RETIREMENT PLANS

Please consult your CPA or Tax Professional for your specific situation.

Does the credit include the first-year administration costs or specifically the start-up cost?
Eligible expenses include those incurred for establishing and/or administering the plan and retirement-related education for employees, with respect to the plan, for the first three years.

What forms are required to claim the credit?
The IRS requires Form 8881 to be completed to claim the tax credit.

What if an employer starts up two plans?
If it is a DB/DC combo plan, then the plans are aggregated and treated as one plan for purposes of the tax credit.

Would the start-up credit extend to businesses that move from a SIMPLE IRA plan or SEP to a 401(k)?
Generally, no. SIMPLE IRA plans and SEPs are retirement plans for purposes of the tax credit. If these plans have been in existence for three years, then switching to a 401(k) is not a new start-up plan. If you only had a SIMPLE IRA or SEP for one year, then switching to the 401(k) would still be within the three years for start-up credits, and you would still have two years for the credits to apply to the 401(k) costs.

Are there any restrictions to the additional tax credit for automatic enrollment?
Yes, regulations state that the automatic enrollment must be an EACA to qualify for the credit. A QACA safe harbor plan design will satisfy the definition of an EACA and will, therefore, qualify for the credit.

Does the automatic enrollment tax credit apply to existing 401(k) plans adding automatic enrollment for the first time?
Yes.

Does adding a 401(k) feature to an existing profit-sharing plan count toward the credit?
No. The credit is based on starting a new plan and not upgrading existing plans. However, the automatic enrollment tax credit may apply if automatic enrollment is added.

Is the credit applicable to not-for-profit organizations starting a new 403(b) plan?
Unfortunately, the credit is not applicable to tax-exempt entities because it is not a refundable credit. Therefore, the credit is not available for the adoption of a 403(b) plan.

By joining a multiple employer plan (MEP) or other variations of MEPs, is a plan sponsor eligible for the credit?
Yes, as long as the employer qualifies for the credit. Please consult your tax professional.

Do the tax credits apply to Solo or Individual 401(k) plans?
No. The tax credits require that at least one Non-Highly Compensated Employee is covered by the plan. Solo or Individual 401(k) plans are designed to cover owners and spouses only.