THREE TAX CREDITS ARE AVAILABLE FOR START-UP PLANS

Businesses with 2 to 100 employees have up to three tax credits available to help reduce costs during the first five years. There must be at least one Non-Highly Compensated Employee (NHCE) to qualify for the credits.

This summary is inclusive of the rules in SECURE 1.0 and 2.0.

The first tax credit is equal to the greater of $500 or $250 per NHCE with a cap of $5,000 applied to 100% of the costs you incurred. For employers with 51 to 100 employees the credit can be used on 50% of the costs incurred. Any start-up costs paid by the employer, but not covered by the tax credit, may be deducted as a regular business expense by the employer as well. See below for specific examples.

EXAMPLE 1

An employer with **10 NHCEs** incurs **$4,000 in start-up costs** during Year 1 of a new 401(k) plan. During Year 2, the employer spends **$6,000 in start-up costs** on the plan, and **$4,000 in start-up costs** in Year 3.

How much is the tax credit in this example?
ANSWER: $7,500

	YEAR 1	YEAR 2	YEAR 3
# of NHCEs:	10	10	10
	x $250	x $250	x $250
	$2,500	**$2,500**	**$2,500**
Start-Up Costs:	$3,000	$3,500	$3,500
	100%	100%	100%
	$3,000	**$3,500**	**$3,500**

The start-up credit is calculated on the lesser of either $250 x the number of NHCEs or 100% of the plan's start-up costs up to a $5,000 maximum each year.
*Year 1: **$2,500** + Year 2: **$2,500** + Year 3: **$2,500** = **$7,500***

EXAMPLE 2

Another employer sets up a new plan with **80 NHCEs**. During Year 1, the employer incurrs **$12,500 in start-up costs**. The number of **NCHEs increased to 105** in Year 2 and the **start-up costs reached $14,500**.

How much is the tax credit in this example?
ANSWER: $5,000

	YEAR 1	YEAR 2
# of NHCEs:	80	**105**
	x $250	x ----
	$5,000	
Start-Up Costs:	$12,500	$14,500
	50%	50%
	$6,250	**$7,250**

Even though this employer has 80 NHCEs (x $250 = $20,000) the start-up credit is capped at $5,000 each year. When the number of NHCEs increased to 105 in Year 2, the employer is no longer an eligible small employer for the tax credits.

The second tax credit is equal to 100% of the amount the employer contributed to each of the first 50 employees making $100,000 or less (in the prior year), capped at $1,000 per employee (HCE/NHCE status irrelevant). In the third year the credit is 75% of contributions, 50% in the fourth year, and 25% in the fifth year. The credit percentage per employee is reduced for the number of employees between 51 and 100. This tax credit is available for taxable years beginning after December 31, 2022.

What is the possible tax credit when there are 10 employees receiving employer contributions?
ANSWER: $10,000

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The third tax credit available is an additional $500 annual credit for using an auto-enrollment feature in a new or existing plan. The credit is available for the first taxable year in which the employer's plan contains an EACA or QACA and the following two taxable years. Employers will need to weigh the possible additional administrative and fiduciary burdens of automatic enrollment versus the cost savings.

Although unintentional, this credit is available for solo plans.

How much is the tax credit worth over three years?
ANSWER: $1,500

Note: To be eligible for the tax credit, the plan must be a start-up plan. For the 3-year period before the effective date of the plan, the employer, or any member of a controlled group including the employer, cannot have had a plan that benefitted substantially the same employees. Eligible plans are a qualified plan, SEP or SIMPLE. The auto-enrollment credit can be applied to an existing plan only if the auto-enrollment feature is ADDED to a plan on or after January 1, 2020, and is in addition to the start-up tax credit. The auto-enrollment credit is NOT linked to the number of NHCEs eligible for the plan, nor the costs associated with the auto-enrollment feature.

1 **Small employer:** *an employer which had no more than 100 employees who received at least $5,000 in compensation from the employer for the preceding year.*

2 **Start-up Costs:** *any ordinary and necessary expenses which are paid by the employer in connection with the establishment or administration of the plan (e.g., plan document, set up fees, 5500 filing, testing, educational meetings, asset management fees).*

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7639 Leesburg Pike

Falls Church, Virginia 22043

888.689.5530

703.893.7322

www.retirementplanners.com

sales@retirementplanners.com