Tax Credit For Startup & Amended 401K Plans

CREATED IN SECURE ACT AND ENHANCED IN SECURE ACT 2.0, AN ELIGIBLE EMPLOYER MAY CLAIM UP TO 100% OF ITS QUALIFIED STARTUP COSTS FOR ADOPTING AND MAINTAINING A NEW 401(K) PLAN, OR AMENDING AN EXISTING PLAN.

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WHO IS AN ELIGIBLE EMPLOYER?

To be eligible, employer must meet 3 requirements:

- Have 100 or fewer employees who were paid at least $5,000 in compensation by employer in the preceding year;
- Cover at least one non-HCE with your retirement plan; and
- In the 3 tax years before the first year you're eligible for the credit, your employees weren't substantially the same employees who received contributions or accrued benefits in another retirement plan sponsored by you, a member of a controlled group that includes you, or a predecessor of either.

A non-Highly Compensated Employee (non-HCE) is an employee who is not considered a Highly Compensated Employee (HCE). An HCE is an individual who:

- Owned more than 5% of the interest in the business at any time during the year or the preceding year, regardless of how much compensation that person earned or received, or
- For the preceding year, received compensation from the business of more than $135,000 (if the preceding year is 2022 and $150,000 if the preceding year is 2023), and, if the employer so chooses, was in the top 20% of employees when ranked by compensation .

WHAT ARE QUALIFIED STARTUP COSTS?

Qualified startup costs include the ordinary and necessary expenses incurred by a small business to:

- Establish or administer a qualifying retirement plan, or
- Educate employees about the plan.

An eligible employer with 50 or fewer employees may claim a tax credit for 100% of its qualified startup costs. An eligible employer with 51 to 100 employees may only claim a tax credit for 50% of its qualified startup costs.

Eligible startup costs with Benefit Providers include our one-time setup fee of $600 and our annual administration fee of $890*. If you choose to start a 401 (k) plan with Benefit Providers, that will mean your first-year startup tax credit would equal $1490 and $890* the next two years.

** If employer uses second service, the administrative fee is reduced to $800*

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IS THERE A MAXIMUM LIMIT TO THE TAX CREDIT?

The maximum tax credit is $5,000 each year. The maximum tax credit is reduced for a business with less than 20 employees. The maximum for businesses with less than 20 employees cannot exceed $250 times the number of non-Highly Compensated Employees (non-HCEs) eligible for plan participation.

An eligible employer can always claim a tax credit of at least $500 each year. For example, a business with one owner and one non-HCE may receive the minimum tax credit of 500, while a business with five owners and five non-HCEs may receive the minimum tax credit of $1,250 (250 x 5).

A business with an owner, three managers, and 59 non-HCEs may receive a tax credit up to the $5,000 limit. Remember that a business with over 50 employees can only claim 50% of its qualified startup costs. Therefore, expenses incurred by this business to establish and administer the plan would have to exceed $10,000 a year to reach the $5,000 tax credit.

HOW LONG CAN AN ELIGIBLE EMPLOYER CLAIM THE TAX CREDIT?

The tax credit is available for the first three years starting when the plan is effective or, if elected by the business, the preceding year.

HOW DO I APPLY FOR THE TAX CREDIT?

You must file IRS Form 8881 (Credit for Small Employer Pension Plan Startup Costs) with your tax return to claim the startup tax credit. As of 4/1/2023, this form has not yet been amended to accommodate the SECURE 2.0 change allowing businesses with 50 or fewer employees to claim 100% of its qualified startup costs, but is expected to be done by year end.

EMPLOYER CONTRIBUTION TAX CREDIT

SECURE 2.0 created a tax credit for employer contributions provided by small businesses over the first few years of the 401(k) plan, and would be in addition to the start-up credit. To receive this credit, a business must still meet the eligible employer requirements described under the startup tax credit section.

The maximum limit is $1,000 per eligible employee per year. An eligible employee is paid no more than $100,000 a year (adjusted for inflation). The exact tax credit depends upon the number of employees and the number of years since plan startup.

Employer Contribution Tax Credit For Businesses with 50 or Fewer Employees

	2023	2024	2025	2026	2027	2028	Total
Tax Credit	$15,000	$15,000	$11,250	$7,500	$3,750	0	**$52,500**
Calculation	15 EEs x $1,000	15 EEs x $1,000	$15,000 x 75%	$15,000 x 50%	$15,000 x 25%	No more credit	
Tax Deduction	$1,000	$1,000	$4,750	$8,500	$12,250	$16,000	**$27,500**
Calculation	1 owner x $1,000	1 owner x $1,000	$1,000 + ($15,000 x 25%)	$1,000 + ($15,000 x 50%)	$1,000 + ($15,000 x 75%)	N/A	

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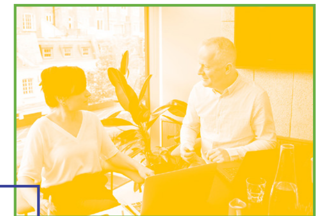
CREDIT FOR BUSINESSES WITH 50 OR FEWER EMPLOYEES

A business with 50 or fewer employees may receive a tax credit for 100% of employer contributions in the first two years (including the startup year), 75% of employer contributions in the third year, 50% in the fourth year, and 25% in the fifth year. There is no tax credit available for employer contributions after the fifth year of the plans' startup.

TAX CREDIT FOR BUSINESSES WITH 51 TO 100 EMPLOYEES

The tax credit for a business with 51 to 100 employees is based on a sliding scale. The percentage is reduced by 2 points for each employee over 50. To illustrate, the tax credit for a business with 80 employees would only be 60% (100% x 2 x 30) of employer contributions for the first two years, 45% (75% x 2 x 30) for the third year, 30% (50% x 2 x 30) for the fourth year and 15% (25% x 2 x 30) in the fifth year.



FOR EXISTING PLANS AUTO-ENROLLMENT TAX CREDIT

SECURE created an auto-enrollment tax credit. Small businesses are eligible for a $500 tax credit by adding an automatic enrollment feature to a new or existing 401(k) plan. To be eligible for this tax credit, the auto-enrollment feature must meet Eligible Automatic Contribution Arrangement (EACA) requirements. A QACA safe harbor 401(k) plan will also meet EACA requirements. Unlike the startup tax credit, the only requirement to be an eligible employer is having 100 or fewer employees who were paid at least $5,000 in compensation in the preceding year.

Also different from the startup tax credit, the auto-enrollment tax credit is available to existing 401(k) plans and profit sharing plans adding a 401(k) feature. For example, you have sponsored a 401(k) plan over 20 years. If you are considered an eligible employer, you could add the automatic enrollment feature now and receive the tax credit. **The credit is available for each of the first three years the feature is effective.**

The auto-enrollment tax credit became much more relevant due to a law change in SECURE 2.0. Beginning in 2025, most 401(k) plans must have the auto-enrollment feature. Although businesses starting 401(k) plans now do not need to have the auto-enrollment feature, they will be required to adopt the feature by 2025. Small businesses may want to add the autoenrollment feature now to minimize the potential disruption in 2025 as well as take advantage of this tax credit.

For more information, please e-mail us at info@benefitproviders.com, visit us at www.benefitproviders.com, or call Joel Bernstein at 703-370-2226

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