The SECURE 2.0 Act

Enhancements to the retirement plan tax credits for small employers

The SECURE 2.0 Act of 2022 was signed into law in December 2022. SECURE 2.0 introduced some important enhancements to the SECURE Act of 2019 tax credits to help small employers make it more affordable to start a retirement plan.

SECURE 2.0 enhancements effective for taxable years on or after Jan. 1, 2023

Small employers with 50 or fewer employees may now apply 100% of their qualified start-up costs toward the start-up tax credit formula (employers with 51-100 employees may apply 50% of qualified start-up costs, as originally established in the SECURE Act of 2019) up to $5,000 per tax year for the first three years.

A new tax credit is available for small employers who include an employer contribution when they start a defined contribution (DC) retirement plan. The tax credit is equal to a percentage of the employer contributions made to employees-up to $1,000 per employee* a year if the employer has no more than 50 employees (for employers with 51-100 employees, the credit is reduced by 2% for each employee in excess of 50). The tax credit gradually grades down over five years.

Important details on these enhancements are outlined below.

Plans that qualify:

These start-up tax credits apply to qualified employer plans defined by the Internal Revenue Code including: Simplified Employee Pensions (SEPs), Savings Incentive Match Plans (SIMPLEs), 401(k), 403(a) annuity plans, DB plans, and pooled or multiple employer plans (PEPs/MEPs).

If you're a small business (one with no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year) and you've been thinking about starting a retirement plan, or if you've already done so within the past two years, these tax credits could provide additional support.

If you do not pay taxes in a given year, you cannot take advantage of the tax credits for that year. See your tax advisor for guidance on how these credits may apply.

*Credit only applies to contributions made for employees with FICA wages of $100,000 or less which this amount will be adjusted in the future for cost-of-living increases.

Available tax credits for small employers

Start-up tax credit

For each of the first three years, the tax credit is the greater of:

A. $500, or
B. The lesser of:
   1) $250 multiplied by each non-highly compensated employee (NHCE), eligible to participate in the plan, or
   2) 50% of the qualified start-up costs (maximum $5,000)
      - **NEW for 2023 taxable years:** employers with *50 or fewer employees* may consider 100% of their qualified start-up costs (maximum $5,000)

You can't deduct the start-up costs and claim the start-up tax credit for the same expenses.

NEW for 2023 taxable years–tax credit for DC start-up plans offering employer contributions

For employers with *50 or fewer employees,* the tax credit is equal to the "applicable percentage" of employer contributions made on behalf of employees with FICA wages of $100,000 or less, up to a per-employee cap of $1,000. The $100,000 wage threshold will be indexed to inflation adjusted beginning in 2024. The employer contribution credit only applies to contributions to DC plans.

- For employers with 51-100 employees, the credit is phased out by reducing the amount of the credit each year 2% for each employee in excess of 50.

The applicable percentage is:

- 1st and 2nd year = 100%
- 3rd year = 75%
- 4th year = 50%
- 5th year = 25%
- 6th year = 0%

You can't deduct the employer contribution costs and claim the employer contribution credit for the same expenses. If you have included employer contributions in your "Qualified start-up costs" when calculating the start-up tax credit, you are also not eligible for this tax credit.

Tax credit for small employers that add an Eligible Automatic Contribution Arrangement (EACA)

Under SECURE Act of 2019, employers with 100 or fewer employees who add an EACA are eligible for a $500 annual tax credit for three years.

New small employer tax credit for each military spouse who participates in a DC plan

For employers with 100 or fewer employees this tax credit is a maximum of $500 per participating military spouse who is an employee ($200 plus all employer contributions, excluding deferrals, up to $300) each year for the first three years of the employee's participation.

The employer's plan must include the following provisions:

- Making the military spouse eligible within two months of hire, with employer contributions immediately vested.
- Must also make them eligible for employer contributions upon plan eligibility.

Eligible employees can certify to the employer they are a military spouse.

Qualified start-up costs[1]

Qualified start-up costs generally refer to ordinary and necessary expenses an employer paid or incurred in connection with:

- The establishment or administration of an eligible employer plan, or
- The retirement-related education of employees of the plan.

The following are types of expenses typically viewed as ordinary and necessary expenses if they are paid directly by the employer. They cannot be collected from plan assets or directly from participants.

Operational Expenses

- Mandatory participant disclosure costs
- Educational participant communication costs
- Compliance or legal costs to maintain the tax-favored status of the plan or as required to amend the plan
- Recordkeeping fees
- Advisor compensation
- PBGC premiums
- ERISA bond
- Fiduciary liability insurance
- Governmental reporting costs
- Investment management, consulting and advice fees

Settlor Costs[2]

- Plan design work before establishing the plan
- Discretionary plan amendment fees
- Union negotiation costs before a plan amendment
- Certain accounting costs relative to the employer's finances

Employer-Provided Plan Contributions

- Profit sharing contributions
- Matching contributions
- Qualified nonelective contributions

What we know:

If you're an employer with 50 or fewer employees and you've started a retirement plan within the last one or two years, you may still take advantage of the ability to consider 100% of your qualified start-up costs for the remainder of the three-year eligibility period for the start-up tax credit.

For any employer with 100 or fewer employees who has started a retirement plan with employer contributions within the last four years, and you're not already taking employer contributions into account as qualified start-up expenses for the start-up tax credit, you may be eligible to take advantage of the new tax-credit (not to exceed $1,000 per employee)[3] for start-ups with employer contributions for the remainder of the five-year eligibility period. No tax deduction is allowed for the portion of the credit allocable to employer contributions.

Businesses that convert an existing SEP or SIMPLE plan to a new qualified plan, such as a 401(k), are not eligible for the start-up tax credit.

All of the tax credits covered in this paper are general business tax credits; an employer can carry it back one year or forward twenty years if the business is not able to use it in the current year.

A plan must have at least one, non-highly compensated employee eligible to participate in the plan in order to benefit from the start-up tax credit.

[1] Refer to IRS Form 8881 and consult your tax or legal adviser for a more specific determination.
[2] Settlor costs are defined as expenses that will benefit the plan sponsor of the retirement plan as opposed to plan participants. They generally relate to decisions about the plan amendment, establishment or termination of a plan.
[3] Credit only applies to contributions made for employees with FICA wages of $100,000 or less which this amount will be adjusted in the future for cost-of-living increases.

Calculating the start-up tax credit

If you had 50 or fewer employees who made more than $5,000 in the prior year **100% of the total ordinary and necessary start-up costs** =	$______________	
If you had 51-100 employees who made more than $5,000 in the prior year **50% of the total ordinary and necessary start-up costs** =	$______________	
	=	
	$______________	**A**
$250 x # of NHCEs (compensation $5,000 or more in the year) =	$______________	**B**
Insert the lower of "**B**" or "**A**" (maximum $5,000)	$______________	**C**

Potential start-up tax credit

Is **A** or **C** < $500?	Yes—Insert $500	$______________
	No—Insert amount "**C**"	

Calculating the tax credit for start-ups with employer contributions

If you have included employer contributions in your "employer contribution credit" when calculating the start-up tax credit, you are not eligible for this tax credit.

Total annual employer contributions for all employees with FICA wages of $100,000 or less =	$______________	**A**
# of employees with FICA wages of $100,000 or less =	______________	**B**
A ÷ **B**	$______________	**C** (max. of $1,000)

Potential employer contribution tax credit

For employers with 50 or fewer employees: (**C** x **B**) x the applicable percentage*	$______________	**D**
For employers with 51-100 employees: # of employees in excess of 50 =	______________	**E**
E x 2% =	______________%	**F**
(The applicable percentage*-**F**) x **D** =	$______________	

*The applicable percentage is:
- 1st and 2nd year = 100%, 3rd year = 75%, 4th year = 50%, 5th year = 25%, 6th year 0%

Intended for plan sponsor and financial professional use.

Next steps: If you've been thinking about adding a retirement plan, but worried about the costs, now's your chance. Calculate your potential tax credits for starting a plan. And don't forget to consider including the tax credit for adding an eligible automatic contribution arrangement.

Reach out to your financial professional or Principal® representative, we're here to help.

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