Tax Credits for Start Up Retirement Plans

SECURE 2.0 increased the maximum tax credit allowed for setting up a new retirement plan. A tax credit is a powerful tool that reduces the amount of taxes you may owe on a dollar-for-dollar basis. It is important to note a deduction reduces income used to calculate the tax liability, while a credit directly reduces the tax liability itself. Eligible employers may be able to claim a tax credit of up to $5,000, for three years, for the costs of starting a SEP, SIMPLE IRA or qualified plan (like a 401(k) plan.)

What companies are eligible to receive the tax credit?

- Applies to companies with 100 or fewer employees but is phased out for companies with more than 50 employees.
- No credit for contributions to any employee making more than $100k (indexed after 2023). NOTE: no deduction for employer contributions qualifying for credit.
- An Employer who establishes a new plan is NOT eligible for the credit if that employer (or any member of any control group including the employer, or a predecessor of either) maintained another qualified plan (including a Simple or a SEP) for substantially the same employees during the 3-taxable year period immediately preceding the 1st taxable year for which the credit would otherwise be applicable. All eligible employer plans are treated as one plan.
- The plan must cover at least 1 non-Highly Compensated Employee (meaning a sole proprietor is not eligible for the credit).

What is the tax credit?

- Credit is based on $250 per non-Highly Compensated Employee.
- Credit is 100% of administrative costs up to $5,000 per year for 50 or fewer employees. Employers with 51 to 100 employees receive a credit of the lesser of $5,000 or 50% of plan related expenses.
- Credit is 100% in years 1 and 2, 75% in year 3, 50% in year 4 and 25% in year 5. Employers with 51 to 100 employees have their credit reduced 2% for each employee above 50.
- You cannot take both a deduction and credit for start up costs. So you need to figure out which is the most valuable.
- Qualified startup costs are ordinary and eligible expenses paid or incurred in connection with the establishment or administration of the plan or retirement-related education provided to the employees of the plan.
- The first year for the credit can be the first year that the plan is effective, or the taxable year preceding the first year the plan is effective (since there might be billable startup costs for the preceding year for consulting services, etc.).
- An eligible employer that adds an auto-enrollment feature to their plan can claim a tax credit of $500 per year for a 3-year taxable period beginning with the first taxable year the employer includes the auto-enrollment feature.

Example:	
Eligible NHCEs	10
NHCEs * $250	$2,500
Max Credit (lesser of 2 or $5,000)	$2,500
Actual Plan Expenses	$2,100
Available Credit	$2,100

Comparison of Credit versus Deduction (assuming 21% corporate tax rate)		
Company Income	$80,000	$80,000
Plan Expense as a Deduction	$0	$-2,100
Taxable Income	$80,000	$77,900
21% Tax Due	$16,800	$16,359
Plan Expense as a Credit	$-2,100	$0
Net Tax Due	$14,700	$16,359