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Simplifying the Retirement Plan Tax Credit for Start-Ups

For start-up small businesses, establishing a retirement plan can be costly as well as resource and time prohibitive. Legislation has now made it easier. The following are answers to common questions related to a potential tax credit for start-ups.

What is the Tax Credit for Start-Ups?

The SECURE Act includes many significant changes to retirement plans including providing a tax credit to start-up businesses that establish a new retirement plan. The purpose of the tax credit is to make it more feasible for small businesses to provide a retirement plan for its employees, thus giving more workers the opportunity to save for a secure retirement.

Which start-ups are eligible for the tax credit?

- Those with no more than 100 employees who received at least $5,000 in compensation for the preceding year
- Those with at least one plan participant who was a non-highly compensated employee (NHCE)
- In the last three years, a different qualified retirement plan for employees was not sponsored by the business. In short, businesses can't change to a new plan every three years and receive a new tax credit each time.

What is a Non-Highly Compensated Employee?

An employee is considered a NHCE if:

- They own less than 5% of the company
- They make less than the income threshold for that year as determined by the IRS. For 2022, a NHCE must make less than $135,000[1]

How much is the credit?

- The start-up credit is 50% of eligible start-up costs, up to the greater of:
  - $500: or
  - The lesser of:
    - $250 for each employee that is eligible to participate in the plan and is not a Highly Compensated Employee (HCE), or
    - $5,000
- The start-up credit is $500 for adding an automatic enrollment feature to a new or existing 401(k) plan.

Which costs are eligible?*

The tax credit can be claimed for common and necessary costs to:

- Set up a new qualified plan
- Execute plan administration
- Educate your employees about the plan

When can the tax credit be claimed?

The credit can be claimed for each of the first three years of the plan. The first year of claiming the credit can be the tax year before the plan becomes effective.

What is the auto enrollment tax credit?

An eligible employer that adds an automatic enrollment feature to its plan can claim a tax credit of $500 per year for a three-year taxable period. With this feature, employees have to opt-out rather than opt-in. The credit starts with the first taxable year the employer includes the auto enrollment feature.

Are there any new retirement plan types a start-up might consider?

Yes. The Pooled Employer Plan (“PEP”), a significant offering, entered the employer-sponsored retirement plan (401(k) plan) arena as of January 2021. A PEP enables unaffiliated plan sponsors (employers) to put their retirement plans of any asset size into a pooled or umbrella structure as “adopting employers.” A PEP has a Pooled Plan Provider (“PPP”) managing it, and benefits include lower cost, reduced fiduciary liability, decrease in employer workload and lower audit expense on a plan with more than 100 participants.

For more information visit: marinerwealthadvisors.com

*No tax deduction is allowed for expenses on which the credit is claimed.

Source:
[1] “COLA Increases for Dollar Limitations on Benefits and Contributions”

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