Tax Credits for Small Employer Retirement Plan Startup Costs and Employer Contributions – Frequently Asked Questions

The business tax credit for small employer pension plan startup costs, which has been around since 2002, makes it more affordable for small businesses to set up qualified retirement plans. Congress has recently expanded the credit. Congress increased the amount of the credit in the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act"). Congress made further enhancements in the SECURE Act 2.0 of 2022 ("SECURE 2.0"), including enacting a new plan startup tax credit for employer contributions.

IMPORTANT INFORMATION: In SECURE 2.0, Congress clarified that eligible employers joining an existing 401(k) plan are able to take the credit for tax years beginning after 2019. This means that clients electing the Insperity 401(k) Plan may be eligible to take this tax credit going back to 2020.

GENERAL QUESTIONS

Q: What is the small employer retirement plan startup costs tax credit?

A: After the passage of SECURE 2.0, there are really two separate credits for eligible employers establishing a new eligible employer plan.

1. The eligible startup costs tax credit for three years.
2. Beginning with the 2023 tax year, the employer contributions tax credit for five years.

Q: What employers are eligible to claim these tax credits?

A: To claim the credits, the employer must:

- Have 100 or fewer employees who received at least $5,000 in compensation for the preceding year.
- Have at least one eligible plan participant who was a non-highly compensated employee ("NHCE"). An NHCE is someone who was not paid more than the applicable compensation limit in the preceding year ($135,000 for 2022 and $150,000 for 2023), and also does not own more than 5% of your company at any time during the applicable or prior year
- Not have maintained, at any time during the three taxable years preceding the first tax year for which the credit is allowable, an eligible employer plan that covered substantially the same employees as the startup plan.

Q: Are 401(k) plans covered by the tax credits?

A: Yes. 401(k) plans are eligible employer plans for purposes of this credit.

QUESTIONS RELATED TO ELIGIBLE STARTUP COSTS TAX CREDIT

Q: How is the startup costs tax credit calculated?

A: The tax credit is equal to 50% of eligible startup expenses. Beginning in 2023, the percentage increases to 100% of eligible startup expenses only for eligible employers with 1 to 50 employees (other eligible employers remain at 50%).

The credit is limited to the amount each to $250 multiplied by the number of NHCEs eligible to participate in the plan, but has a minimum of $500 and a maximum of $5,000 per year.

Here are some examples of how the credit amount is calculated for 2023 and going forward:

Scenario	Limited by Percentage of Eligible Expenses	Limited by Eligible NHCEs	Credit Amount with Max/Min Applied
$11,000 in eligible expenses and 51 eligible NHCEs	$11,000 x 0.5 = $5,500	51 x $250 = $12,750	$5,000
$9,000 in eligible expenses and 51 eligible NHCEs	$9,000 x 0.5 = $4,500	51 x $250 = $12,750	$4,500
$5,000 in eligible expenses and 51 eligible NHCEs	$5,000 x 0.5 = $2,500	51 x $250 = $12,750	$2,500
$5,000 in eligible expenses and 50 eligible NHCEs	$5,000 x 1.0 = $5,000	50 x $250 = $12,500	$5,000
$5,000 in eligible expenses and 8 eligible NHCEs	$5,000 x 1.0 = $5,000	8 x $250 = $2,000	$2,000
$450 in eligible expenses and 8 eligible NHCEs	$450 x 1.0 = $450	8 x $250 = $2,000	$500

Q: What startup costs are eligible for this tax credit?

A: Eligible startup costs include any necessary expenses for setup and administration of the plan or plan-related education. This may include installation costs, administrative fees and costs to educate employees about their benefits and options under the plan. The expenses must be paid by the employer rather than from plan assets or revenue sharing.

Q: For which years is the startup costs tax credit available?

A: The eligible employer may claim the credit for the tax year in which the eligible plan becomes effective, or for the preceding tax year, and for the subsequent two years.

QUESTIONS RELATED TO EMPLOYER CONTRIBUTIONS TAX CREDIT

Q: How is the employer contributions tax credit calculated?

A: The tax credit is equal to a percentage of the employer contributions made during the tax year up to $1,000 per covered employee. Covered employees are those who received wages from the employer of no more than $100,000 for 2023 (adjusted for inflation in subsequent years).

The percentage of employer contributions decreases over time and is further reduced for eligible employers with over 50 employees in the preceding tax year:

Tax Year	Applicable Percentage with 1-50 Employees	Applicable Percentage with 51-100 Employees
1st	100%	Same minus 2% per employee over 50
2nd	100%	Same minus 2% per employee over 50
3rd	75%	Same minus 1.5% per employee over 50
4th	50%	Same minus 1% per employee over 50
5th	25%	Same minus 0.5% per employee over 50

Here are some examples of how the credit amount is calculated:

Year	Applicable Percentage	Credit Amount
Scenario 1: $1,000 in eligible employer contributions for each of 35 employees per year Total $35,000 in eligible employer contributions ($1,000 x 35)		
1st	100%	$35,000 x 100% = $35,000
2nd	100%	$35,000 x 100% = $35,000
3rd	75%	$35,000 x 75% = $26,250
4th	50%	$35,000 x 50% = $17,000
5th	25%	$35,000 x 25% = 8,750
Scenario 2: $1,000 in eligible employer contributions for each of 65 employees per year Total $65,000 in eligible employer contributions ($1,000 x 65)		
1st	100% - (2% x 15) = 70%	$65,000 x 70% = $45,500
2nd	100% - (2% x 15) = 70%	$65,000 x 70% = $45,500
3rd	75% - (1.5% x 15) = 52.5%	$65,000 x 52.5% = $34,125
4th	50% - (1% x 15) = 35%	$65,000 x 35% = $22,750
5th	25% - (0.5% x 15) = 17.5%	$65,000 x 17.5% = $11,375

Q: What employer contributions are eligible for this tax credit?

A: Eligible employer contributions include matching, nonelective, and profit-sharing contributions. Participant deferrals (pretax or Roth) are not included.

Q: For which years is the employer contributions tax credit available?

A: The eligible employer may claim the credit for the tax year in which the eligible plan becomes effective and for the subsequent five years. Tax years beginning prior to 2023 are not eligible for the credit.

QUESTIONS RELATED TO TAX REPORTING

Q: May I take a tax deduction for the same eligible startup costs?

A: While plan-related expenses and employer contributions may be tax deductible to the employer, you cannot claim both a deduction and a credit related to the same expenses/contributions.

Q: How does a tax credit differ from a tax deduction?

A: A tax deduction reduces the income used to calculate the tax liability, while a tax credit directly reduces the tax liability itself. Since each company is unique, you should consult your company's tax advisor on the advantages of taking a tax deduction vs. claiming tax credits.

Q: How do I claim this tax credit?

A: Employers can claim the startup costs tax credit by filing IRS Form 8881 (Credit for Small Employer Pension Plan Startup Costs) in conjunction with your company's tax return. The IRS has not yet indicated how employers can claim the employer contributions tax credit.

*The information contained in these Frequently Asked Questions is informational only and not intended as legal or tax advice. You should consult your tax advisor regarding the requirements and consequences of claiming the Small Employer Pension Plan Startup Costs Tax Credit.