CONGRESS EXPANDS NEW RETIREMENT PLAN TAX CREDITS

On December 29, 2022, the president signed the Consolidated Appropriations Act of 2023 into law. Tacked onto the appropriation bill were the provisions of SECURE Act 2.0. SECURE Act 2.0 is meant to encourage formation of retirement plans – especially by small employers.

Expanded Credit for Plan Set Up and Administration Fees

Included in the SECURE Act 2.0 was an expansion of the tax credits available to small employers (employers with 50 or fewer employees) who adopt a new qualified plan. Effective for plan years beginning after December 31, 2022, the new credit is 100 percent of the plan's qualified start-up costs with a dollar limit of the greater of a or b: a. $500 b. $250 times the number of non-highly compensated employees eligible to participate in the plan but no more than $5,000. The credit is available for the plan's first year and the two years immediately following. An additional $500 credit is available for small employer start-up plans that include an automatic enrollment provision in the plan.

Example

A small business owner sets up a new 401(k) plan covering himself and six employees. The fee to set up the plan is $700, and the annual administration fee is $1,375. The plan does not include an automatic enrollment feature.

The first-year credit is calculated as follows:
($700 + $1,375) x 100% = $2,075
$250 x 6 non-highly compensated employees = $1,500
First year tax credit = $1,500

Year two there is no plan set-up fee so the credit would be calculated as follows:
$1,375 x 100% = $1,375
$250 x 6 non-highly compensated employees = $1,500
Second year tax credit = $1,375

New Credit for Employer Contributions

SECURE 2.0 also includes a new five-year tax credit for employer contributions made to a new plan. The credit is equal to the amount contributed to the plan for each employee with a cap of $1,000 per employee. 401(k) salary deferral contributions do not count nor do contributions to defined benefit pension plans. Contributions for employees who earn more than $100,000 annually (indexed for inflation) also do not count.

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The credit phases out over five years as follows:

Years 1 and 2: Full Credit

Year 3: 75% Credit

Year 4: 50% Credit

Year 5: 25% Credit

Year 6+: No Credit

Example

An employer adopts a new profit-sharing plan for its employees. The participants are the business owner and four other employees. Assume the employer contributes to the participants' accounts as follows for all years;

Employee	Salary	Contribution
Owner	$150,000	$7,500
Employee One	$60,000	$3,000
Employee Two	$40,000	$2,000
Employee Three	$25,000	$1,250
Employee Four	$19,000	$960

In years one and two the employer's tax credit would be $3,960 ($1,000 each for Employees One, Two and Three and $960 for Employee Four. The owner's contribution doesn't count since she has earnings in excess of $100,000). In year three the credit would be $2,970 ($3,960 X 75%). In year four it would be $1,980 ($3,960 X 50%) and in year five it would be $990 ($3,960 X 25%). Total contribution tax credits = $13,860.

The new plan tax credit is claimed by filing IRS Form 8881 with the employer's Federal tax return.

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