Pinnacle Plan Design

Tax Credits for Small Employer Plans

SECURE 2.0 significantly increases the available tax credits for small employer plans. The following provides an overview of the credits and how they are valuable to business owners considering a new plan.

Credit for Start-Up Administrative Costs

Certain small employers who establish a new plan are eligible for a tax credit for the first three years in which the plan is maintained. An employer is eligible for the tax credit if it (1) had no more than 100 employees making at least $5,000 in the prior year and (2) did not maintain a 401(a), 403(a), SIMPLE, or SEP plan in the three taxable years immediately preceding the tax year in which the plan is adopted. An eligible employer can take a credit as follows:

Size of Employer*	Amount of Tax Credit	Maximum Credit	Additional Notes
1-50 employees	100% of Eligible Startup Costs	Lesser of $5,000 or $250 *times* # of eligible non-highly compensated employees	Must have at least one non-highly compensated employee Minimum credit is $500 Eligible for up to three tax years
51-100 employees	50% of Eligible Startup Costs		
100+ employees	0% of costs	$0	

*Employees are based on the number of employees who made at least $5,000 in the preceding year.

"Eligible Startup Costs" includes ordinary and necessary costs to set up, administer, and educate employees about the new plan. This might include document fees, advisor fees, plan documentation fees, and any other expense necessary to establish and run the plan.

This tax credit often makes it nearly free for employers with 50 or fewer employees to start a plan.

Credit for Employer Contributions

SECURE 2.0 added a new tax credit for small employers that provide employer contributions to a new defined contribution plan. An employer is eligible for a tax credit if it had no more than 100 employees making at least $5,000 in the prior year as follows:

Years Since Plan Adoption	Tax Credit		Maximum Credit
	1-50 Employees	51-100 Employees	
Year of Adoption*	100% of eligible employer contribution	100% minus 2% times number of employees over 50	Lesser of the employer contribution or $1,000 for *each employee* making $100,000 or less in FICA wages
1st tax year after adoption	100% of eligible employer contribution	100% minus 2% times number of employees over 50	
2nd tax year after adoption	75% of eligible employer contribution	75% minus 1.5% times number of employees over 50	
3rd tax year after adoption	50% of eligible employer contribution	50% minus 1% times number of employees over 50	$0 for each employee making >$100,000 in FICA wages
4th tax year after adoption	25% of eligible employer contribution	25% minus 0.5% times number of employees over 50	

*If the employer maintained a 401(a), 403(a), SIMPLE, or SEP plan in the three taxable years immediately preceding the tax year in which the plan is adopted, the employer cannot take a deduction for the year of adoption, but *is* eligible for tax credits in the next four tax years (regardless of how long the prior plan had been maintained).

This provides an incredible incentive for small employers to provide employer contributions in the first five years of the plan!

Credit for Automatic Enrollment

SECURE 2.0 also requires plans established after December 29, 2022, to add an eligible automatic contribution arrangement (EACA) to the plan no later than the 2025 plan year. While this is an administrative complexity, the addition of an EACA feature will generate an additional tax credit for eligible small employers for the first three tax years in which the EACA feature is maintained.

Size of Employer*	Amount of Tax Credit	Additional Notes
1-100 employees	$500	Eligible for up to three tax years
100+ employees	$0	

*Employees are based on the number of employees who made at least $5,000 in the preceding year.

The Bottom Line for Business Owner

Tax credits are extremely valuable. These credits often make the qualified plan significantly more economical for the business owner. For example, the following shows how the tax credits make a qualified plan significantly more valuable for the business owner, *even if* the owner is only interested in making the IRA deferral limit *and even if* the plan is more expensive than an IRA. The economics become even better when employer contributions and higher deferrals are considered.

	Deferral IRA	Quaified Plan (IRA deferral limit)	Qualified Plan (ER Contribution)
Revenue	$ 250,000	$ 250,000	$ 250,000
Admin Expenses for Plan	$ 1,000	$ 2,500	$ 2,500
Tax Credit for Admin Expenses	$ —	$ 2,500	$ 2,500
Tax Credit for Auto Enrollment	$ —	$ 500	$ 500
Owner Contribution	$ 6,000	$ 6,000	$ 66,000
Employer Contribution (for others)	$ —	$ —	$ 23,100
ER Contribution Tax Credit Amount	$ —	$ —	$ 12,000
Earnings Before Tax	$ 243,000	$ 241,500	$ 158,400
Tax Before Credits	$ 51,030	$ 51,240	$ 36,309
Tax Credits	$ —	$ 3,000	$ 15,000
Net Earnings	$ 191,970	$ 193,260	$ 137,091
Owner Retirement Benefit	$ 6,000	$ 6,000	$ 66,000
Net Retained Benefit for Owner	$ 197,970	$ 199,260	$ 203,091

The above example shows the cost savings that the tax credits create when setting up a plan. It does not include any analysis of the addtional benefits created by tax-deferred accumulation of savings, nor the benefit of the plan attracting new employees and retaining current employees.

Small employers can take advantage of the new tax credits starting with the taxable year that begins in 2023. Therefore, now is a great time for business owners to establish plans.