Secure Act 2.0 Retirement Plan Tax Credits

With the recent passage of Secure Act 2.0 one of the many benefits of its passage was the enhancement and addition of several tax credits for qualified retirement plans. In conjunction with the many various state mandates for retirement plans such as Cal savers the Secure Act 2.0 tax credits have become available at the perfect time. With employers in California and many other states being forced into either offering a company-sponsored qualified plan such as a 401(k) or being forced into the state's auto-IRA program many employers are looking for all the help they can get with setting up and making their retirement plans most affordable. The below information and examples are a couple of ways in which employers are maximizing their tax credits while also being able to offer a best-in-class retirement benefit and not just sticking with the bare minimum the government has to offer.

Basic Parameters to be eligible for the tax credit

Must not have sponsored another qualified plan within the past 3 tax years and the company must have less than 100 W-2 employees who made over $5,000 in W-2 earnings the preceding year.

To be eligible for the tax credits you must sponsor a qualified plan such as a SEP IRA, Simple IRA/401(k), 401(k), Profit Sharing, Defined Benefit, or Cash Balance plan. You must have at least one non-highly compensated employee.

Startup Tax Credit

The initial credit is up to $5,000 per year for the first 3 years you sponsor the plan if you have 50 or fewer employees. If you have 51-100 employees the prior credit under Secure Act 1.0 applies which is a 50% tax credit up to $5,000 per year for the first 3 years.

Credit Formula Example:

Number of NHCE employees	Credit Amount
1	$500 (minimum credit with 1 NHCE)
2	$500
3	$750
4	$1,000
5	$1,250

6	$1,500
7	$1,750
8	$2,000
9	$2,250
10	$2,500

20 or more employees reach the $5,000 startup tax credit cap per year. This amount cannot exceed the qualified startup costs for sponsoring the plan.

Super Charge the Tax credit with the Contribution Credit

This credit was newly implemented in Secure Act 2.0. If an employer chooses to match or provide another type of employer contribution some of those contributions may also be eligible for additional tax credits.

Parameters for Contribution Credit

Applies to employer contributions to employees with FICA wages <$100,000. For those employees receiving employer contributions and are below this income threshold the employer can be eligible for up to $1,000 in tax credits per employee.

Example-

Employer provides a profit-sharing allocation of 3% per employee.

Employee 1-

W-2 Earnings- $90,000 Based on these wages a 3% profit-sharing allocation equates to $2,700 which exceeds the contribution credit maximum of $1,000 per employee so the tax credit would be capped at the maximum of $1,000 for this particular employee.

Employee 2-

W-2 Earnings- $30,000 based on these wages a 3% profit sharing contribution equates to $900. When applying the tax credit for this employee the amount of the credit would be capped at $900 since the credit cannot exceed the amount provided to the employee and is also capped at $1,000 if the employer contribution does exceed $1,000 per employee.

Example 2-

ABC Corporation has 5 employees earning < $100,000 receiving this contribution and all receive more than $1,000 of this employer contribution meaning the company is eligible for $1,000 in tax credits for each of the 5 employees. This adds $5,000 in tax credits they can utilize for startup costs to the plan in addition to the startup tax credit discussed above.

Other important notes about the contribution credit

It is phased out over a 5-year time frame on a graded basis. In years 1 and 2 the employer is eligible for 100% of the eligible tax credits. In year 3 the credit reduces to 75% of eligible contributions. In year 4 it drops to 50% and finally, in year 5, it is reduced to 25% of eligible contributions.

This formula applies to employers with less than 50 employees.

For employers with more than 50 employees, the contribution credit is reduced by 2% per employee over 50 employees.

Over 50 employees Example

ABC Corporation has 70 employees. Assume all earn less than $100,000 and the employer provides employer contributions over $1,000 per employee to all 70 employees meaning they are eligible for $70,000 in tax credits before the over 50 employee reduction kicks in. For the additional 20 employees over the 50 employee threshold, we need to reduce the credit by 2% per employee.

We would multiply our maximum credit of $70,000 by 40% since we have 20 additional employees to reduce at 2% per employee. ABC Corporation would then multiply $70,000 by 40% which is $28,000. The initial maximum of $70,000 would be reduced by $28,000 for a maximum eligible contribution credit of $42,000.

Assuming the scenario remains the same the credit would then be reduced to 75% in year 3, 50% in year 4, and finally 25% in year 5.

What costs are eligible for the startup and contribution tax credits?

Qualified startup costs include any necessary expenses related to the setup and administration of a qualified plan.

It also includes retirement-related education of employees for the qualified plan.

Tax credits cannot be carried over. For additional information regarding eligible expenses to be used for these tax credits please consult with your CPA or tax professional for further guidance. ERA Admin does not provide tax advice.

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