Small Employer Plan Credits

In late December of 2019 President Trump signed into law a budget bill to fund the government for the remainder of the fiscal year. Included as an addition to the bill was the SECURE Act (Setting Every Community Up for Retirement Enhancement Act of 2019). The intent of the Act is to amend the Internal Revenue Code of 1986 and ERISA to encourage retirement savings.

Sections 104 and 105 *of the Act amend the tax laws to increase the employer credit for small plan startup costs and to provide an additional credit for plans that incorporate an auto-enrollment provision.*

INCREASED CREDIT LIMIT: Prior to the SECURE Act the tax credit for small employer pension plans was 50% of the qualified startup costs paid or incurred, but limited to no more than $500 for the first credit year and each of the 2 taxable years immediately following.

The new limit is 50% of the qualified startup costs paid or incurred, but limited to the greater of –

- (a) $500, or
- (b) The lesser of –
    - (i) $250 for each employee who is not a Highly Compensated Employee and who is eligible to participate in the plan, or
    - (ii) $5,000.

Note that while the maximum credit allowed has increased, there is still an overriding limit of 50% of total costs. The new limit applies to taxable years after December 31, 2019.

For example: Assume the business has 23 employees. 5 are Highly Compensated Employees (meaning they own more than 5% of the business and/or they earned more than $125,000 in 2019). Of the remaining 18 non-Highly Compensated Employees, 13 are eligible for the plan. The credit each year would be 50% of startup costs, but no more than $3,250 (13 non-Highly Compensated Employees x $250).

Other provisions related to the rules regarding the tax credit have not been amended. Namely:

1. Employers eligible for the credit include employers with no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year. If an eligible employer fails to meet the 100 employee criteria for any subsequent year, there is a 2-year grace period following the last year the employer was eligible (except in the case of failure due to acquisition or similar transaction).

2. An Employer who establishes a new plan is NOT eligible for the credit if that employer (or any member of any control group including the employer, or a predecessor of either) maintained another qualified plan (including a Simple or a SEP) for substantially the same employees during the 3-taxable year period immediately preceding the 1st taxable year for which the credit would otherwise be applicable.

3. Qualified startup costs mean ordinary and necessary expenses paid or incurred in connection with the establishment or administration of the plan or retirement-related education provided to the employees of the plan.

4. The plan must cover at least 1 non-Highly Compensated Employee (meaning that a sole proprietor is not eligible for the credit).

5. Plans that are eligible for the credit include 401(a) plans, 401(k) plans, SEPs, and SIMPLEs. 403(b) plans and 457(b) plans are NOT eligible for the credit. Note: it is not clear if adopting into a MEP or PEP will qualify an employer for the startup credit. Hopefully there will be additional guidance provided on that question.

6. The first year for the credit can be the first year that the plan is effective, or the taxable year preceding the first year the plan is effective (since there might be billable startup costs for the preceding year for consulting services, etc).

7. All eligible employer plans are treated as one plan.

8. The employer cannot take the credit and a tax deduction for the same startup costs.

CREDIT FOR ADDING AUTO-ENROLLMENT: Eligible employers (as defined in 1. above) can receive a tax credit of $500 for each year of the 3-taxable-year period beginning with the first taxable year for which the employer includes an eligible automatic contribution arrangement. The eligible automatic contribution arrangement is an arrangement under which the participant is auto enrolled in the plan at some uniform percentage of compensation unless he specifically opts out or elects a different percentage and under which the participant receives an automatic enrollment notice. Plans that are eligible for the credit include 401(a) plans, 401(k) plans, and SIMPLEs. 403(b) plans and 457(b) plans are NOT eligible for the credit. The credit is available for auto-enrollment added to a new plan or to an existing plan. Unlike the startup credit, the credit for adding auto-enrollment is not tied to plan expenses.

The credit for adding auto-enrollment is in addition to the startup credit. The credit is available for taxable years beginning after December 31, 2019.

The purpose of the SECURE Act is to encourage retirement savings and Congress is hoping that these credits will encourage small employers who do not currently have a plan to adopt one, and will encourage employers with new or existing plans to consider adding an auto-enrollment feature.