Understanding the Small Employer Tax Credits Available Under SECURE and SECURE 2.0

Webinar

This webinar is being provided for educational purposes only. It should not be construed as providing legal or investment advice and is not designed to be complete in all material respects.

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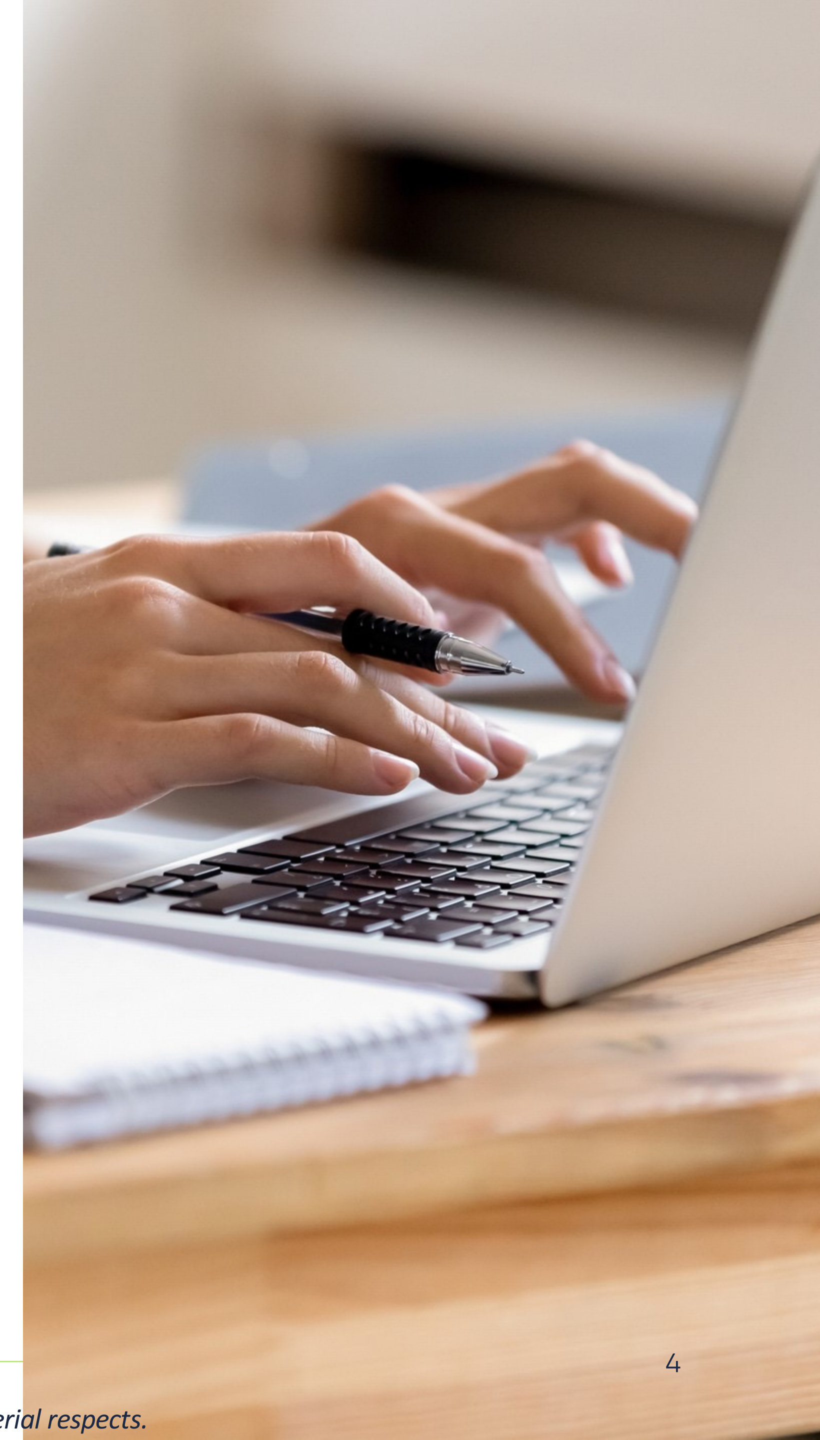
Introduction

- The Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE 1.0") introduced a number of tax credits designed to encourage small employers to sponsor retirement plans and to incentivize retirement savings by their employees
- The SECURE Act 2.0, which was included in Consolidated Appropriations Act of 2022, clarified and enhanced some of these credits
- **SECURE 2.0 Effective Dates**:
    - Enhancements to 45E are effective for tax years beginning after Dec. 31, 2022
    - Clarification about how 45E applies to MEPs/PEPs is retroactive
- Reminder: vendors discussing tax credits with clients should remind clients that they are not providing tax advice and that the clients may wish to consult with tax professionals
- SECURE 2.0 is recent and there is limited guidance on the issues discussed in this presentation

Agenda

- Tax Credits for Sponsoring a Plan
- Tax Credits Based on Plan Design
    - Employer Contributions
    - Eligible Automatic Contribution Arrangements (EACAs)
    - Military Spouse Credit
- Additional Incentives for Participation
- Q&A



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Tax Credits for Sponsoring a Plan ("Start-up Credits")

Overview: Start-up Credits

- Certain small employers who establish a new retirement plan (including SEPs, SIMPLEs, and qualified plans) are eligible for a Start-up Credit for up to three years to help cover administrative start-up costs
- The credit applies to the following three years: the tax year the plan becomes effective with respect to the employer and the two subsequent tax years; or, if the employer elects, the tax year preceding the tax year in which the plan becomes effective with respect to the employer and the two subsequent tax years
- Employers may not both deduct the start-up costs and claim the Start-up Credit; they must choose to either deduct the expenses or claim the credit.

Overview: Start-up Credits

- This is not a new tax credit (it was initially introduced via the SECURE Act); however, SECURE 2.0 made the following changes:
    - **clarified** that the date an employer joins a MEP/PEP is what is relevant for determining whether an employer is eligible for the Start-up Credit, not the date the MEP or PEP itself was established
    - **increased** the Start-up Credit for certain small employers to further incentivize small employers to offer a retirement plan, and
    - **enhanced** the Start-up Credit to provide for an additional tax credit that is attributable to employer contributions

Eligibility: Start-up Credits

- An employer is eligible for the Start-up Credit if the employer:
  1. Had no more than 100 employees making at least $5,000 in the prior year;
  2. Had at least one plan participant who was a nonhighly compensated employee (NHCE); and
  3. Did not maintain a 401(a), 403, SIMPLE or SEP plan in the last three taxable years preceding the tax year in which the plan is adopted
- The technical language of Requirement 3 is intended to prevent manipulation
- SECURE 2.0 clarifies that the relevant year for determining whether an employer who joins a MEP or PEP is eligible for the Start-up Credit is the year in which they join the MEP or PEP; not the year in which the MEP or PEP was first established
- The NHCE requirement means that an owner-only business will generally not be eligible for the Start-up Credit

Amounts & Phaseouts: Start-up Credits

- The Start-up Credit reimburses employers for "Eligible Start-up Costs" incurred for the first three years following the plan's effective date (or, if elected by the employer, following the year preceding the plan's effective date)
- Eligible Start-up Costs are the ordinary and necessary costs to (1) set up and administer the plan, and (2) to educate employees about the plan.
- These costs may include:
    - Document fees
    - Administrative fees
    - Advisor fees
    - Others
- The amount of the Start-up Credit phases out as the size of the employer increases and is capped each year at <u>the lesser of</u> $5,000 or $250 times the number of eligible NHCEs.

Amounts & Phaseouts: Start-up Credits

Size of the Employer	Start-up Credit
1-50 employees	100% of Eligible Start-up Costs (up to the maximum credit amount*)
51-100 employees	50% of Eligible Start-up Costs (up to the maximum credit amount*)
101+ employees	0% of costs

* The amount of the Start-up Credit is subject to a maximum credit amount of the lesser of $5,000 or $250 times the number of eligible NHCEs.

- The Start-up Credit as provided by SECURE 2.0 covers a much higher percentage of Eligible Start-up Costs but is subject to the same cap
- The SECURE Act only reimbursed 50% of Eligible Start-up Costs (up to the maximum credit) for any employer with 100 or fewer employees
- SECURE 2.0 allows the credit to cover 100% of Eligible Start-up Costs for employers with 50 or fewer employees

Tax Credits Based on Plan Design

Tax Credits Based on Plan Design

- In addition to the Start-up Credit describe above, there are two additional credits to keep on your radar.
- **Employer Contribution Credit:** SECURE 2.0 enhanced Code Section 45E to provide a significant tax credit based on the amount of employer contributions made by a small employer to a new plan
- **EACA Credit** "Eligible Automatic Contribution Arrangment"**:** SECURE 1.0 introduced a tax credit for small employers that add an EACA to their plan or establish a new plan with an EACA.

Enhanced Start-up Credit (Employer Contributions)

Additional Employer Contribution Tax Credit

- **Background:** Employers may be eligible for an additional tax credit to offset the cost of employer contributions to a new defined contribution plan made with respect to participants making $100,000 or less in FICA wages (as adjusted by inflation)
- **Eligibility**: Employers with 100 or fewer employees making at least $5,000 in the preceding tax year (with credits phased out based on number of employees in the preceding tax year for employers with more than 50 employees in the preceding tax year)
- **Maximum Credit**: Lesser of actual employer contribution or $1,000 for each employee making $100,000 or less in FICA wages (as adjusted by inflation)

	Assume 50 ee's making $100K	Assume 75 ee's making $100K
Years Since Plan Adoption	**Tax Credit (1-50 Employees)**	**Tax Credit (51-100 employees)**
Year of Adoption*	100% of eligible employer contribution 50 ee's x $1K =$50K	Same minus 2% times number of employees over 50** .02 x 25 =.50 $75k x .50 = $37,500 $75K - $37,500 = **$37,500**
1st tax year after adoption	100% of eligible employer contribution $50K	Same minus 2% times number of employees over 50** $37,500
2nd tax year after adoption	75% of eligible employer contribution 50 ee's x $1K =$50K X 75% = $37,500	Same minus 2% times number of employees over 50** $37,500 x 75% = $28,125
3rd tax year after adoption	50% of eligible employer contribution 50 ee's x $1K = $50k x 50% = $25K	Same minus 2% times number of employees over 50** $37,500 x 50% = $18,750
4th tax year after adoption	25% of eligible employer contribution 50 ee's X 1$K =$50K X 25% = $12,500	Same minus 2% times number of employees over 50** $37,500 X 25% = $9,375

* If the Plan is not newly adopted, it appears that the employer cannot receive the credit for the year of adoption but may be eligible to receive it for the four subsequent years. *See* 26 USC 45E(f)(4)

*** Phaseout applies based on the number of employees in the preceding taxable year.*

Maximum Credit: Lesser of actual employer contribution or $1,000 for each employee making $100,000 or less in FICA wages (as adjusted for inflation)

Tax Credit for Adopting an Eligible Automatic Contribution Arrangement (EACA)

Additional EACA Tax Credit

- **Background:** Small employers may also be eligible for an additional tax credit if the new plan includes an auto-enrollment feature that meets the IRS' EACA requirements.
  - Additionally, this tax credit is available to existing plans that add a new EACA feature to their plans.
  - The EACA credit is available for the first three years in which the EACA feature is effective.
  - Note that Section 101 of SECURE 2.0 requires that all new plans are required to have an EACA feature, subject to certain modifications, by 2025.
  - It is not entirely clear whether the modified EACA that SECURE 2.0 requires new plans to adopt would cause these plans to be eligible for the EACA tax credit.

Additional EACA Tax Credit

- **Eligibility**: To be eligible for the EACA credit, the employer must have 100 or fewer employees who earned at least $5,000 in compensation in the preceding year.
- Unlike the Start-up Credit, there are not separate tiers for 1-50 and 51-100 employees, there is no phaseout based on number of employees, and there is no NHCE requirement.

Size of the Employer	EACA Credit
1-100 employees	$500
101+ employees	$0

Military Spouse Credit

Military Spouse Credit

- **Eligibility:**
  - Employers: 100 or fewer employees who received at least $5,000 in compensation
  - Military Spouses: non-highly compensated employees who self-certify (within certain parameters) that they are married to a member of the uniformed services who is serving on active duty
    - Determination appears to be based on when the spouse first becomes employed with the employer
- **Plan Design Requirements**:
  1. Military spouses must be eligible to participate in the plan within two months of hire
  2. Once eligible, the military spouse must be immediately eligible to receive the same amount of employer contributions that a similarly situated non-military spouse would receive after two years of service
  3. All employer contributions to military spouses must be 100% vested when made
- **Effective Date**: Plan years beginning after the date of SECURE 2.0's enactment

Military Spouse Credit

- **Credit Amount**:
  - Up to maximum of $500 per military spouse, the sum of:
    - $200 credit for each military spouse that participates in the plan, and
    - 100% of employer contributions, up to $300, made to each military spouse
  - Credit applies for the tax year in which the military spouse starts participating and for the subsequent two tax years.
- **Maximum:**
  - No statutory cap but limited by the eligibility criteria (100 or fewer employees who received at least $5,000 in compensation)
  - Can receive over multiple years; not phased out 3 years after first military spouse participates; determined military spouse by military spouse

Additional Incentives for Participation

De Minimis Financial Incentives

- Section 113 of SECURE 2.0 allows employers to offer certain *de minimis* incentives to employees to encourage retirement plan participation.
- Prior to SECURE 2.0, *de minimis* financial incentives were prohibited under the "contingent benefit rule" and implicated ERISA's prohibited transaction rules.
- It is not entirely clear what qualifies as *de minimis*, as SECURE 2.0 does not define the term or provide examples.
- However, the Senate summary of SECURE 2.0 indicates that it would include "low-dollar gift cards."
- Note that these incentives may <u>not</u> be purchased with plan assets.

- <u>**Effective Date**</u>: Plan years beginning after the date of SECURE 2.0's enactment

Total Potential Tax Credits

General Example of Maximum Potential Tax Credits

Years Since Plan Adoption	Start-Up Credit	Enhanced Start-up Credit	EACA Credit	Military Spouse Credit*
Year of Adoption	$5,000	$50,000	$500	$500 per military spouse
1st tax year after adoption	$5,000	$50,000	$500	$500 per military spouse
2nd tax year after adoption	$5,000	$37,500	$500	$500 per military spouse
3rd tax year after adoption	N/A	$25,000	N/A	$500 per military spouse
4th tax year after adoption	N/A	$12,500	N/A	$500 per military spouse

* for the military spouse credit, the credit applies for the first tax year in which the military spouse participates and for the subsequent two years

SECURE Act 2.0 Resources

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Q & A

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