SECURE 2.0's New & Improved (But Really Math-y) Tax Credits for Startup Plans

SECURE 2.0 (S2) took the tax credits of OG SECURE and enhanced them, particularly for plans with fewer than 50 employees. And if you think "enhanced" sounds a bit loaded, you're right; credits have increased, but so has the complexity of the calculations. If you're guessing this may be a trend in all things S2, you're also on the right track and DWC has you covered.

OG SECURE

When OG SECURE passed in 2019, we took a deep dive into the tax credit calculations as well as a review of the difference between tax deductions and tax credits. We won't regurgitate here, but if you're interested in revisiting, you can do so here.

For context and comparison, here's a quick recap of the OG SECURE provisions

- A credit of 50% of eligible expenses,
- Subject to a minimum credit of $500, and
- A maximum credit of $250 per eligible nonahighly compensated employee (capped at $5,000).

S2

Now, the real reason you're here, the new (and improved?) tax credits under S2:

- An enhanced tax credit for implementation expenses that varies based on the number of employees (providing an increased credit for smaller plans), and
- A new credit for employer matching and/or profit sharing contributions.

Let's take a look at these in more detail, but be forewarned…much math lies ahead (we are talking taxes, after all)!

Credit for Implementation Expenses

S2 breaks out this tax credit based on the number of employees and is available for the first three (3) plan years.

For companies that have fewer than 50 employees, the credit is equal to:

- 100% of eligible expenses,
- Subject to a minimum credit of $500, and
- A maximum credit of $250 per eligible nonahighly compensated employee (capped at $5,000).

For companies that have 50 to 100 employees, the credit remains the same as OG SECURE and is equal to:

- 50% of eligible expenses,
- Subject to a minimum credit of $500, and
- A maximum credit of $250 per eligible non-highly compensated employee (capped at $5,000).

Words matter, so let's make sure we're defining "employees" for this purpose before we dive in any deeper. Employees are those who received at least $5,000 of compensation from the Employer in the prior year. This count matters to help you determine the tax credit percentage you're eligible for (50% versus 100%). When we get into the actual calculations of the credit, though, you'll want to know the number of non-highly compensated employees eligible for the plan.

1. Determine how many NHCEs are eligible for your plan.
2. Multiply that number by $250.
3. The result from step #2 is your maximum tax credit for the year (subject to an overall cap of $5,000).
4. Determine your actual eligible plan expenses for the year.
5. Multiple the result of step #4 by the applicable percentage based on your number of employees.
   - More than 49 employees, use 50%.
   - Fewer than 50 employees, use 100%.
6. Apply the bookends (minimum of $500 and maximum of $5,000) to the result of step 5. That is your tax credit for the year.

Let's look at an example of how this plays out for two different plans.

Step	Description	Plan 1	Plan 2
1	NHCEs eligible for the plan	35	51
2	NHCEs x $250 each	$8,750	$12,750
3	Maximum credit (lessor of $5,000 or step 2)	$5,000	$5,000
4	Actual plan expenses (includes plan document fee in year 1)	$2,950	$3,650
5	If applicable, reduce by 50%	N/A	-$1,825
6	Available tax credit (minimum of $500 and max of step 3)	$2,950	$1,825

We warned you things would get math-y, but this is just the beginning!

Credit for Company Contributions

Okay, we've made it through the first fun calculation; let's add one more! S2 provides a new startup credit for employer match and/or profit sharing contributions made on behalf of employees whose actual compensation is less than $100,000 for the year to which the contribution applies. It starts at 100% of the contribution amount, up to $1,000 per employee. There are adjustments based on number of employees, and the overall credit phases out over the first 5 plan years.

Companies with more than 50 employees will reduce the credit by two percentage points for each employee after the 50th employee. The last variable to consider here is the number of years the plan has been in place. The starting point of a 100% credit applies to the plan's first two years in existence and is reduced by 25% each year, thereafter, until fully phased out after year 5.

Since algebra classes are far behind us (and none of us thought we'd use those lessons on variables), let's look at a year-by-year example for two different plans.

Plan Year 1

Step	Description	Plan 1	Plan 2
1	Number of participants with compensation under $100,000	35	60
2	Employer contributions for the plan year (assumes $1,000 per participant)	$35,000	$60,000
3	Credit for employer contributions	100%	100%
4	Reduction to credit percentage based on number of employees*	0%	20%
5	Applicable credit percentage for year 1 (step 3 minus step 4)	100%	80%
6	Available tax credit for year 1 (step 2 multipled by step 5)	$35,000	$48,000

* For Plan 2: 60 employees - 50 employee limit = 10 "extra" employees
10 "extra" employees x 2 percentage points each = 20% credit reduction

Plan Year 2

Step	Description	Plan 1	Plan 2
1	Number of participants with compensation under $100,000	35	60
2	Employer contributions for the plan year (assumes $1,000 per participant)	$35,000	$60,000
3	Credit for employer contributions	100%	100%
4	Reduction to credit percentage based on number of employees*	0%	20%
5	Applicable credit percentage for year 1 (step 3 minus step 4)	100%	80%
6	Available tax credit for year 1 (step 2 multipled by step 5)	$35,000	$48,000

Plan Year 3

Step	Description	Plan 1	Plan 2
1	Number of participants with compensation under $100,000	35	60
2	Employer contributions for the plan year (assumes $1,000 per participant)	$35,000	$60,000
3	Credit for employer contributions	75%	75%
4	Reduction to credit percentage based on number of employees*	0%	20%
5	Applicable credit percentage for year 1 (step 3 minus step 4)	75%	55%
6	Available tax credit for year 1 (step 2 multipled by step 5)	$26,250	$33,000

Plan Year 4

Step	Description	Plan 1	Plan 2
1	Number of participants with compensation under $100,000	35	60
2	Employer contributions for the plan year (assumes $1,000 per participant)	$35,000	$60,000
3	Credit for employer contributions	50%	50%
4	Reduction to credit percentage based on number of employees*	0%	20%
5	Applicable credit percentage for year 1 (step 3 minus step 4)	50%	30%
6	Available tax credit for year 1 (step 2 multipled by step 5)	$17,500	$18,000

Plan Year 5

Step	Description	Plan 1	Plan 2
1	Number of participants with compensation under $100,000	35	60
2	Employer contributions for the plan year (assumes $1,000 per participant)	$35,000	$60,000
3	Credit for employer contributions	25%	25%
4	Reduction to credit percentage based on number of employees*	0%	20%
5	Applicable credit percentage for year 1 (step 3 minus step 4)	25%	5%
6	Available tax credit for year 1 (step 2 multipled by step 5)	$8,750	$3,000

The requirements to claim the credit remain the same as OG SECURE, so a quick reminder on those:

- The credits are only available for startup plans.
- You cannot have sponsored a plan at any time in the immediately preceding three years.
- For the expense credit, the expenses must be related to plan establishment, administration, and or participant education. Note While participant education is listed as an eligible expense, advisory fees are not.
- At least one plan participant must be a nonahighly compensated employee.
- You must have 100 or fewer employees with at least $5,000 in compensation in the preceding year.

Credit for Company Contributions

It is important to note that you cannot claim both a deduction and a credit for the same expenses/contributions, and the expenses must be paid by the company rather than from plan assets (including forfeitures) or revenue sharing.

Since each tax situation is different, we always recommend that you consult your tax advisor for specific projections and tax savings related to deducting plan expenses vs. taking advantage of available tax credits.