Retirement Plan Tax Credits for Small Employers

Maximizing Tax Incentives for Employee Benefits

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Tax Credits Overview

Small employers establishing retirement plans can benefit from two key tax credits:

1. **Startup Costs Tax Credit:** Covers a percentage of the costs to set up and educate employees about a retirement plan.
2. **Employer Contributions Tax Credit:** Provides incentives for contributions made to employees' retirement accounts.

These credits are designed to make offering retirement benefits more affordable. However, it's important to note:

- **Upfront Costs Required:** Tax credits apply only to actual expenses incurred.
- **Non-Deductible Expenses:** Costs claimed for these credits cannot also be deducted as business expenses.

Eligibility Requirements

To claim these tax credits, you must meet the following criteria:

- **Small Employer:** You had 100 or fewer employees who earned at least $5,000 in the preceding year.
- **Non-Highly Compensated Employee (NHCE):** At least one plan participant must be a non-highly compensated employee.
- **No Prior Plan:** In the three tax years before the first year you claim the credit, you must not have offered a retirement plan to substantially the same employees.

Key Tax Credits Breakdown

1. Startup Costs Tax Credit

Covers costs to set up and administer the plan, as well as employee education.

Credit Amount for Employers with 50 or Fewer Employees:

- 100% of eligible costs, up to the greater of:
  - $500, or
  - The lesser of:
    - $250 multiplied by the number of NHCEs eligible to participate, or
    - $5,000.

Credit Amount for Employers with 51–100 Employees:

- 50% of eligible costs, up to the same limits.

2. Employer Contributions Tax Credit

Applies to contributions made to employees' retirement accounts under defined contribution plans, SEPs, or SIMPLE IRAs.

Credit Amount for Employers with 50 or Fewer Employees:

Year 1–2	100% of contributions	up to $1,000 per employee.
Year 3	75% of contributions	
Year 4	50% of contributions	
Year 5	25% of contributions	

Credit Amount for Employers with 51–100 Employees:

- Contributions are reduced by 2% for each employee exceeding the 50-employee limit.

Other Tax Credits

Auto-Enrollment Tax Credit

Employers adding an auto-enrollment feature to a new or existing plan can claim:

- ❐ $500 annually for three years, regardless of costs incurred.

Military Spouse Tax Credit

For hiring and offering retirement benefits to military spouses:

- ❐ $200 for hiring the spouse.
- ❐ 100% of contributions, up to $300.
- ❐ Maximum total credit of $500 per year for the first three years.

Scenario: A SIMPLE IRA Plan in Action

Assumptions:

» Employer with 15 employees earning less than $100,000 annually.

» Annual contributions of $1,000 per employee.

» Eligible startup costs of $10,000.

Year	Startup Costs Credit	Employer Contributions Credit	Auto-Enrollment Credit	Total Tax Credits
Year 1	$5,000	$15,000	$500	$20,500
Year 2	$5,000	$15,000	$500	$20,500
Year 3	$5,000	$11,250	$500	$16,750
Year 4	N/A	$7,500	N/A	$7,500
Year 5	N/A	$3,750	N/A	$3,750

Key Takeaways:

Over five years, the employer claims $69,000 in tax credits.

These credits reduce costs but require upfront expenditures by the business.

Other IRS Considerations

1. **Expenses Must Be Paid:** Tax credits apply only to actual expenditures made.
2. **No Double Dipping:** Claimed expenses cannot also be deducted as business expenses.
3. **Credits Aren't Mandatory:** Employers may choose not to claim allowable credits if it better suits their tax strategy.

This fact sheet is for informational purposes only and does not constitute legal advice.