UNDERSTANDING THE SECURE ACT TAX CREDIT

For businesses starting a 401(k) plan, there are two tax credits available to help lower the start-up costs. The SECURE Act expands the tax credit for eligible employers starting a 401(k) plan with at least one non-highly compensated employee (NHCE).

Generally speaking, the tax credit is equal to $250 for each NHCE. However, the total credit is limited to half of the administrative expensive paid by the employer during the first three years. The minimum credit is $500 and the maximum is $5,000. Any start-up costs paid by the employer but not covered by the tax credit may be deducted by the employer as well. See below for specific examples.

EXAMPLE 1

An employer with **10 NHCEs** incurs **$4,000 in start-up costs** during Year 1 of a new 401(k) plan. During Year 2, the employer spends **$6,000 in start-up costs** on the plan, and **$4,000 in start-up costs** in Year 3.

How much is the tax credit in this example?
ANSWER: $6,500*

	YEAR 1	YEAR 2	YEAR 3
# of NHCEs:	10	10	10
	x $250	x $250	x $250
	$2,500	**$2,500**	**$2,500**
Start-Up Costs:	$4,000	$6,000	$4,000
	50%	50%	50%
	$2,000	**$3,000**	**$2,000**

The start-up credit is calculated on the lesser of either $250 x the number of NHCEs or 50% of the plan's start-up costs up to a $5,000 maximum each year.
*Year 1: **$2,000** + Year 2: **$2,500** + Year 3: **$2,000** = **$6,500***

EXAMPLE 2

Another employer sets up a new plan with **75 NHCEs**. During Year 1, the employer incurrs **$12,500 in start-up costs**. The number of **NCHEs increased to 105** in Year 2 and the **start-up costs reached $14,500**.

How much is the tax credit in this example?
ANSWER: $5,000

	YEAR 1	YEAR 2
# of NHCEs:	75	**105**
	x $250	x ----
	$5,000	
Start-Up Costs:	$12,500	$14,500
	50%	50%
	$6,250	**$7,250**

Even though this employer has 75 NHCEs (x $250 = $18,750) the start-up credit is capped at $5,000 each year. When the number of NHCEs increased to 105 in Year 2, the employer is no longer an eligible small employer for the tax credits.

*Save $1,500 More with An Automatic Enrollment Credit

An Automatic Enrollment Credit increases the tax credit in Example 1 to $8,000. The eligible small employer in Example 1 could see an additional $500 credit annually for adding an auto-enrollment feature to any plan (new or existing). The credit is available for the first taxable year in which the employer's plan contains an EACA or QACA and the next two taxable years.

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Note: To be eligible for the tax credit, the plan must be a start-up plan. For the 3-year period before the eff ecti ve date of the plan, the employer, or any member of a controlled groupincluding the employer, cannot have had a plan that benefi tt ed substanti ally the same employees. Eligible plans are a qualifi ed plan, SEP or SIMPLE. The auto-enrollment credit can be applied to an existi ng plan only if the auto-enrollment feature is ADDED to a plan on or aft er January 1, 2020, and is in additi on to the start-up tax credit. The auto-enrollment credit is NOT linked to the number of NHCEs eligible for the plan, nor the costs associated with the auto-enrollment feature.

1 Small employer: *an employer which had no more than 100 employees who received at least $5,000 in compensation from the employer for the preceding year.*

2 Start-up Costs: *any ordinary and necessary expenses which are paid by the employer in connection with the establishment or administration of the plan (e.g., plan document, set up fees, 5500 fi ling, testing, educational meetings, asset management fees).*

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