TURNING PLAN COSTS INTO TAX SAVINGS: A RETIREMENT PLAN CREDITS GUIDE FOR ADVISORS

Tax credits are one of the most compelling reasons a small employer will say “yes” to starting a retirement plan. Yet, many business owners never claim them because no one raised the topic. Advisors are uniquely positioned to educate clients on these incentives. Understanding the basics can help advisors turn a cost objection into a plan installation.

Why These Credits Matter

The federal government offers several business tax credits to offset the cost of starting, administering, and funding a retirement plan. These are dollar-for-dollar reductions of tax owed, not mere deductions. As a result, they are far more valuable than an equivalent deduction would be. For an eligible small employer, stacking the available credits can offset most or all of a new plan’s early costs.

The Startup Cost Credit

The startup cost credit was originally a modest incentive: 50% of qualified startup costs, capped at $500 per year for three years. Congress has since expanded it significantly.

SECURE Act. In 2019, the SECURE Act raised the annual cap to the greater of $500, or the lesser of (a) $250 multiplied by the number of non-highly compensated employees eligible to participate, or (b) $5,000. Put simply, this means an eligible employer can claim up to $5,000 per year in tax credits based on their new plan. The three-year limit still applies, meaning an eligible employer could claim up to $15,000 over three years!

Because the credit was still limited to 50% of qualified startup costs, an employer would have had to spend $30,000 in qualified startup costs to claim the full $15,000 credit.

SECURE 2.0 Act. For tax years beginning after 2022, the SECURE 2.0 Act increased the credit percentage from 50% to 100% of qualified startup costs (for employers with 50 or fewer employees who received at least $5,000 in compensation in the preceding year). Unfortunately, eligible employers with 51-100 such employees remain capped at 50%. The three-year credit period generally begins with the tax year in which the plan becomes effective, but the employer may elect the preceding tax year as the first credit year.

Qualified startup costs include ordinary and necessary expenses paid or incurred to establish or administer the plan and to educate employees about the plan. To be eligible for the startup cost credit, the employer must have had no more than 100 employees who received at least $5,000 in compensation in the tax year preceding the first credit year, must have at least one non-highly compensated employee eligible to participate, and during the three tax years preceding the first credit year, neither the employer, a related employer, nor a predecessor employer may have established or maintained a qualified employer plan under which contributions were made or benefits accrued for substantially the same employees.

Other Credits

In addition, several other tax credits are available to many small businesses sponsoring a retirement plan:

- **The Employer Contribution Credit** – this credit is equal to an applicable percentage of employer contributions (excluding elective deferrals) to an eligible employer plan other than a defined benefit plan, capped at $1,000 per employee. The applicable percentage phases down over five years: 100% in Years 1 and 2, 75% in Year 3, 50% in Year 4, and 25% in Year 5. The full applicable percentage is available only for employers with 50 or fewer employees in the preceding tax year; the percentage is reduced by 2 percentage points for each employee over 50, counting all employees for this purpose. No credit is allowed for contributions on behalf of an employee who receives more than $110,000 in FICA wages from the employer in 2026.
- **The Auto-Enrollment Credit** – this credit provides a flat $500 per year for three years to an employer that adds and maintains an Eligible Automatic Contribution Arrangement to a new or existing qualified plan. Unlike the startup cost credit, this credit does not require a non-highly compensated employee to be eligible to participate.

- **The Military Spouse Participation Credit** – this credit applies to eligible small employers with defined contribution plans that (1) make military spouses eligible within two months of hire, (2) provide employer contributions at the level a similarly situated non-military-spouse would receive after two years of service, and (3) provide immediate full vesting. The credit equals $200 per participating military spouse plus up to $300 of employer contributions on their behalf, for the first three tax years of participation in an eligible plan. The military spouse must be a non-highly compensated employee who, when first employed or rehired, is married to a member of the uniformed services serving on active duty.

Stacking Credits and Practical Considerations

These credits can generally be stacked. Combining the enhanced startup credit ($5,000 per year) and the auto-enrollment credit ($500 per year) yields up to $5,500 per year for three years. And that is before adding the separate employer contribution credit!

When discussing credits with clients, advisors should keep several practical points in mind. First, for the startup cost and employer contribution credits, the otherwise allowable deduction must be reduced by the credit amount; a client may instead elect not to claim the credit. Second, controlled groups, common-control entities, and affiliated service groups are treated as a single employer for employee-count and credit-computation purposes. Third, these credits are nonrefundable, so a client with little or no tax liability may not benefit fully in a given year, although unused general business credits generally may be carried back one year and forward 20 years. Timing and entity structure matter!

If you have any questions or are looking for more information on turning plan costs into tax savings, feel free to reach out to your trusted TBC TPA.

Upcoming deadlines:

September 15. Deadline for employer contributions to be deductible for the prior tax year for calendar-year partnerships and S corporations that filed an extension; also, their extended deadline for funding SEP contributions.

September 30. Summary Annual Report (SAR) due to participants for calendar-year ERISA retirement plans subject to the SAR requirement whose 2025 Form 5500 was not extended.

October 1. Adoption deadline for a new safe harbor 401(k) plan for the current plan year for a calendar-year employer with no existing plan (or a profit-sharing-only plan).

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