



Small Business Tax Incentives for Retirement Plans

Studies show that employees are far more likely to save for retirement when they can participate in a retirement plan at work. But for small companies, the cost and resources required to start and maintain a retirement plan can be prohibitive.

In fact, only 53 percent of small business employees have access to workplace retirement plans. And with nearly half of all private sector workers employed by small companies, that means almost 30 million Americans are without retirement plan access.¹

Fortunately, Congress has taken notice. Recent legislation expanded tax incentives designed to make it more affordable for small businesses to establish retirement plans—and easier for Americans to save.

Startup Costs Tax Credit

Establishing a retirement plan can be costly, especially for small employers. The small-employer retirement plan startup credit helps reimburse some of the expenses required to create a new plan.

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 increased these tax incentives. Now, small businesses can take advantage of a \$250 credit per non-highly compensated (NHCE) employee. This includes a minimum credit of \$500 and a maximum credit of \$5,000 per year.

Small businesses can apply this credit to 50 percent of the costs related to plan administration and participant education. Businesses can claim this tax deduction for up to three years.

Automatic Enrollment Credit

Automatic enrollment is a plan feature that allows employers to enroll eligible employees in a retirement plan at a set contribution amount without direct permission. Participants can change the deferral amount or opt out at any time but do not need to take action to start saving.

Employee inertia is one of the major roadblocks to retirement savings. Thus, automatic enrollment has proven to enhance retirement plan participation—and retirement outcomes.

The SECURE Act incentivizes employers to add automatic enrollment to their plans by offering a tax credit of \$500 per year, for up to three years. The credit is available to all new and existing small-employer plans that add an automatic enrollment feature. For new plans, it is in addition to the startup credit.

It is also important to note that the automatic enrollment tax credit is not limited to individual plans. Small employers that participate in a multiple employer plan (MEP) can also take advantage of the credit by adding automatic enrollment.

Who Is Eligible?

The small-employer credits are available to businesses with 100 or fewer employees. These employees need to have earned at least \$5,000 in compensation in the prior year. Among them, there must also be at least one plan participant who is an NHCE. An NHCE must own less than 5 percent of the business or earn less than \$125,000 annually.

Additionally, the employees cannot have received contributions or accrued benefits in another retirement plan sponsored by the same employer, a member of a controlled group that includes the employer, or a predecessor of either for the three tax years before the first year of eligibility.

On the Horizon

Concerns about Americans' ability to successfully retire are widespread. But retirement plan access may help mitigate a potential crisis. Thus, expanding retirement plan coverage continues to be a legislative priority.

Some states have taken matters into their own hands. State-sponsored automatic individual retirement accounts (auto-IRAs) provide a retirement savings vehicle for workers without an employer-sponsored plan.

Proposed legislation like the Build Back Better Act—approved by the House Ways and Means Committee in September—seeks to mimic this on a national level. It would require employers that do not sponsor a retirement plan to automatically enroll their employees in an IRA or a 401(k)-like plan, starting in January 2023. Should this become law, it may motivate private employers to establish plans to avoid a government-run option.

Another piece of legislation, the Securing a Strong Retirement Act of 2021—known as the SECURE Act 2.0, seeks to further encourage small businesses to establish retirement plans. The SECURE Act 2.0 proposes an additional increase to the small-employer startup plan credit. It would also allow small employers that join an established MEP to take the startup credit for the first three years in the plan.

With retirement plan access center stage, employers are likely to face continued pressure to provide employees with an option to save. Small businesses are wise to be proactive.

Along with the current tax incentives—which combined can total up to \$5,500 per year, or \$16,500 for three years—employer-sponsored plans have business advantages. Retirement plans support employee wellness and retirement readiness. They also serve as a recruitment and retention tool. These benefits may be the competitive edge a small business needs to thrive.

¹ ‘2020 Small Business Profile,’ U.S. Small Business Administration Office of Advocacy

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