Betterment at Work

WHERE CREDIT IS DUE

How tax credits can play a big role for small businesses

Small businesses are the backbone of the economy. Despite having limited resources, they're the innovators, designers, and risk takers who disrupt and often outfox large companies. They drive meaningful innovation for the economy, and in turn, the government rewards them with tax incentives.

This gives small businesses the chance to grow and receive financial benefits along the way, so it's worth getting familiar with. But if the idea of diving into the minutiae of tax codes makes your head spin, we totally understand.

That's why we're breaking down the ABCs of small business tax credits, and how they can be used to drive growth. Let's get started.

Tax credits vs. tax deductions

The government can provide a tax deduction or a tax credit to incentivize specific activities. Tax deductions reduce income subject to tax, whereas tax credits reduce the amount of taxes owed. Which is more valuable? As with most answers in taxes, it depends.

For example, if a business is eligible for a 30% tax credit for an investment, OR a deduction which reduces income that would normally be taxed at 50%, the deduction provides a greater financial benefit. Make sense? That's why it's important to consider the implications of tax credits and deductions on your business' overall financial picture.

Types of tax credits and who is qualified

1. Nonrefundable tax credits can only reduce the amounts of taxes owed.
2. Refundable tax credits can provide for a refund larger than the tax paid. If a business is not yet profitable, they can provide the immediate benefit of a cash infusion.

SECURE Act 2.0 employer tax credits

Thanks to the recently passed SECURE Act 2.0, you might be eligible for valuable tax credits by setting up a retirement plan, like an employer-sponsored 401(k). Here are the three main types of tax credits addressed in the legislation:

Startup tax credit

Starting a new plan? There are tax credits available to help offset the costs of that plan for up to three years with this new clause.

According to SECURE Act 2.0, eligible startup costs include “ordinary and necessary costs to set up and administer a new plan and educate employees about the plan.” Here’s how the credits stack up based on your number of employees:

NUMBER OF EMPLOYEES	TAX CREDIT
1-50	100% (up to $5,000)
51-100	50% (up to $5,000)
101+	0%

Note that there are some stipulations when counting who is considered an employee:

- Employees who earn less than $5,000 do not count towards the calculation of the number of employees
- Tax credit calculation is the lesser of $250 multiplied by the number of non-highly compensated employees (HCEs) OR $5,000 (the minimum credit is $500)
- For 2023, non-HCEs must own less than 5% of the company and have earned less than $135,000 in 2022

Employer contribution credit

To enable small businesses to support their employees' retirement, this clause allows businesses to claim back costs associated with making employer contributions toward employees' 401(k)s.

If your company adopts employer contributions as a part of your plan design, you may be able to claim these costs for up to five years.

Here's how to determine whether your company is eligible:

NUMBER OF EMPLOYEES	ADOPTION YEAR *	YEAR 1 CREDIT	YEAR 2 CREDIT	YEAR 3 CREDIT	YEAR 4 CREDIT
1-50	100% of employer contribution	100% of employer contribution	75% of employer contribution	50% of employer contribution	25% of employer contribution
51-100	100% minus 2% EE count over 50	100% minus 2% EE count over 50	75% minus 1.5% EE count over 50	50% minus 1% EE count over 50	25% minus 0.5% EE count over 50
101+	0%	0%	0%	0%	0%

*If the employer maintained a 401(a), 403(a), SIMPLE, or SEP plan in the three taxable years immediately preceding the tax year in which the plan is adopted, the employer cannot take a deduction for the year of the adoption, but is eligible for tax credits in the next four tax years

Additional considerations for eligibility include:

- Employees who earn less than $5,000 do not count towards the calculation of the number of eligible employees
- Tax credit only applies to employees who make less than $100,000 in FICA wages
- Maximum credit amount is the lesser of actual employer contributions or $1,000 per employee making $100,000 or less in FICA Wages

Automatic enrollment credit

Employers that establish a new 401(k) plan after 12/29/22 that includes automatic enrollment can take advantage of this new credit for up to three tax years.

Eligibility for the automatic enrollment credit depends on your company's employee count:

NUMBER OF EMPLOYEES	TAX CREDIT
1-100	$500
101+	$0

This trend of opting all employees into the plan aims to increase participation and encourage employees to get started with their 401(k) now, rather than wait to prioritize this crucial financial decision.

Credit for small employer health insurance premiums

The Affordable Care Act (colloquially known as Obamacare) encourages employers to provide health insurance to employees by offsetting some of the premium cost. If you qualify, this credit is equal to 50% of employer-paid health insurance premiums for up to two years.

The biggest tax credit breaks go to companies with fewer than 10 employees who are paid an average of $27,000 or less. That means, the smaller the business, the bigger the credit!

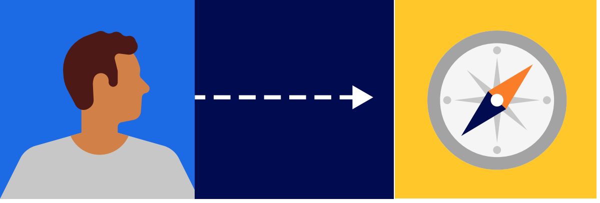
The details can be a little tricky to follow, but here are the basic requirements to qualify:

1. Have fewer than 25 full-time or equivalent employees
2. Pay an average wage of less than $56,000 a year per full-time employee
3. Pay at least half the cost of each employees' health insurance premiums
4. Have purchased a qualified health plan from the Small-Business Health Options Program (SHOP) Marketplace

Research and development tax credit

Innovation is the cornerstone of American business, and plays an important role in the global economy. The government recognizes the value of research and development activities, so they provide a tax credit of 5-10% of R&D costs (for most companies). The credit is normally limited to the businesses tax liability, as it is nonrefundable.

However, there is a small business exception where up to $250,000 in credits can be used to offset payroll taxes. A small business is defined as having less than $5 million in revenue and being in business for five years or less. That means they can offset payroll taxes for up to five years for a maximum of $1.25 million in total credits!



NEXT STEPS

How the government determines eligibility:

1 Qualified purpose

The purpose of the research activity must be to create a new or improved product or process, resulting in increased performance, function, reliability, or quality.

2 Elimination of uncertainty

The company must have technological uncertainty as to capability, design, or product improvement.

3 Process of experimentation

- Identify the uncertainty regarding the development or improvement of a business component that is the object of the taxpayer's research activities;
- Identify one or more alternatives intended to eliminate that uncertainty; and
- Identify and conduct a process of evaluating the alternatives.

4 Technological in nature

The business component's development must be based on hard science (physics, engineering, chemistry, life science, biological science, computer science).

How to claim tax credits

The rules for meeting the requirements of a tax credit can be confusing, but finding the right forms isn't too bad. We've added a few below.

- Retirement plan startup costs tax credit - Form 8881
- Credit for small employer health insurance premiums - Form 8941
- Research and development tax credit - Form 6765

Use tax incentives to cut costs of your 401(k)

Taking advantage of the tax credits and deductions discussed above is one great way to save money when starting a retirement plan for your company—choosing an easy-to-manage 401(k) is another.

Betterment at Work offers modern financial wellness solutions and ongoing support to drive your business forward:

1. **An easy-to-manage 401(k) plan**

   Get the tools you need to make administration simple, from streamlined onboarding and payroll integration to detailed reporting.

2. **Give employees the support they need**

   Financial tools and guidance help employees make decisions that are right for them, including expert-built portfolios, automated investing strategies, and access to a full suite of wealth building tools for retirement—and beyond.

3. **Additional financial benefits**

   Option to add on Student Loan Management, 529 Education Savings, and 1-1 Financial Coaching to support the needs of your diverse workforce.

4. **Simplified plan administration**

   From payroll integration to plan design to administrative and limited fiduciary support, we're here to help you set up and manage your plan with ease.

5. **Transparent and flexible pricing**

   We offer clear and flexible pricing to meet your business's specific needs, so that you always understand what you're paying for.

A Betterment 401(k) plan could be better for you—and better for your employees. Find out more today.

Betterment at Work

529 accounts and their plans are held and managed by program administrators and managers outside of Betterment. 529s are only available as part of a bundled offering with a Betterment 401(k). Not available in the Essential plan.

Student Loan Management by Betterment at Work is provided in partnership with Spinwheel.

For financial coaching services, additional fees apply for use in the Pro plan. Services not available in the Essential plan.