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SECURE ACT-Small Business Retirement Plan Startup Tax Credit

By Jim Foote, CRPS

The Setting Every Community Up for Retirement Enhancement (SECURE) Act intends to improve retirement savings for employees in the US. One of the Act's most attractive provisions has made it less expensive for many small businesses to start new retirement plans, including 401(k)s, SEP IRAs, and SIMPLE IRAs. One major advantage to business owners provided by the SECURE Act is startup retirement plan tax credit. If you are considering setting up a small-business retirement plan, you can potentially benefit from the credit.

What is the startup tax credit?

The credit reduces the amount of federal taxes that an employer may owe on the small business's first-ever retirement plan for the plan's first three tax years. The credit covers 50% of the employer's ordinary and necessary out-of-pocket plan costs, up to a certain limit. For tax years beginning after December 31, 2019, the maximum annual credit is $500 or, if greater, $250 multiplied by the number of plan-eligible non-highly compensated employees, up to $5,000. Previously, the maximum credit was $500 a year.

What are the eligibility requirements for the credit?

To qualify for the credit, businesses must meet all of the following requirements:

- No more than 100 employees who received compensation of $5,000 or more in the preceding year.
- At least one plan participant who was a non-highly compensated employee.
- The employer did not offer a plan covering substantially the same employees during the previous three tax years.

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What types of plan costs does the credit apply to?

The credit covers 50% of ordinary and necessary plan costs paid by the employer to set up and administer the plan — such as advisor and TPA compensation, recordkeeping fees and employee education expenses — up to the limit, as previously shown. The credit does not apply to plan costs paid through plan assets or investment expenses. The credit only applies to plan costs that the employer pays out of pocket — not costs paid by participants through investment expenses or costs paid from plan assets.

Example of how the credit is calculated

Suppose a new 401(k) plan sponsor has 12 non-highly compensated employees and pays first-year plan setup fees of $1,000, investment recordkeeping fee of $1,000, an annual TPA administration fee of $1,500, financial professional compensation of $1,000, and a third-party fiduciary services fee of $500.

The maximum credit would be $3,000 ($250 × 12).

Employer plan costs total $5,000, so 50% would be $2,500. In this case, the tax credit would be $2,500.

To learn more about how RetireWell can assist please contact Jim Foote at jfoote@retirewelltpa.com or call 215-932-4009.

Important Upcoming Deadlines

Form 5500 for Plans with a December 31 plan year end:

The deadline, without extension, for filing the required Form 5500 is July 31st. The Application for Extension of Time, Form 5558, can be filed by that date for a one-time extension to October 15th. There is no penalty for filing the extension but the fee for Form 5500-SF filers is $150.00.

Cycle 3 Restatement:

The deadline for executing plan documents, restated for Cycle 3, as required by the IRS, is also July 31st. The restatement applies to 401(k) plan documents that are tax-qualified and pre-approved by the Internal Revenue Service.

Failure to restate the plan document in accordance with Cycle 3 by the deadline may result in the plan becoming "disqualified." In general, upon disqualification, the participants of the plan would be immediately subject to federal income tax on all of their accrued benefits in the plan as ordinary income. Such income would be taxed for all open years with penalties and interest.

In addition to the taxation of plan participants, the trust of the plan could be immediately subject to federal trust tax on an amount equal to all of the accrued benefits in the plan. Such trust income would be taxed for all open years with penalties and interest.

Investment of ESG Funds Through Retirement Plans

By Anthony L. Scialabba, Esq. and Anthony L. Scialabba IV, Esq., QKA

This article depicts the recent actions the Department of Labor ("DOL") has taken with regard to the investment of Environmental, Social, and Governance ("ESG") funds by retirement plans. This article also discusses forthcoming rules in this area. However, please note that efforts to predict when and where the DOL will offer guidance can be difficult. Primarily, this is due to the fact that government achievements are powered by shifting political climates, changes made to retirement plans from other federal agencies, societal

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interests, the work loads of DOL representatives, and the priorities of the Employee Benefits Security Administration ("EBSA").

1. History

On November 13, 2020, under the administration of President Donald J. Trump, the DOL issued a "final" rule (Financial Factors in Selecting Plan Investments (i.e., the "Trump Rule")) which limits the selection of investments in ESG funds by retirement plans. 85 Fed. Reg. 72846 (Nov. 13, 2020). The Trump Rule generally mandates plan fiduciaries to root investment decisions on exclusively financial factors and bans plan fiduciaries from picking investments based on "non-pecuniary" considerations. For a plan fiduciary to include an investment option that supports non-pecuniary goals, there must be a "tie-breaker" situation under which the plan fiduciary was unable to distinguish investment alternatives on the basis of solely "pecuniary" factors. The plan fiduciary is required to provide documentation in this regard. Further, the Trump Rule does not permit a fund that considers ESG factors to be used as a Qualified Default Investment Alternative ("QDIA").

On October 14, 2021, the DOL issued a "proposed" rule (Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (i.e., the "Biden Rule")). 86 Fed. Reg. 57272 (Oct. 14, 2021). The Biden Rule attempts to strengthen the retirement savings and pensions of Americans through removing and expanding upon the barriers set by the Trump Rule. The major features of the Biden Rule are as follows:

- The evaluation of the investment or the investment course of action is required to be based on risk and return factors that a plan fiduciary prudently selects are material to investment value, utilizing investment horizons that align with the retirement plan's investment goals and funding policies. Certain ESG factors are considered as possible material risk and return factors. Thus, an affirmative duty is placed on plan fiduciaries to consider ESG factors where they have a materially economic impact (Proponents for permitting ESG factors to be considered in retirement plan investing decisions may argue that this level of concern is what is and has always been required of plan fiduciaries (i.e., the consideration of all material economic factors).).
- The recognition that a plan fiduciary must use appropriate consideration with regard to an investment or investment course of action. This may require a review of the economic impacts of climate change and other ESG factors. This review shall be performed in the setting of evaluating risks and returns against alternative investments with similar risks.
- A fund that considers ESG factors can be used as a QDIA. However, the fund must be financially prudent and satisfy the standards of DOL Regulation Section 2550.404c-5.
- The plan fiduciary need not indicate through documentation why he or she was unable to choose investment alternatives by only considering pecuniary factors where a non-pecuniary factor is used in a tie-breaker scenario.
- "Collateral benefits" (such as potential increases in the assets in the accounts in a retirement plan) can be viewed as a tie-breaker where competing investments equally promote the financial interests of the retirement plan over an appropriate time horizon. However, as under the Trump Rule, a plan fiduciary cannot accept reduced financial returns or greater risks to obtain any such collateral benefits.
- The collateral benefit characteristic must be noticeably displayed in disclosure materials provided to plan participants and beneficiaries if the plan fiduciary makes an investment decision based on collateral benefits with respect to a

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designated investment alternative for a defined contribution plan.

The DOL has received a significant amount of comment letters in support of the Biden Rule. Thus, it is likely to be finalized.

II. Stances Taken on ESG Investing in General

There is a divide on the matter of retirement plans investing in ESG funds. Democrats, such as U.S. Senators Tina Smith, D-Minnesota and Patricia L. Murray, D-Washington, believe that investments in ESG funds offer comparable returns and potentially lesser risk than traditional funds. Republicans are generally opposed to this view and have taken a different approach to investing in ESG funds. For example, on May 27, 2022, Rep. Chip Roy, R-Texas, introduced H.R. 7896 ("No ESG at TSP Act") which aims to stop federal employees and retirees from investing their money in the Thrift Savings Plan ("TSP") towards ESG funds. No ESG at TSP Act, H.R. 7896, 117th Cong. (2022). The No ESG at TSP Act bans investments under the TSP in particular mutual funds that make investment decisions on ESG criteria to accomplish this objective. Rep. Roy presented the No ESG at TSP Act because he claims that in America, ESG funds undermine the freedom of energy and promote gender and racial ideologies which have the effect of separating Americans.

Differences of opinion towards ESG investing can also be found at the state level. For instance, in March of 2022, the Idaho Senate State Affairs Committee passed a bill that bans the investment of state funds in companies that prioritize the promotion of ESG over financial returns. 1405, 66th Leg., 2nd Reg. Sess. (Id. 2022). However, in states such as Kentucky, Texas, and West Virginia, state funds must be restricted in their transactions with companies that divest coal, natural gas, and oil. In addition, a number of states promote green energy while others are tied to the fossil fuel industry. Not only are these states displaying their respective positions in various manners, they have also decided on how their state pension plans are invested.

In addition to the positions of states, retirement plans of many companies are not invested in ESG funds, but there is a trend of companies that lean towards such investments. For example, on October 14, 2021, Morningstar, Inc. and Plan Administrators Inc. announced their plans for the first "pooled" employee plan that offers an investment lineup of almost solely ESG funds. Another example is the fact that on March 23, 2022, Transamerica Corporation announced that it was teaming up with FuturePlan by Ascensus, LLC, Natixis Investment Managers, and LeafHouse Financial Advisors, LLC to offer the first group plan that utilizes an ESG-driven "target-fund" series.

III. Arguments for and Against Retirement Plans Investing in ESG Funds

Proponents of retirement plans investing in ESG funds argue that investors generally want (or at least should want) to divest their money into companies that do business in a manner that leads to a healthy environment. Taylor Tepper, *Does An ESG Fund Belong In Your 401(k)?*, Forbes Advisor (Nov. 2, 2021, 10:14AM). Their arguments proceed as follows. The environment may not be healthy for a variety of reasons, such as climate-related disasters. In this regard, in 2020, the United States faced a record 22 climate-related disasters resulting in damages of near $100,000,000,000. Adam B. Smith, *2020 U.S. billion-dollar weather and climate disasters in historical context*, Beyond the Data (Jan. 8, 2021). Such disasters impact almost all sectors of the economy and are happening more frequently. Proponents of investments in ESG funds may further argue that such funds make a real impact in combating threats to the environment. Thus, the proponents claim that through protecting the environment, the economy is also being protected. This is because meteoric damages will not occur or occur less frequently.

In addition to environmental considerations, proponents of retirement plans investing in ESG

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funds contend that such investing is beneficial to the mental state of Americans. Paula Allen, *Why boosting workplace mental health is good for business*, Corporate Knights (June 22, 2021). They argue that if the economy is suffering because the environment is in shambles, Americans will not be happy as their retirement savings and pensions will "pay the price". Their perspective emanates from layoffs, companies adopting restricting provisions to their retirement plans, and in other respects. A rational person would usually want to have as much money as they can stowed away for retirement (and presumably, most people would like to have a healthy environment). More Americans will likely become or remain employed (thereby accruing retirement savings by contributing to their retirement plans as they may not feel the urge to access certain money immediately) and in other facets. Thus, through shielding the environment and consequently the economy, the mental state of Americans is being safeguarded as well.

Proponents insist that investors have the ability to reward companies that either promote or seek to promote a workforce that is diverse, energy that is "green", and corporate behavior that is ethical. They argue that by investing in such companies, better financial returns will accrue over time (i.e., performing "moral services" yields positive results). Tepper, *supra*. In other words, proponents maintain that certain ESG funds may outperform non-ESG funds due to the screening out of "bad" companies and the detecting of "good" companies. In particular, a 2021 paper observed 13 corporate meta-analysis studies published (across 1,272 unique studies) with a quantitative approach and two investor meta-analysis studies published (across 107 unique studies) from 2015-2020. Whelan, Tensie, Atz, Ulrich, Holt, Tracy Van, and Clark, Casey (2021, Aug.). ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015 – 2020. The former studies noticed consistent positive correlations between ESG and corporate financial performance, while the latter studies detected that financial returns with regard to ESG were generally indistinguishable from conventional financial returns. Even if the ESG funds do not outperform the non-ESG funds, investors may still opt to choose to invest in the ESG funds as a way to ensure that they are not furthering the factors that attribute to issues which ESG funds may be able to redress.

Opponents of retirement plans investing in ESG funds cite the purpose of ERISA, which is to protect the retirement plan assets of Americans so that funds put into their retirement plans during their working careers will be there when they retire. Susan Gary, Keith Johnson, and Tiffany Reeves, ERISA Regulations Should Address Evolving Nature of Prudence and Duty of Impartiality, The FinReg Blog (Mar. 15, 2022). Under ERISA's duty of prudence, a plan fiduciary must exercise prudent investments and investment courses of action display appropriate consideration to the facts and circumstances that, with regard to the scope of the plan fiduciary's investment duties, the plan fiduciary knows (or should know) are pertinent before undertaking action. ERISA § 401(a)(1)(B). With respect to ERISA's duty of loyalty, a plan fiduciary cannot subordinate the interests of plan participants and beneficiaries in retirement income or financial benefits to alternative goals. ERISA § 401(a)(1)(A). The opponents argue that plan fiduciaries may not forgo financial return or accrue further investment risk to highlight benefits or aims unrelated to those interests. In other words, if retirement plans are purposefully investing in ESG funds for non-pecuniary reasons (e.g., to protect the environment), ERISA will be violated. Consequently, the retirement futures of Americans will suffer due to the ultimate financial returns.

Opponents of investing in ESG funds claim that (1) ESG funds do not perform as well as non-ESG funds, and (2) the costs of ESG funds are high. John Sullivan, *Republicans Slam 'Woke' ESG 401k Fiduciary Requirements*, 401K Specialist (Dec. 13, 2021). For example, a 2020 paper determined that

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with the exception of the short-duration bond funds, Vanguard funds usually outperformed ESG funds by a wide degree. Aubry, Jean-Pierre, Chen, Anqi, Hubbard, Patrick M., and Munnell, Alicia H. (2020, Oct.). ESG Investing and Public Pensions: An Update. This conclusion was in part because the fees in the ESG funds were roughly 80 basis points higher (this may evince the supplemental resources necessary for screening). Similarly, iShares ESG Aware MSCI USA has a 0.15% expense ratio, whereas iShares Core S&P 500 has a 0.03% expense ratio. This example supports the perception that passively traded index funds have significantly lower charges than the charges surrounding ESG funds. Tepper, *supra*. As seen by these examples, opponents posit that the duties of prudence and loyalty would be violated by a retirement plan investing in ESG funds because after consideration of all the facts and circumstances, a lower financial return will likely be received. They also claim that aiming for such a lower financial return is not in the exclusive benefit of providing that an American has sufficient retirement plan assets saved at the time he or she retires.

Other arguments posited by opponents of investing in ESG funds are that such investing should not be undertaken because (1) the objectives sought will not be reached, (2) the pursuit of such objectives (for instance, "climate change") will be disgraced by the seriousness of the pursuit being undermined, and (3) the formation of an industry of well-compensated but sham employments afforded by escalated fees for investment management, will lead individuals astray from more significant work in which these individuals should be occupied. Robert Powell, *The retirement crisis: where do we stand?*, MarketWatch (Jan. 6, 2022, 8:05AM). Opponents claim that the objectives sought will not be reached since investing in ESG funds does not make a real impact with aiding or solving an objective such as climate change. Therefore, opponents argue that using time, money, and resources to invest in ESG funds belittles the pursuit of an objective like climate change. Thus, opponents contend individuals who do or seek to invest in ESG funds are being handsomely compensated for "false hope" when these individuals should be applying themselves in other aspects of their respective work.

IV. Conclusion

As demonstrated by the aforementioned discussion, the Biden Rule will likely be adopted due to the overwhelming support it has received. This is evidenced by the comment letters the DOL has received from the public. Consequently, the administrative uncertainty that has caused many companies to not invest their retirement plans in ESG funds will be removed. Therefore, a number of companies may choose to have their retirement plans invest in ESG funds. However, as seen above through viewpoints of government officials, there are positives and negatives to ESG funds, and states and businesses have their own respective opinions. Thus, it is unforeseeable how many companies will elect to have their retirement plans invest in ESG funds. What is predictable is that the debate about investing in ESG funds will persist in the future.

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