Retirement Plans Startup Cost Tax Credit

Tax credit for small plans that start a new retirement plan

Small companies that start a new qualified retirement plan (401k, profit sharing, SEP, or SIMPLE) may claim a credit for the costs of starting the plan. If you qualify, you can claim the credit on IRS Form 8881.

Who is Eligible?

You can claim the credit if:

- You had 100 or fewer employees who received at least $5,000 in compensation from you for the preceding tax year;
- You had at least one plan participant who was a non-highly compensated employee; and
- In the 3 tax years before the first year you are eligible for the credit, your employees weren't substantially the same employees who received contributions or accrued benefits in another plan sponsored by you, a member of a controlled group that includes you, or a predecessor of either.

How Much is the Credit?

If you qualify, you can claim up to 50% of the ordinary and necessary eligible startup costs up to a maximum of $500 per year.

***Eligible Startup Costs* –** Eligible Startup Costs include the ordinary and necessary costs to:

- Set up and administer the plan, and
- Educate your employees about the plan

***Eligible Tax Years* –** You can claim the credit for each of the first 3 years of the plan and may choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective. The tax credit may be carried back or forward if you cannot use it in the current tax year; however, it cannot be carried back prior to January 1, 2002.

No Deduction Allowed

You cannot both deduct the startup costs as general business expenses and claim the credit for the same expenses.

Fees Paid by Plan

To be eligible for the credit, the fees must be paid by the employer and not from plan assets. While it is permissible to pay most plan expenses from plan assets, small and start-up plans are generally advised to wait until plan assets reach a size where total expenses as a percentage of overall plan assets are relatively small in comparison. We generally advise small businesses to wait until assets reach $200,000.

Example of Credit

Assume Bob's Bicycle Shop starts the process of setting up a plan in calendar year 2018 with an effective date of January 1, 2019 and incurs the following costs over the first 4 years:

Year	Cost Incurred	Fees	Credit
2018	Plan Setup Costs	$350	
2019	Annual Plan Fees	$2,500	$500
2020	Annual Plan Fees	$2,500	$500
2021	Annual Plan Fees	$2,500	$500
Total		**$7,850**	**$1,500**

Bob's Bicycle Shop could claim a dollar-for-dollar tax credit of $500 pear year on the company's annual tax returns for years 2019 through 2020. While the company could claim the credit in 2018, the total credit allowable would be $175 (50% of the eligible expenses). Since the plan started in 2019, Bob's Bicycles can claim the credit for the next three years. As a result, it would be more advantageous to claim the credit in 2019 through 2021 and receive the maximum allowable credit of $500 per year. Any amounts not claimed as a credit can be deducted as an ordinary and necessary business expense in the year incurred.

Please contact JULY at **888.333.5859** for more information.