

Small Business Tax Credit for Retirement Plan Startup Costs

According to U.S. Department of Labor statistics, 64 percent of all employees in medium- and large-sized firms are covered by an employment-based retirement plan, compared with only 34 percent at small firms. One reason cited by small businesses for not offering retirement plans is the high costs associated with set-up and administration of a retirement plan.

Startup costs have always been a major hurdle to small businesses who want to start a 401k plan, but a provision of The Economic Growth and Tax Relief and Reconciliation Act (EGTRRA) now helps scale this barrier to employee saving opportunities. EGTRRA implemented **a tax credit for employers to offset the startup cost and the cost of educating employees about the new plan.**

For costs paid or incurred in tax years beginning *after* December 31, 2001, for retirement plans that first become effective after that date, you may be able to claim a tax credit for part of the ordinary and necessary costs of starting a SEP, SIMPLE, or other qualified plan (including a 401k and a Cash Balance plan).

The credit equals 50% of the cost to set up and administer the plan and educate employees about the plan, up to a maximum of \$500 per year for each of the first three years of the plan. For plans that become effective after 2002, you can choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective.

You must have had 100 or fewer employees who received at least \$5,000 in compensation from you for the preceding year. At least one participant must be a non-highly compensated employee. The employees generally cannot be substantially the same employees for whom contributions were made or benefits accrued under another qualified plan (such as a SEP, SIMPLE or 401(k) profit sharing plan) of any of the following employers in the three-tax-year period immediately before the first year to which the credit applies.

1. You.
2. A member of a controlled group that includes you.
3. A predecessor of (1) or (2).

The credit is part of the general business credit, which can be carried back or forward to other tax years if it cannot be used in the current year. However, the part of the general business credit attributable to the small employer pension plan startup cost credit cannot be carried back to a tax year beginning before January 1, 2002.

To take the credit, get [Form 8881](#), Credit for Small Employer Pension Plan Startup Costs, and the instructions or contact your tax professional.