START-UP COSTS TAX CREDIT

If you have a client that is a small business owner who recently established a retirement plan for their business, they may be eligible to receive a nonrefundable tax credit for expenses they incurred to implement the plan.

Most people get that 401(k)s are designed with big advantages over traditional IRAs when it comes to retirement savings. Yet, few small business owners realize 401(k) plans also offer tax advantages ranging from tax credits and deductions for their business to protecting more of their individual hard earned money from taxes within their own account. During these times, it has never been more cool or necessary to spend less, save more, and build up reserves for when it's needed down the road.

A tax credit reduces the amount of taxes you may owe on a dollar-for-dollar basis. If you qualify, you may claim the credit using Form 8881, Credit for Small Employer Pension Plan Startup Costs. Below is a summary.

Eligible employers

You qualify to claim this credit if:

- You had 100 or fewer employees who received at least $5,000 in compensation from you for the preceding 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're 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.

Amount of the credit

The credit is 50% of your ordinary and necessary eligible startup costs up to a maximum of $500 per year.

Eligible startup costs

You may claim the credit for 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 credit is part of the general business credit and you may carry it back or forward to other tax years if you can't use it in the current year. However, you can't carry it back to a tax year beginning before January 1, 2002.

No deduction allowed

You can't both deduct the startup costs and claim the credit for the same expenses. You aren't required to claim the allowable credit.

Obviously, everyone's tax situation is different so, as much as we hope this helped you to better understand this topic, it is not to be construed as financial, tax or legal advice. Therefore, if you believe that it may apply to your (or your client's) company, be sure to further discuss it with a qualified accountant or tax professional.