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BENEFIT BRIEFING
FOR BUSINESS OWNERS AND THEIR ADVISORS

Questions and Answers about Tax Credit for Retirement Plan Start-Up Costs

Introduction

If you are a small business owner who recently established a retirement plan for your business, you may be eligible to receive a nonrefundable tax credit for expenses you incurred to implement your retirement plan.

This *Benefit Briefing* will provide answers to frequently asked questions (FAQs) to help you understand how this can be accomplished.

What is the Tax Credit?

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) added a tax credit of up to 50% of the first $1,000 in retirement plan startup expenses for the first three years of a plan. Thus, the credit cannot exceed $500 during each of the first three years of the plan.

Who is an eligible employer?

An employer is an eligible employer if, during the preceding year, there were 100 or fewer employees who received at least $5,000 of compensation.

Planning Note: An employer with more than 100 employees may still be eligible if no more than 100 of the employees earned at least $5,000.

What happens if an employer fails to meet the eligibility requirement in one year?

If the employer meets this requirement in one year but fail to do so in a subsequent year, the employer is allowed a two-year grace period to claim the credit.

For example, assume the employer meets the requirement in 2014, but exceeds the 100-employee limitation in 2015 and 2015. The employer is still eligible to claim the credit for year 2015 and 2016 because of the two-year grace period.

Can the plan cover only Highly Compensated Employees?

No. The plan must cover at least one Non-Highly Compensated Employee. Highly Compensated Employees (HCEs) are employees who own 5% of the business or who have earned more than $115,000 in 2013 for purposes of the 2014 plan year. Certain family members of the 5% owners are also considered to be HCEs regardless of how low their salaries are. The 2014 dollar amount is indexed for inflation.

Planning Note: The extent to which a participant is considered an HCE for a particular year is based on the applicable definition in the plan document.

Does the plan have to be new?

Yes. The employer must not have established or maintained any employer plan during the three tax-year period immediately preceding the first tax year in which the new plan is effective.

What types of plans are eligible for the Tax Credit?

Eligible plans include qualified plans such as 401(k) plans, profit sharing plans, traditional pension plans, cash balance pension plans, and employee stock ownership plans. In addition, SEP IRAs and SIMPLE IRAs could qualify.

What expenses are eligible?

Expenses include those incurred to establish the plan, administrative fees and costs incurred to educate employees about the plan.

Do the Control Group Rules Apply?

Yes. This means that if more than one business is under common control, they may be treated as one for plan purposes. Thus, all eligible employer plans in the Control Group must be aggregated in order to determine the number of employees as well as to determine the $500 limit on the credit

Is a "double tax benefit" available?

No. Qualified costs are not deductible to the extent they are effectively offset by the Tax Credit.

Planning Note: Employers can claim deductions for the remaining qualified costs that are considered Ordinary and Necessary Business Expenses under the Internal Revenue Code.

What if the employer is unable to claim the Tax Credit in the year because there is no taxable income?

Tax credits are not "refundable". This means that the employer may not generate an income tax refund for the credit.

Planning Note: Employers who owe no tax may choose to treat the eligible expenses as regular business deductions as discussed above.
In addition, the Tax Credit does not necessarily have to be lost.

For example, if an employer is unable to claim the credit in one year, he or she may choose to claim it for a previous or subsequent tax year. For instance, if the credit applies to tax year 2014, the employer may choose to claim it for 2013 or 2015.

How does the employer claim the Tax Credit?

To claim the credit, an employer must file IRS Form 8881 - Credit for Small Employer Pension Plan Startup Costs.

This explanation of the retirement plan tax credit is for general information purposes only and should not be considered tax or legal advice. Always check with a qualified tax advisor for the application of the tax laws to your specific situation.

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About National Benefit Services, Inc.

Founded in 1978, National Benefit Services, Inc. provides retirement plan consulting and administrative services for a wide range of privately held and publicly traded employers. Clients include business owners and employers in a wide range of industries in the United States, Canada, and overseas.

Our activities are focused on the design and administration of qualified retirement plans using innovative plan design techniques to accomplish the plan sponsor's objectives.

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