



Tax Credits for Startup Retirement Plans

Eligible employers may be able to claim a tax credit of up to \$5,000, for three years, for the costs of starting a SEP, SIMPLE IRA or qualified plan (like a 401(k) plan.) A tax credit is a powerful tool that reduces the amount of taxes you may owe on a dollar-for-dollar basis. *



How do I calculate the credit?

1. Determine how many NHCEs are eligible
2. Multiply that number by \$250
3. This is the maximum tax credit for the year, subject to a cap of \$5,000
4. Determine actual eligible plan expenses for the year
5. Multiply that number by 50%
6. The result from step #5 is your tax credit for the year, subject to a minimum credit of \$500 and a maximum credit equal to the result from step #3

Example:

Task		
1	Eligible NHCEs	25
2	NHCEs * \$250	\$6,250
3	Max Credit (lesser of 2 or \$5,000)	\$5,000
4	Actual Plan Expenses	\$2,100
5	Plan Expenses * 50%	\$1,050
6	Available Credit	\$1,050

Is a credit better than a deduction?

We suggest consulting with your tax adviser to look at your specific situation, but here's how the above example would work if this company was subject to a 21% corporate tax.

	Credit	Deduction
Company Income	\$100,000	\$100,000
Plan Expense as Deduction	\$0	-\$2,100
Taxable Income	\$100,000	\$97,900
21% Tax	\$21,000	\$20,559
Plan Expense as a Credit	-\$1,050	\$0
Net Tax Due	\$19,950	\$20,559

* <https://www.irs.gov/retirement-plans/retirement-plans-startup-costs-tax-credit>

Who is Eligible?

- Employers with less than 100 employees who received at least \$5,000 in compensation from your company for the preceding year
- Your company had at least one plan participant who was a non-highly compensated employee (NHCE); and
- Your company has not sponsored a retirement plan in the past three years

How much is the credit?

The credit is 50% of your eligible startup costs, up to the greater of:

- \$500; or the lesser of:
 - \$250 multiplied by the number of NHCEs who are eligible to participate in the plan, or
 - \$5,000

Is there an additional credit for plans using an auto-enrollment feature?

An eligible employer that adds an auto-enrollment feature to their plan can claim a tax credit of \$500 per year for a 3-year taxable period beginning with the first taxable year the employer includes the auto-enrollment feature.

What startup costs are eligible?

You may claim the credit for ordinary and necessary costs to:

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

What tax years are eligible to receive the credit?

You may 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.

Can I take both a deduction and credit for the startup costs?

No. You may not deduct the startup costs and claim the credit for the same expenses. However, it is important to note a deduction reduces income used to calculate the tax liability, while a credit directly reduces the tax liability itself.

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