

Unlocking Tax Savings: The Benefits of the Retirement Plans Startup Costs Tax Credit

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As companies explore creating employee retirement plans to help attract and retain talent, they should know that establishing a plan can also unlock significant tax savings. The IRS offers a valuable tax credit to help offset the initial costs associated with setting up and administering a qualified retirement plan. This credit, known as the Retirement Plans Startup Costs Tax Credit, was designed to encourage small businesses to establish retirement savings plans for their employees to help secure their financial futures.

What is the Retirement Plans Startup Costs Tax Credit?

This federal income tax credit is designed to help small businesses cover the expenses associated with establishing an employee retirement plan. Eligible employers may receive a credit of up to \$5,000 per year for the first three years the plan is in effect. This credit can be applied to necessary costs, including set-up and administrative fees and the costs of educating employees about the new plan.

Who is Eligible?

To qualify for the credit, an employer must:

1. Have 100 or fewer employees who received at least \$5,000 in compensation in the preceding year.
2. Have at least one plan participant who is not a highly compensated employee (NHCE).
3. Not have had a retirement plan covering substantially the same employees in the three tax years preceding the first year the new plan is established.

The credit is available only for new retirement plans, including 401(k) plans, SIMPLE IRAs, and SEP IRAs.

How Does the Credit Work?

The Retirement Plans Startup Costs Tax Credit reduces federal income tax liability each year on a dollar-for-dollar basis. The amount of the credit ranges between \$500 – \$5,000 each year (up to a maximum of \$15,000 over the three years) based on the number of NHCEs and the amount of startup costs incurred. For businesses with up to 50 employees, the credit can cover up to 100% of eligible startup costs, but the credit drops to 50% of costs for businesses with 51 – 100 employees.

Companies may also claim up to \$1,000 per employee for individuals earning less than \$100,000, based on the amount of employer contributions to those employees' plan accounts over a five-year period. Additionally, qualified businesses can claim a credit of \$500 per year for each of the three years if it includes an auto-enrollment feature with the plan. Companies that employ NHCEs who are military spouses can also receive an additional \$500 for each spouse participating in the plan.

It is important to note that companies can't deduct the startup costs and employer contributions and claim the Retirement Plans Startup Costs Tax Credit for the same expenses; however, if total expenses exceed the credit amount, the excess may be deducted.

How to claim?

To claim this tax credit, a company must complete IRS Form 8881, *Credit for Small Employer Pension Plan Startup Costs*, as part of its tax return. Corporate taxpayers may utilize the credit to reduce any corporation tax liability, whereas S corporations and partnerships flow the credit through to each of its shareholders or members to be claimed at the owner level. If the credit exceeds the tax liability, it can be carried back one year or forward up to 20 years.

Conclusion

In today's competitive job market, small businesses constantly look for opportunities to differentiate themselves from their competition. Establishing a retirement plan to help attract and retain top talent and leveraging the Retirement Plans Startup Costs Tax Credit to offset the financial impact of implementing a plan enables companies to position themselves as a desirable workplace for existing and prospective employees while reducing their overall tax liability. By understanding the credit's eligibility and filing requirements, businesses can take full advantage of the benefits provided by this tax incentive.

To learn more about the Retirement Plans Startup Costs Tax Credit and how it can benefit your business, please contact [Adam Pizzo](#) - Partner and Co-Leader of Anchin's Technology Group, [Brent Lessey](#) - Partner and Tax Leader of Anchin's Consumer Products Group, [Robert Smith](#) - Partner and Leader of Anchin's Emerging Companies Group, or your Anchin Relationship Partner.