

Tax credit for small businesses for costs of starting a pension plan

Dear Reader:

I am writing to tell you about an opportunity to lower your tax bill somewhat while establishing a pension plan for your employees, which, as you know, can help you retain better employees. If you start a pension plan, you can take a credit of up to \$500 a year for each of the first three years of the plan. The credit is for 50% of certain start up costs you incur in each of those years. Those costs include the expenses you incur in establishing and administering the plan, as well as the cost of any retirement planning education programs you sponsor for your employees. Thus, if you spend \$1,200 this year in establishing a plan, and \$1,100 in the next two years on administration and employee education, you would be eligible for a \$500 credit against your taxes in each of those three years.

You must meet several requirements to qualify for this credit:

- you must have no more than 100 employees who received at least \$5,000 of compensation in the year before you start the plan (i.e., you can have more than 100 employees, as long as no more than 100 of them earned at least \$5,000);
- you must have at least one employee participate in the plan who meets the definition of a “nonhighly compensated employee”—generally someone who makes \$110,000 (as adjusted for inflation for 2009) or less a year and who is not an owner of the company; and
- you cannot have had a pension plan during the three tax years right before the year in which you start your plan.

If you had a pension plan in the last couple of years, you may want to consider waiting three years from the time the plan was terminated before starting a new plan so that you qualify for the credit. As an example, if you had a plan that was terminated in 2008, you would have to wait until 2012 to start a new plan and qualify for the credit.

There are several types of plans you can establish for your employees and still qualify for the credit. For example, you could start a pension, profit sharing, or an annuity plan, among other choices. If you are interested in pursuing this further, please call us.