



Qualified Pension Professionals, Inc.
specializing in the administration of 401(k) plans



January 2020

HERE'S THE SCOOP ON INSIGHTS ABOUT PLAN COMPENSATION

There are multiple calculations required for your plan. Some are calculated each pay date and others are annual calculations. **Plan Compensation** is the starting point for almost every calculation we do, whether it is to allocate contributions, identify the Highly Compensated Employees, or to demonstrate that the Plan passes required nondiscrimination testing. It is critical that accurate Compensation is used. If wrong/inaccurate Plan Compensation were used, that would jeopardize a Plan's qualified status, and would require corrective calculations when identified.

► COMPENSATION IS COMPLICATED!

Your Plan Document defines Plan Compensation and what must be included in the various calculations. If you intend to change items in your payroll system, you may need to update your Plan Document first, in anticipation of the change, to ensure the plan's definition reflects what you need before and after the payroll change. Specifically if something changes from a non-taxable reimbursement to a taxable reimbursement, or vice versa that could impact Plan Compensation, and therefore Plan Contributions and/or testing.

You may need to verify what your payroll system reports as Gross Compensation. Some payroll reports may include different pay items in Gross Compensation; some may even include non-taxable items that cannot be counted for plan purposes.

► IS IT GROSS?

When we request Gross Compensation, we define that as total taxable wages before any deductions. This includes W-2 Box 1 wages plus any pre-tax deferrals such as 401(k) deferrals and pre-tax 125/Health deductions. If you have questions about your payroll regarding what items are or should be included in plan calculations, please contact us.

► SEVERANCE PAY

As always, there is, of course, an exception. If an employee receives **Severance Pay**, that amount cannot be included in Plan Compensation. Pay that an employee received because of the employment termination is not considered Plan Compensation, and that Severance amount would need to be reported as part of the Gross Pay and as a separate amount so that we can exclude it from Plan calculations. No 401(k) deferrals should be contributed out of Severance Pay.

► POST-SEVERANCE PAY

Post-Severance Pay is amounts the employee is due regardless of the termination of employment, and those amounts are paid after the employment ended. This includes vacation, sick or other paid time off, commissions, regular pay, etc. Your Plan Document specifies how post-severance pay must be treated, but typically this pay should have 401(k) deferrals applied unless the terminated employee

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requests to stop his/her deferrals. (Remember to get the request in writing for your Plan/Payroll records.)

► ANNUAL §401(a)(17) COMPENSATION LIMITS

Each year the IRS stipulates a maximum limit of how much pay can be included in Plan calculations. For Payroll purposes this limit can impact Company/Employer contributions calculated each pay date. Company contributions are usually calculated as a percentage of Plan Compensation. For example, a 3% Safe Harbor Non-elective Contribution or a 4% Match contribution cannot exceed a total for the year of 3% or 4% of the IRS maximum compensation limit. For 2020 the limit is \$285,000, therefore the 3% of pay contribution must be limited to 3% of \$285,000 or a maximum contribution of \$8,550. The 4% contribution must be limited to a maximum contribution of \$11,400.

Especially if you or any employees have pay in excess of this limit, please check that your payroll system is set up to limit the contribution accordingly and prevent too much from being contributed as a Company contribution, which would result in additional time and cost for corrections.

For Plans with a non-calendar year-end, the \$285,000 compensation limit change will be effective for your Plan Year that begins in 2020.

► TAX LAW CHANGES

The Tax Cuts & Jobs Act changed how transportation and moving expenses are treated for tax and deduction purposes. If this impacts your payroll it may also have changed how those amounts are treated for Plan calculations. You may want to review this if you have concerns about the changes.

► ENTRY DATE PAY

Some plans may calculate Plan Compensation for new participants only for the period of the year that they are eligible to participate (from the Entry Date to the Plan year-end). Certain rules require us to look at the full year Gross Pay, so we will usually need both full year pay and pay from the Entry Date for those new participants.

If you have any questions about how Compensation is defined in your Plan Document and what needs to be included when you report the year-end census data or calculate Plan contributions, please contact QPPI at 630-469-3581.

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