thePensionStudio

COMPENSATIONS FOR:
CASH BALANCE/DEFINED BENEFIT/PROFIT SHARING CALCULATIONS

Retirement Plan calculations can only recognize earned income – income subject to employment tax. Calculations cannot use rental income, dividend income, pass-through income, etc.

SOLE PROPRIETORS AND PARTNERS:

Self-employed individuals taxed as sole proprietors file a Schedule C to report their self-employment income and partners receive a Schedule K-1 reporting their share of self-employment income. The Schedule C or K-1 self-employment income amount must be reduced by 50% of the self-employment tax attributable to the income from the Plan sponsor and also reduced by the owner's share of the retirement Plan cost, as well as other business expense deductions claimed by the owner.

Below is an example of what the top line amount of the Schedule C must be in order to produce an income of $270,000 when calculating a pension contribution of $252,856.

$538,000 - $252,856 (retirement Plan cost) - $15,091 (1/2 SE Tax) = $270,053 net compensation to be used for retirement Plan purposes

The actual amount of SE tax adjustment may be somewhat less if there are other sources of income on which SE tax or FICA withholding has been paid.

S CORPORATIONS:

S Corporations must pay W-2 compensation to shareholder employees. K- 1 income (pass through income or shareholder distributions) is **NOT** recognized as compensation for Plan purposes.

LLCS:

LLCs taxed as S Corporations are treated the same as S Corporations above.

LLCs taxed as sole proprietorships and partnerships are treated the same as sole proprietors and partners as described above. The self-employment income amount must be reduced by 50% of the self-employment tax attributable to the income from the Plan sponsor and also reduced by the owner's share of the retirement Plan cost, as well as other business expense deductions claimed by the owner.

WHY USE 3401(A) COMPENSATION FOR PLAN PURPOSES AND NOT W-2 COMPENSATION IN MOST 401(K) PLANS?

W-2 compensation will include additional forms of compensation not subject to income tax withholding. Examples would include certain fringe benefits, Group Term Life Insurance, moving expenses etc. As these items are generally not "cash" compensation, it is likely that withholding of deferrals is not occurring, or deferrals are inaccurate. Under this Plan definition, all items would be subject to deferral.

3401(a) compensation is limited to forms of compensation subject to income tax withholding. This will increase the likelihood of accurate withholding of deferrals.