

COMPENSATION DEFINITIONS FOR QUALIFIED RETIREMENT PLANS

Compensation paid by employers to employees, including owner/employees, is defined in several ways and is used for a variety of qualified retirement plan operational purposes, including the following:

- Allocation of employer contributions in a defined contribution retirement plan.
- Accrual of pension benefits in a defined benefit retirement plan.
- Determining employer deduction limits in a defined contribution retirement plan.
- Determining maximum employer defined contribution plan allocations under Internal Revenue Code (“IRC”) Section 415.
- Determining which employees are Highly Compensated Employees.
- For top heavy plans, determining the minimum benefit accrual for defined benefit plans and determining the minimum employer contribution for defined contribution plans.
- If applicable, determining minimum “gateway employer contributions” in combined defined benefit/defined contribution plan designs.
- If applicable, testing employer contributions or benefit accruals to be certain that no prohibited “discrimination” exists in favor of Highly Compensated Employees.

Owners’ Compensation for all plan purposes equals W-2 earnings from corporations or LLCs taxed as a corporation. Partnerships,

LLCs taxed as partnerships, and sole proprietor owner’s Compensation equals Earned Income as described in IRC Section 401(c) and in the applicable retirement plan document.

Compensation used to allocate employer contributions or accrue defined benefit plan benefits for non-owner retirement plan participants is a matter of plan design and can vary widely from plan to plan. However, one of three basic definitions of compensation prescribed by law is used as the starting point and various compensation components may be excluded or added as a matter of design. The three available basic definitions are:

- W-2 Compensation.
- Income Tax withholding compensation (Code 3401(a)).
- Current includible “safe harbor” compensation per Code 415 and associated regulations.

Regardless of which of the three above definitions is selected, compensation is “grossed up” to include elective deferral contributions by participants to most retirement plans, cafeteria plan contributions, and qualified transportation fringe benefit plans. All three of the definitions include wages, salary, overtime, bonuses, commissions, nonqualified moving expenses, taxable fringe benefits, taxable medical/disability benefits, and some tips. “Qualified” moving expenses are excluded, as are expense reimbursements. Most post-severance compensation that meets the special 2.5 month timing rule is included, while other post-severance compensation is generally excluded.

Although the three basic compensation definitions are very similar, minor differences do exist. For example, group term life insurance, whose coverage is above \$50,000, is included in W-2 and Code 415 compensation, but excluded from tax withholding compensation.

Plan design may encourage the exclusion of any one or several of the following elements of compensation:

- Compensation paid before becoming a plan participant.
- Overtime.
- Bonuses.
- Commissions.
- Compensation paid by an affiliated employer that has not adopted the plan.

Tax qualified retirement plans can be designed with exclusions of compensation decided upon by the employer and resulting net compensation may be used to determine the allocation of employer contributions or the accrual of defined benefit plan benefits. For example, a company employing an owner whose base pay exceeds the current \$265,000 annual limit on compensation imposed by Code 401(a)(17) might design the plan to ignore bonuses. However, definitions of compensation that exclude items such as overtime, bonuses, commissions and compensation paid by affiliated employers may not necessarily be used for other plan purposes. These purposes include defining what compensation may be recognized for purposes of making 401(k) deferral contributions, as well as compensation

used to determine a 3% of compensation non-elective safe harbor 401(k) contribution. Furthermore, plans that exclude these items from recognized compensation cannot rely on plan designed “safe harbor” employer contribution allocation or defined benefit formulas that would normally be exempt with respect for testing for the absence of prohibited discrimination.

Thus, plan sponsors are encouraged to include their tax CPAs, as well as their NRS Account Manager, in the design of the term “compensation” such that the optimal group of employee retirement contributions, or pension accrued benefits, are maximized each year, while maintaining the simplicity of plan design and administration.

NRS CLIENT PORTAL REMINDER

National Retirement Services, Inc. provides an online Client Portal that provides for Plan Year-End Data Collection, ongoing communication and pertinent retirement plan information to be immediately available. The Client Portal also provides an interactive capability to complete and process your Plan information online through a secure transmission.

Here are some of the NRS Client Portal features:

- The Portal is SSL Secured, which means messages and data files sent through the Client Portal are encrypted and secure.

- The Year-End Data Collection is completed online with key information carried over from year to year, increasing accuracy and reducing completion time.
- The Plan Census can be completed online or securely imported.
- Access to secure messaging for sending and receiving files.
- Access to a secure File Cabinet for file retrieval.

Thus, we strongly encourage you to use the NRS Client Portal to complete your Year- End Data Collection and Plan Census, to increase the accuracy of your data submission and decrease the completion time.

Please contact your NRS Account Manager for more information.

NOVEMBER 2015 REMINDERS

November 16 - Retirement plan employer contributions are due if contributions are claimed as deductions on tax returns due November 16, including returns on extension.

November 16 - Forms 5500 series and Form 8955-SSA are due for Plan Years ending January 31, 2015 if they are on extension.

November 30 - Forms 5500 series and Form 8955-SSA are due for Plan Years ending April 30, 2015, unless an extension applies.

December 1 - Safe harbor notices for calendar 2016 401(k) safe harbor plans are required to be distributed to plan participants in order to satisfy the timing requirement in federal regulations.

FOR MORE INFORMATION OR TO REQUEST A PROPOSAL, PLEASE VISIT OUR WEBSITE AT WWW.NRSERVICES.COM, OR FOR SALES SUPPORT, PLEASE CONTACT:

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