



Sole Proprietor/Partnership Calculations for Defined Contribution Plans

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Who are Self Employed Individuals?

- A Sole Proprietor
- A Partner (any Percentage of Ownership)
- An Owner of a LLC taxed as a Partnership
- An Owner of a LLP



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Terminology

- Concept of Earned Income Important--Terminology may vary
- Net Earnings from Self Employment (NESE or "Gross" Compensation)
- Earned Income (Net Compensation) or (EI)
- Federal Insurance Contributions Act (FICA)
- Old Age Survivors and Disability Insurance (OASDI)



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Net Earnings does not Automatically Create Earned Income

- Owner's Services must be a Material Factor in Producing Income of the Business
Example-- A male Doctor buys a Catering business and his wife runs the business. He does not work or contribute to the operation of the business in any way. He has no Earned Income.
- If Uncertain, have Determination made by the Accountant or Legal Counsel



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Identifying & Entering Ownership

- Collect Data on actual Ownership
 - Extremely Important
 - Avoid using “Owner” Overrides
- Identify all Members of Family where Attribution Applies
 - Link family Members by using Family Code
 - Enter on Employees | Census | Addr., Etc. tab
- What if Ownership Percentage are not Entered?
 - System will identify owners by check box overrides
 - Ownership Assumed in Proportion to Gross Compensation



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Components of Earned Income

- Gross Compensation (before any Retirement Plan Deductions)
- Less 50% FICA Deduction
- Less Owner’s Share of Rank and File (Non-Owner) Non-Elective Contributions
- Less Non-Elective Contributions Allocated to Owner



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50% FICA Deduction Calculation

- Owner's Share of Gross Profit before any Contributions
- LESS Owner's Share of Rank and File Contributions gives us NESE
- Multiply NESE by .9235 gives us NESE Subject to FICA
- Medicare Tax (NESE times 2.9% tax rate)
- OASDI Tax (NESE, capped at Taxable Wage Base, times 12.4%)
- Total FICA Tax (Medicare plus OASDI taxes)
- ½ of Total equals out 50% FICA Deduction



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50% FICA Deduction Example-- Assumptions

- Taxable Year is 2007 Calendar Year
- Sole Proprietor has net profit on line 31 of form 1040 of \$122,500
- \$12,000 Matching Contribution allocated to Rank and File (shown on line 19 of Schedule C)--no Profit Sharing Contribution
- Owner Contributed \$7,000 Salary Deferral and was allocated \$3,500 Match



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50% FICA Deduction -- Calculation

• Gross Comp before Contributions	\$134,500.00
• Rank and File Contributions	<u>12,000.00</u>
• Net Earnings from SE	\$122,500.00
• FICA Factor	0.9235
• Net Earnings subject to SE Tax	113,128.75
• Medicare Tax (.029 rate)	\$ 3,280.74
• OASDI Tax (.124 rate up to TWB)	<u>12,090.00</u>
• Total FICA Tax	\$ 15,370.74
• 50% Deduction (1/2 above)	7,685.37



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Earned Income Calculation

• Net Earnings from Self Employment (previous example)	\$122,500.00
• Less 50% FICA Deduction	7,685.37
• Less Employer Non-Elective Contributions Allocated to Owner	<u>3,500.00</u>
• Earned Income (subject to the 401(a)(17) Comp Limit)	\$111,314.63
• Note Earned Income Unaffected by Owner's Salary Reduction Contribution (that adjustment is made on tax form 1040)	



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Special Considerations

- The Maximize Contribution to Owner option not available
- What if Owner is paid W-2 Compensation from an Unrelated Entity
 - Must input Other W-2 Wages
 - Why? Other wages directly affect calculation of the 50% FICA Deduction
 - Where? Use Other FICA Wages field on Employees | Census | Employee tab



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Administration Checklist/Procedure

- Verify Ownership Percentages
- Ownership Attribution (use Family Code)
- Enter Gross Compensation for Owners before any contributions for anyone
- When running Calculations, note any Screen Messages
- Print Sole Prop/Partnership Contrib Calc Report
- Print and Review Notes Report



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Situations Requiring Special Attention

- Plan is Top Heavy but Non-Elective Contribution less than 3%
- Owner has No Gross Profit
- Plan has Multiple like-kind Sources
- Period Payroll Processing not handled
- Sponsor is an LLC electing to be taxed as a Corporation
 - Change Form of Business Type to Corporation



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2 pm CST**

DC/Win 410(b) Testing

This webinar will cover the mechanics of the 410(b) test. When is someone excluded versus not benefitting? How does the Safe Harbor Contribution get tested?

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