Compensation Fundamentals

Plan Compensation

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HOUSEKEEPING

- Location for handouts (same as registration): www.datair.com/training.htm
- Webinar is being recorded and will be posted within a week of the live session (technology permitting)
  - To listen to the recording, register again
  - Once registered, recording will begin playing
- Problems with audio through your computer?
  - Close other programs (e.g. email)
  - Or, use audio panel to switch to phone
- Questions during the live session?
  - Submit questions through the Question panel
  - We'll answer during the session, as time allows
  - Others will be answered, shortly after and posted to website
Agenda

- What is Compensation?
- How will Compensation be used?
- What definitions of Compensation can I use in the Plan?
  - Design limitations
  - Payroll considerations

What is Compensation?

- Commissions
- Tips
- Moving Expenses
- Bonus
- Stock Options
- Fringe Benefits
- Group Life Insurance
- Wages
- Salary
- Deferred Compensation
- Fees
- Overtime
- Deferrals

415(c) Compensation Basic Components
What is Compensation?

415(c) General Definition

“Total” and “Includible” Income
- Cash or Non-Cash
- Paid for personal services “actually” performed
- “Earned Income”
- Payments for injuries or sickness
- Moving Expenses – nondeductible
- Value of Non-Statutory Options
- Fair Market Value of Property under Sec. 83(b)
- Amount arising from Constructive Receipt Rules
Compensation Statutory Exclusions 415(c)-2(c)

- Deferred Compensation – SEP, Simple-k
- Restricted Stock or Non-Statutory Option
- Proceeds from Sale or Exchange of Statutory Stock Option
- Special Tax Benefits from group life insurance

Exclusions should be interpreted broadly. Exclude other items that are “similar.”

415(c) Compensation Excluded Components

- Deferred Compensation
- Deferrals
- Overtime
- Commissions
- Fees
- Tips
- Bonus
- Moving Expenses
- Stocks Options
- Fringe Benefits
- Group Life Insurance

Compensation
What is Compensation?

**Alternative Safe Harbor Definitions**

- 415(c) Compensation
  - Total – “Includible” Compensation
- 414(s) Safe Harbors Definitions
  - “Simplified” 415(c)
  - W-2 “Reportable” Income
  - 3401(a) Income Tax Withholding
  - Others
    - 414(s)(d)

What is Compensation?

**Related Definitions**

- “Compensation Limitation 401(a)(17)”
- “Compensation Computation Period”
- “Earned Income” (net earnings)
What is Compensation?

Related Definitions

- When is “Earned Income” a consideration?
- Who determines Earned Income?
- When is Earned Income determined?

What is Compensation?

- For all qualified plan purposes - subject to Code section 401(a)(17) limitations
  - $200,000 + annual index
  - $245,000 for 2009 and 2010
  - E.g. Qualified Plan Accruals/Allocations, Deduction and SEP
- Defined Benefit Plans
- Defined Contribution Plans
How will Compensation be used?
Defined Benefit Plan

- Benefit Accruals and Payments
- Limitation and Adjustments to Benefits
- Testing
- Employer Tax Deduction under Code Sec. 404

How will Compensation be used?
Defined Benefit Plan

- Defined Benefit Plan Maximum Annual Benefit
  - Sec 415(b)(1)
    - lesser of $160,000 (as Indexed, $195,000 in 2010), or
    - 100 percent of Average Compensation for highest 3 year of service
How will Compensation be used?

Defined Contribution Plan

- Limits on Contributions
  - Allocation
  - Deferrals
    - Active, Disabled or Terminated Employee
- HCE and Key Employee Status
- Testing
- Employer Tax Deduction under Code Sec.404

Defined Contribution Plan Maximum Annual Additions - Sec 415(c)(1)
- lesser of $40,000 (as Indexed, $49,000 for 2010), or
- 100 percent of 415 Compensation for the Limitation Year.
How will Compensation be used?

**Defined Contribution Plan**

- Payroll Considerations
- Design Options and Considerations

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How will Compensation be used?

**Payroll Issues**

- Wages
- Elective Deferrals
- Commissions
- Overtime
- 3401(a)
- Fees
- Work
- Non-Cash
- Expenses
- Bonus
- 6041 Overtime
- Elective Deferrals
- 3401(a)
How will Compensation be used?

Design Limitations

- Plan Design and Features

  415(c) General Definition
  vs
  414(s) Safe Harbor Definitions

- When am I required to use each type of definition?

What Definition Compensation can I use?

Allocation of Contributions

<table>
<thead>
<tr>
<th>Voluntary Allocations</th>
<th>vs</th>
<th>Mandatory Allocations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elective Deferrals</td>
<td></td>
<td>Safe Harbor</td>
</tr>
<tr>
<td>Match</td>
<td></td>
<td>Top Heavy Minimum</td>
</tr>
<tr>
<td>Profit Sharing</td>
<td></td>
<td>Corrective</td>
</tr>
<tr>
<td>Non-Elective</td>
<td></td>
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</tbody>
</table>
What Definition of Compensation can I use?
Design Limitations

<table>
<thead>
<tr>
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<th>Type of Definition</th>
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<tr>
<td>Top Heavy 416</td>
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<td>Determine HCE/Key</td>
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Wherever possible the same definition should be used in the Plan.

Compensation in a DC Plan

Inside of a DATAIR document
Compensation – Design Options
415(c) General Definition

“Total” and “Includible” Income

<table>
<thead>
<tr>
<th>Include or Exclude</th>
<th>Amounts deferred under Code sections 125, 132(f)(4), 402(e)(3), 402(h), or 403(b).</th>
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<tr>
<td>Overtime*</td>
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<td>Bonuses*</td>
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<td>Taxable Employee Benefits*</td>
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*Modification permitted, if it does not favor the highly compensated employees.

Compensation – Design Options
414(s) Safe Harbor Compensation

<table>
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<tr>
<th>W-2</th>
<th>3401(a)</th>
<th>415(c)</th>
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<tr>
<td>Reportable Income</td>
<td>Income Tax Withholding</td>
<td>Total and Includible Income</td>
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Compensation – Design Options

**Warning**

Can not use a Definition of Compensation that discriminates in favor of a highly compensated employee, unless you can pass Compensation Ratio Test 414(s)(d)

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Compensation Design Options

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- **Deemed Section 125 Compensation**
  - Do you have a Cafeteria Plan?
  - Do you automatically enroll employees for group health coverage?
  - Are there dollars available to employee in lieu of group health coverage
### Prior to Severance of Employment

- **Option**:
  - Initial Year Limit to period of Eligibility

*May be excluded*

### Post-Severance of Employment

- **Options**:
  - Bona Fide Vacation, Sick or Leave of Absence
  - Military Pay
  - Disability Pay

*May be excluded*
DC Plan Design

Once Again! Many Compensation Definitions

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<td>Allocation to Disabled EE</td>
<td>Timing Delays</td>
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2009 Interim Amendment
Differential Wage Payments
Questions

Resources

- DS/WIN Release Notes

- DATAIR Employee Benefit Systems, Inc.
  - Customer Support:
    Email: support@datair.com
    Telephone: (630)325-2600
  - DATAIR Discussion Forum: http://www.datair.com/

- Internal Revenue Service (IRS)
  - Retirement Plans Community: