

UNDERSTANDING COMPENSATION FOR 401(K) PLANS.



Understanding the definition of compensation for purposes of your 401(k) plan is important because it is used to calculate employee deferrals, matching contributions, profit sharing allocations and is used to perform required nondiscrimination testing.

Compensation FAQs: for your 401(k) compliance

Additional Information can be found at <https://www.irs.gov/pub/irs-tege/epchd304.pdf>.

Q Should severance pay be included on compensation ?

A Severance pay should only be included if the compensation is paid after termination of employment. Regular compensation for the employee's services, commission, bonuses or similar payments or other payments which have been paid to the employee had they not termed (final paycheck pay.) should not be included.

Q What is the difference between severance and post severance pay?

A Severance is paid by an employer to an employee after employment has ended while post-severance pay is the unused sick time, vacation time, or any other payments that were not paid prior to termination.

Q Are hours worked but not paid until the following year counted at year end?

A It depends on what the company is using as compensation, it all depends on consistency. For example, if using W-2, payroll for hours worked in 2022 won't be paid until 2023 so this final run would not be reflected on 2022 W-2.

Q What compensation is included if you or your spouse own another company?

A Compensation from all members are aggregated. For example, employee works for Company A, Inc. and Company B, Inc., part of a controlled group. Compensation from both entities count for plan purposes whether A Plan, B Plan or both have plans.

Q Can the definition of compensation be changed throughout the plan?

A Yes, the definition of compensation can be changed from year to year. You can even use a different definition of compensation in different plans. But you must use the same definition for all employees in applying a particular provision like non-discrimination testing under 401(a)(4).