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Are You Highly Compensated and Why Does It Matter?

Administering an employer-sponsored retirement plan (e.g., a 401(k), profit sharing, or a defined benefit plan) always requires the plan sponsor to gather and report employee census information to its third-party administrator (TPA) or entity responsible for plan administration. While data such as employee name and date of birth are straightforward, each employee’s reported compensation for plan purposes generally changes every year. A highly compensated employee (HCE) is defined as an employee who is a more than 5 percent owner for the *preceding* or current year, or earned more than a specified amount in the preceding year. For the calendar year 2022, this compensation amount is \$135,000. The plan can also require that the employee be a member of the “top-paid group” of employees. Furthermore, determining exactly what compensation to report for a given employee will depend upon the purpose of collecting this information and may result in different compensation amounts being reported for the same individual. When gathering and reporting employee census data for plan administrative purposes, the plan document must be consulted to determine which components of employee compensation must be reported and which to ignore.

Compensation Uses Vary

Each employee’s compensation is used for a variety of administrative tasks and the definition of compensation depends upon which task is being performed. For example,



a 401(k) plan with employer matching and a discretionary profit sharing contribution must refer to compensation in order to perform the following tasks:

- Determine which participants are highly compensated employees (HCEs) to ensure that allocated employer contributions do not unduly discriminate in their favor.
- For purposes of implementing the required top-heavy plan rules, determine which participants are key employees (a participant who at any time during the plan year is more than 5 percent owner of the business; an officer earning more than \$200,000 (indexed as of 2022 calendar year); or more than 1 percent owner earning more than \$150,000).
- Ensure that employee salary deferrals do not exceed the limits of Internal Revenue Code Section (IRC Sec. 402(g)).
- Ensure that required top-heavy minimum employer contributions are made if the plan is top-heavy.
- Define what employee compensation is available for the participant to elect to make salary deferral contributions.

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- Determine the amount of employer matching contributions, if any, to be allocated to each participant.
- Determine the amount of employer safe harbor contributions, if any, to be allocated to each participant.
- Determine the maximum deductible employer contribution that can be deducted for the applicable employer's tax year.

One Source for Most Statutory and Design Compensation Definitions

The definition of compensation for purposes of determining HCEs and key employees is a matter of applicable tax law and is not a plan design variable. Likewise, compensation for self-employed individuals (sole proprietors, partners, and members of LLCs taxed as partnerships) is determined by tax law. As stated above, plan design has a direct bearing on how compensation is designed for *nonstatutory* plan administration purposes. Fortunately, all the necessary definitions of compensation are contained in a formal plan document that describes a particular plan in complete detail, not merely the summary plan description (SPD). Often, the plan document consists of both an adoption agreement, where selections are made between various permissible provisions, and a basic document that applies to all provisions not addressed in the adoption agreement.

A careful reading of the plan document will provide concrete guidance concerning the several definitions of compensation and all of the other detailed provisions concerning benefits, benefit limits, and the like.

COLAs: Another Compensation Consideration

While the plan document provides most of the information necessary to administer a plan, some compensation limits are expressed in a way that permits annual changes for the [cost-of-living adjustments \(COLAs\) issued by the IRS](#). These limits, of necessity, are not explicitly stated in the formal plan document and instead reference the annual adjustments.

Plan Compensation Per Employer Plan Design

"Plan compensation" could be defined as before any exclusion for overtime, bonuses, commissions, or any other exclusion. Generally, employee deferral contributions to cafeteria, 401(k), 403(b), or 457(b) plans are included in plan compensation. Nevertheless, employee

deferral contributions may be included or excluded for nondiscrimination testing purposes at the employer's option on a year-by-year basis. "Plan compensation" can also exclude all fringe benefits, expense reimbursements, deferred compensation payments, and welfare benefits.

Employers wishing to use an alternate definition of compensation may do so provided the resulting compensation passes certain additional testing. Tax law and regulations provide employers a good deal of flexibility in the definition of compensation for retirement plan design purposes. Although complicated, the rules permit employers to simplify compliance requirements through the use of safe harbor designs. They also provide employers the option for more sophisticated plan designs, while introducing additional complexities to the process.

Defined benefit pension plans, including cash balance plans, generally require fewer tasks. However, employers with those plans also need to determine HCEs, key employees, IRC Sec. 415 limits, maximum deductible employer contributions, and each participant's benefit that accrues during a given plan year. Determining each of these items involves calculating participant compensation during the plan year.

When in doubt, please contact your FuturePlan consultant. ■

Repaying Coronavirus-Related Distributions (CRDs)

On March 27, 2020, the [Coronavirus Aid, Relief, and Economic Security \(CARES\) Act](#) was signed into law as the largest relief package in U.S. history. The legislation included multiple provisions that affected retirement and health savings arrangements to help millions of Americans affected by COVID-19.

The CARES Act allowed individuals to withdraw up to \$100,000 in the aggregate from eligible retirement plans and IRAs (Individual Retirement Accounts) without paying the 10 percent early distribution penalty tax. The distribution had to have been made on or after January 1, 2020, and before December 31, 2020, by a qualified individual, defined in both the CARES Act and expanded in definition by Notice 2020-50, as someone who was diagnosed with or otherwise adversely affected by COVID-19.

If your participants took CRDs in 2020, they still have time to make repayments to their qualified retirement plan or

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eligible IRA. Because a relatively small number of qualified individuals took CRDs in 2020, you may handle few CRD repayments, but their proper reporting is no less important for their infrequency.

Based on a study of retirement plans with 500 employees or less in 2020, Ascensus reported that the percentage of eligible individuals who took CRDs from their retirement plans was low. Other financial services firms also reported to the Congressional Research Office modest usage of CRDs by their clients in 2020.

Ascensus reported that 16.6 percent of employers adopted CRDs, and 4.9 percent of eligible individuals (i.e., individuals covered by plans that adopted CARES Act provisions) took CRDs. Of those, only 3.2 percent of those who took CRDs withdrew the maximum allowable amount of \$100,000; most CRDs averaged \$14,300 in total withdrawals at the end of 2020, according to Ascensus.

Reporting CRDs

CRDs would have been reported to the IRS for the 2020 tax year by financial organizations in different ways. Like all retirement plan and IRA distributions, CRDs were reported on IRS Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc. Employers were not required to offer CRDs to plan participants. But if an employer had adopted provisions allowing CRDs, participants who were otherwise subject to the 10 percent early distribution penalty tax (other than beneficiaries) would have had their distributions reported on Form 1099-R as a code 2, Early distribution, exception applies, or as a code 1, Early distribution, no known exception. A qualified individual would have claimed the penalty tax exception on his individual tax return, regardless of how the Form 1099-R was coded. Inherited IRA owners were also eligible to take CRDs in 2020, and could have used code 4, Death, another penalty tax exemption; however, a CRD repayment cannot be made to an inherited IRA.

The taxpayer would have reported the CRD and any repayments, if made, on Form 8915E, Qualified 2020 Disaster Retirement Plan Distributions and Repayments. A taxpayer could have claimed CRD status even if the distribution was taken from a retirement plan whose sponsoring employer did not elect to add CRDs as a distributable event.

A CRD was not considered a modification of a series of substantially equal periodic payments as an exemption from the 10 percent early distribution penalty tax, so no retroactive penalty would have been applied to previous payments received.

Reporting CRD Repayments

You may have participants requesting to make a CRD repayment through 2023. Qualified individuals who took CRDs in 2020 have three years, beginning on the day following the date they received the CRD, to repay the distribution to their eligible retirement plan (such as a 401(k) plan, a 403(b) plan, a governmental 457(b) plan, or an eligible IRA). These CRD amounts are taxed ratably over the three-year period unless the taxpayer elected otherwise.

At the time of this writing, the IRS has not officially released repayment reporting requirements. Unofficially, the IRS has indicated to Ascensus that financial organizations should enter the repayment *amount* in Box 14a, Repayments, with *code "DD"* (disaster distribution) in Box 14b, Code, of IRS Form 5498, IRA Contribution Information. Retirement plan participants and IRA owners report these CRD repayments on the Form 8915 series. This is how other qualified disaster distribution repayments are also reported.

2021 IRS Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs), provides some CRD repayment information for taxpayers, including how to include CRDs in their taxable income each year over a three-year period, along with an example. The amount repaid reduces the amount included in income for the year of the distribution. Taxpayers may repay more than is otherwise includible income for a year. The excess amount may be carried forward to a future year or applied to a previous year in order to reduce the amount included in income for the year (if applied to a previous year, the account owner may need to file an amended return.)

If you are uncertain whether your participant is eligible to make a CRD repayment, remember that it is up to the participant to self-certify to the IRS that he is eligible for repayment, and to you if your organization is going to report amounts as repayments on Form 5498. It's always a good idea to recommend that your participant seek competent tax advice first. ■

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Fourth Quarter Compliance Reminders For the Calendar Plan Year 2022

The following list highlights important, but not all, compliance dates for retirement plan administrators. Due to the existence of pending Federal legislation, changes may occur. Please contact your FuturePlan consultant with questions about compliance dates for your retirement plan.

October 2022

1–Imposition of **defined benefit pension plan benefit restrictions** if the Adjusted Funding Target Attainment Percentage or “**AFTAP**” hasn’t been certified for the current calendar plan year.

15–Deadline for defined benefit pension plans with a funding deficiency to make their third quarterly funding contribution for the 2022 calendar plan year.

15–Deadline for a corrective (11-g) amendment to the plan document to cure certain coverage, participation, and non-discrimination requirements on behalf of the *prior* 2021 calendar year end.

17–Under the SECURE ACT, retirement plan benefit statements furnished to defined contribution (profit sharing, 401(k), etc.) participants must include specified Lifetime Income Disclosures. There is an exception for one participant defined contribution plans.

- Non-participant-directed individual account plans–Individual account plans on calendar plan years that do not provide participants with the opportunity to direct investments must include the lifetime income illustrations on the annual statement issued for the 2021 calendar year, which is normally provided no later than October 17, 2022, if filed for a 5500 extension. For off-calendar plan years, see the Department of Labor’s (DOL) Temporary Implementing FAQs, Pension Benefit Statements – Lifetime Income Illustrations Interim Final Rule issued July 26, 2021, and Field Assistance Bulletin 2007-3.

17–Employers will be allowed to treat qualified defined benefit and profit-sharing retirement plans adopted after the close of the 2021 tax year, but before the due date of their income tax return for the year (including extensions) as having been adopted as of the last day of the tax year.



Please contact your FuturePlan consultant.

17–**Retirement plan employer contributions** are due in order to be deducted on employer tax returns due to be filed October 17, 2022.

17–**Form 5500 Series/8955-SSA** – Forms that are on extension are due for the plan year ended December 31, 2021.

17–Deadline for payment of Pension Benefit Guaranty Corporation (PBGC) insurance premiums for defined benefit plans with a calendar plan year end.

31–**Form 5500 Series/8955-SSA** – Forms are due for the March 31, 2022 plan year that are not on extension.

November 2022

15–**Retirement plan employer contributions** are due in order to be deducted on employer tax returns due to be filed November 15, 2022.

15–**Form 5500 Series/8955-SSA** – Forms that are on extension are due for the plan year ending January 31, 2022.

15–Section 401(k), and other participant investment directed retirement plan accounts, should provide **benefit statements to participants** within 45 days after the end of the preceding quarter.

30–**Form 5500 Series/8955-SSA** – Forms are due for the April 30, 2022 plan year that are not on extension.

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December 2022

1-Safe harbor notices for calendar 2022 Section 401(k)/403(b) safe harbor plans, using the employer match design, are required to be distributed to plan participants in order to satisfy the timing requirement in federal regulations.

15-September plan year 401(k) plans must process corrective distributions for failed nondiscrimination tests to avoid a 10 percent excise tax.

15-Retirement plan employer contributions are due to be deducted on employer tax returns due to be filed December 15, 2022.

15-Form 5500 Series/8955-SSA – Forms that are on extension are due for the plan year ending February 28, 2022.

31-Deadline for pension plan's enrolled actuary to calculate a specific funding adequacy/AFTAP calculation if a range AFTAP was previously issued.

31-Recommended deadline to draft and execute discretionary amendments to the controlling retirement plan document on behalf of the 2022 calendar plan year.

31-Deadline for certain RMDs for retirement plan participants who attain age 72. Please contact your FuturePlan consultant.

31-Deadline to make corrective distributions relating to 2021 calendar year failed ADP/ACP tests. Please note, a 10 percent excise tax may apply to such corrective distributions.

31-Deadline for correcting a prior year 2021 calendar year end ADP/ACP test failure with an employer qualified non elective contribution (QNEC).

31-Deadline for electing to be a safe harbor 401(k) plan for the *prior* calendar year end, assuming the plan sponsor agrees to at least a 4 percent non-elective safe harbor contribution. ■



 futureplan.com

 sales@futureplan.com

 866-929-2525

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