

Plan Compensation for the Self- Employed

How Owner Earnings Drive Retirement Plan Contributions

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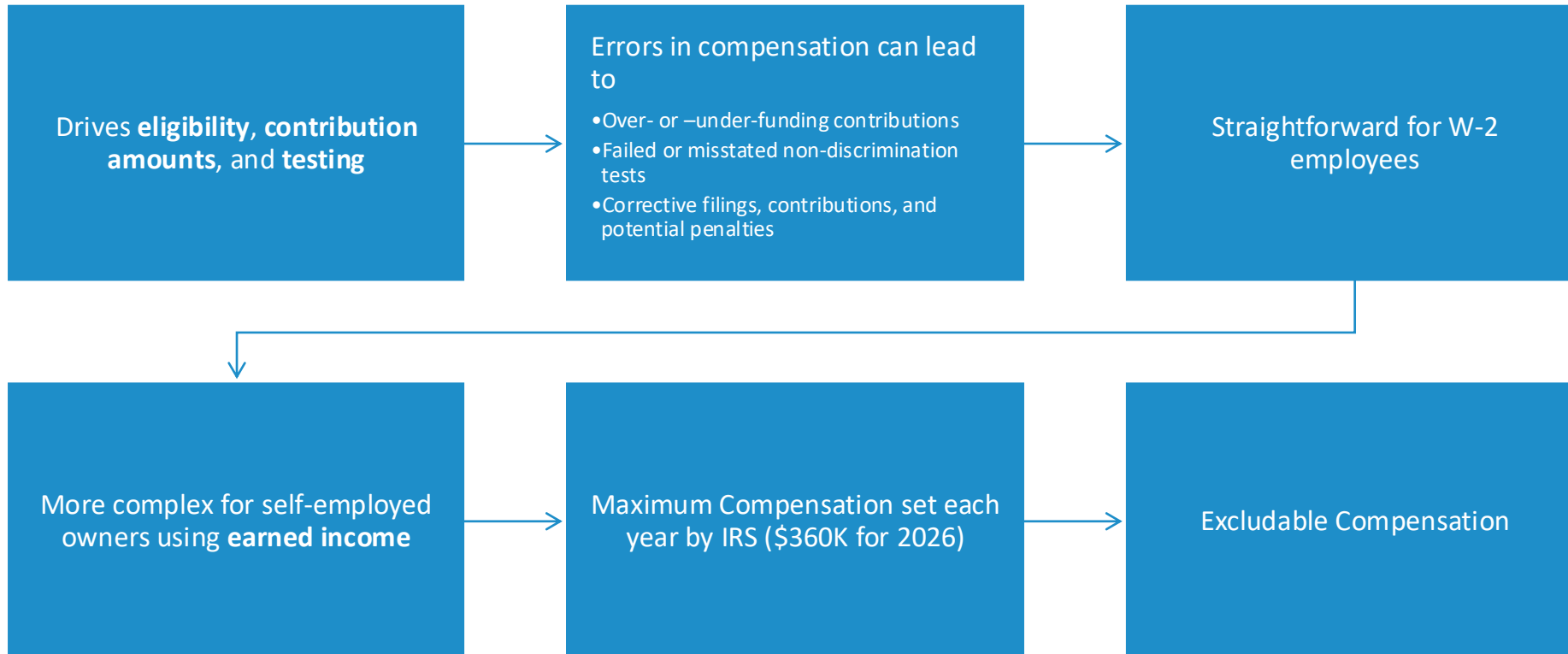
What We'll Cover...
Agenda

- **Why plan compensation definitions matter**
- **Who counts as “self-employed” for plan purposes**
- **Where compensation data comes from (by entity type)**
- **Common pitfalls and compliance issues**
- **Key takeaways and Q&A**



Why Compensation Definitions Matter

Plan Compensation for the Self-Employed



Who Is “Self-Employed” for Plan Purposes?

Plan Compensation for the Self-Employed



Sole proprietors

Report income on **Schedule C** (Form 1040) – **Line 31**



Partners in a partnership

Report via **Schedule K-1** (Form 1065) – **Box 14, code A**
Guaranteed payments + share of partnership income



LLC owners

Follow tax status:

- Disregarded entity → like sole proprietor
- Partnership → like partners with K-1
- Corporation (C or S) → W-2 for owner



C-corp and S-corp owners

Typically employees with W-2 wages

What is “Plan Compensation”



Plan Compensations – Pay used to:

- Allocate employer contributions
- Apply IRS limits and non-discrimination test
- Determines eligibility



Defined explicitly in the plan document



415 Safe Harbor Compensation

(Key Definition)













- Broad taxable-pay concept with specific exclusions
- Automatically includes certain elective deferrals



For Self-Employed Individuals

- Earned income is always based on 415 compensation rules

Entity and Compensation Comparison

BUSINESS TYPE	 SCHEDULE C (Profit or Loss)	 K-1 (Partner/Shareholder Share)	 W-2 (Wage & Tax Statement)
 SOLE PROPRIETOR		N/A	N/A
 PARTNERSHIP	N/A		N/A
 LLC (Limited Liability Co.)	VARIES (Depends on Election)	VARIES (Depends on Election)	VARIES (Depends on Election)
 S-CORP	N/A		W-2 (Reasonable Comp.)
 C-CORP	N/A	N/A	

Process For Determining Plan Compensation



Step 1 – Identify entity type and tax status

Sole prop, partnership, LLC (and election), S-corp, C-corp



Step 2 – Locate the right tax form

Schedule C, K-1 or W-2



Step 3 – Determine “earned income” for self-employed

- Start from net earnings from self-employment
- Apply 415 rules (e.g., adjust for half of self-employment tax)



Step 4 – Apply plan formula & limits

- Contribution formula
- Check 415(c) annual additions and 404(a)(3) deduction limits
- Calculate allowable contributions



Common Pitfalls



Wrong Tax Form

Using the incorrect tax return (e.g. W-2 vs. Scheduled C/K-1) for calculations.
Crucial Error: Income definition varies by entity type.



Ignoring Entity Change

Failing to account for a shift in business structure (e.g. Sole prop to S-Corp).
Crucial Error: Compensation basis and limits reset.



Misaligned Plan Document

Plan document definitions of compensation do not match actual payroll practices.
Crucial Error: Leads to incorrect contributions and compliance issues.



Incomplete Census Data

Missing or inaccurate employee details, hours or ownership information.
Crucial Error: Prevents accurate nondiscrimination testing.



Other
Administrative
and Compliance
Considerations



- **Multiple entities and ownership interests**
- **PEOs**
- **Reasonable compensation**
- **David E. Watson, P.C. v. United States (2012)**
 - Non-working partners
 - Earned income is always based on 415 compensation rules



Key Takeaways

- **Label owners correctly**
- **Plan operations and tax returns must match**
- **Make it a team effort**



Questions?



