



Payroll Pitfalls in Retirement Plans: The Old & The New

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Payroll Pitfalls – List of Topics

The Old Ones:

- Definition of Compensation for Contributions
- Payroll System Calculations of Employer Contributions
- Transfer of Data: Payroll ↔ Recordkeeper (bridge)

[Recordkeeper = Financial Institution maintaining participant accounts, websites, etc.]

- Correction of Auto Enrollment Mistakes

The New Ones:

- Super-Catch-up Contributions (ages 60-63)
- Mandatory Roth Catch-ups for high earners

New Potential Opportunity:

- Matching of Student Loan Repayments

Definition of Contributions Compensation

There are several Compensation definitions that apply to 401(k)/403(b) Plans.

These discussions surround only the definition of Compensation used to calculate plan contributions.

- "Contributions Comp" for short in this presentation.

Three step process to determine Contributions Comp:

1. Starting point is ALL Taxable Wages
2. Back out those Taxable items that are NEVER eligible.
3. Back out those Taxable items that COULD be eligible but which the plan document excludes.

Compliance providers generally require Comp both after steps 2 and 3.

[From a payroll software perspective, the user typically specifies all earnings codes that are eligible. The "steps" above are based on how plan documents and IRS rules are drafted and thus are helpful when selecting which earnings codes are eligible.]

Step 1: Identify ALL Taxable Wages

Most earnings codes are taxable, but the first step is to exclude NON-Taxable Earnings codes.

Examples of cash-based Earnings Codes that are NOT Taxable include the following (these are NEVER included in Contributions Comp).

- Mileage reimbursement or any expense reimbursement
- Employer paid HSA Contributions (often direct deposit)

Examples of Non-Cash Earnings Codes that are NOT Taxable:

- "Memo Codes" such as 401(k) Match and Employer Paid Medical.

Examples of Non-Cash Earnings Codes that ARE Taxable:

- Group-term life (premiums on GTL in excess of \$50,000)
- Ee elects to be taxed on Er paid Long-Term Dis. premiums (so benefits are tax free).
- **Cannot assume "Non-Cash" = excluded from Contributions Comp.**

Step 2: LESS Earnings Never Eligible

Compensation Paid AFTER Termination Date is not Contributions Comp *unless*:

1. It would have been paid to the employee even if employment had continued.
 - Final paychecks
 - Bonuses / commissions
2. AND it is paid no later than the last day of Plan Year during which the employee terminated, or if later, 2.5 months following termination.
 - Example: Plan Year End is 12/31. a) If Term Date = 1/15/2025; Cut-off date = 12/31/2025; b) If Term Date = 12/15/2025, cut-off date is 2/28/2026 (2.5 months).

Severance is only paid because employment *is ending*, and therefore, **Severance is never Contributions Comp.**

- Terminology does not matter.

Step 2: LESS Earnings Never Eligible, cont.

Executive Deferred Compensation payouts where termination of employment "triggers" payout are never Contributions Comp.

- Regularly Scheduled Deferred Compensation Payouts
 - If the payment of Deferred Compensation is based on a pre-determined schedule (*as opposed to their termination of employment*), then it *could be* Contributions Comp (See Step 3! Document can exclude.).
 - Subject to same 2.5 month / last day of plan year timing rules described on previous slide if paid after termination of employment.

Step 3: LESS Comp excludable based on Plan Doc.

Except as described above, broad flexibility to customize Contributions Comp. Examples:

- Exclude "taxable fringe benefits"
 - Personal use company car, taxable Auto Allowances, Group-Term Life >\$50K.
 - If included, generally considered "double dipping" (i.e., so most plans exclude Taxable Fringe)
- Exclude bonuses, commissions, overtime, stipends, holiday bonuses, etc.

Compliance providers will still need to know gross taxable wages for compliance purposes (i.e., Steps 1 and 2).

- Definitions of Compensation *that excludes lots of Compensation for employees w/ under \$150K of comp may cause compliance concerns.*

SIMPLE IRAs are *generally* required to use gross compensation as Contributions Comp (i.e., Steps 1 and 2).

"Base" Definition of Compensation

- Most Plan Documents reference "W-2 Box 1" for the starting point of Compensation (before pre-tax deductions).
- There are others (such as income for purposes of determining federal tax withholding), which have very subtle differences on the more unusual items of compensation.
- Consult with your compliance providers before implementing contribution calculations on payroll (employee payroll deduction AND employer contributions).

Bonuses & Payroll Deduction Elections

If bonuses are Contributions Comp, Participants must be given an opportunity to make payroll deduction contributions. Generally, this is established by administrative policy, *not plan document*.

Option 1: Implement "standing" election.

- If X% of pay, then withhold X% of the bonus.
- If a flat dollar amount, then:
 - If combined with a regular paycheck, just withhold.
 - If a separate pay-date/paycheck is used for the bonus, *typically* no 401(k) withheld because such elections are generally worded as per pay-period (NOT per paycheck).

Option 2: Default to NO 401(k) withholding unless special election received for that bonus.

Option 3: Default to "standing" election unless a special election is received for that bonus.

Preferably the policy will be in writing (e.g., ee handbook) but primary requirement is consistency

Pitfalls of Payroll System Calculations of Employer Contributions

Pitfall #1: Definition of Compensation

- See previous slides!

Pitfall #2: Maximum Compensation Limitations

- The IRS limits the amount of Compensation that can be used to calculate 401(k) plan benefits.
2025 = \$350,000
- Implemented via "goals" on payroll systems:
 - 50% of first 6% Match = Maximum Match of 3% of Compensation. Goal/cap on payroll should be $3\% \times \$350,000$ or \$10,500.
 - Fortunately, do NOT suspend match when comp exceeds \$350,000 – comp limit applied via the "cap" on match.
 - 5% of Pay Non-Matching Contribution requires a cap of $\$350,000 \times 5\% = \$17,500$.
 - Any excesses must be forfeited (and the top-executives don't like this very much!)

Pay-Period Match Calculation Pitfalls

Pitfall #2: Maximum Compensation Limitations (cont.)

- Pitfall #2A: Cap is not updated to take into account increases in Max Compensation
 - If Max Comp increases to \$360,000 in 2026 and cap remains at \$17,500 (5% Non-Match), the Executives will be under-funded by \$500 ($\$360,000 \times 5\% = \$18,000$).
- Add checking these maximum contribution caps to your year-end procedure's checklist!

Pitfalls of Payroll System Calculations of Employer Contributions

Pitfall #3: Who Is Eligible for the Employer Contribution

- "Elapsed Time Eligibility" is relatively easy.
 - E.g., "6 months of service" without regard to hours worked.
 - Most payroll systems can easily commence contributions on that date.
 - *Caveat:* Changes in employment type are not relevant
 - Internship lasts 2 months and then they are hired as a full-time employee. 2-month internship counts towards eligibility!
 - *Caveat:* Rehires are complicated.
 - For "Elapsed Time Eligibility" if an employee leaves for less than 12 months it's as though they never left!
 - Often misinterpreted as "6 months of *continuous* service" – service does not need to be continuous.
 - "continuous service" is available as a method for determining plan design however it brings significant complexity and is therefore rarely elected.

Pitfalls of Payroll System Calculations of Employer Contributions

Pitfall #3: Who Is Eligible for the Employer Contribution (cont.)

- "Counting Hours" Eligibility is more complicated, especially with part-timers.
 - E.g., 1,000 Hours of Service in 1st 12 months of employment OR any subsequent plan year.
 - Example: Johnny hired 5/1/2023 and works 700 hours through 4/30/2024, 700 hours in calendar 2024, and 1,100 hours in calendar 2025. He is eligible 1/1/2026. (Plan Year = Cal. Yr)
- "Counting Hours" Eligibility for rehires has odd outcomes.
 - If an employee terminates and is rehired prior to eligibility, that is NOT relevant:
 - Example: Bill is hired 7/1/2024, terminates 8/31/2024, rehired 1/31/2025. Even still he works 1,000 hours between 7/1/2024 and 6/30/2025 and is therefore eligible 7/1/2025 (assuming 7/1/2025 is an entry date) *even though he only worked 7 months*).
 - If an employee terminates after meeting eligibility, and is rehired *at any point in the future*, generally eligible immediately. *Very few exceptions*.

Pitfalls of Payroll System Calculations of Employer Contributions

Pitfall #3: Who Is Eligible for the Employer Contribution (cont.)

- Changes in Employee "type" are ignored (Elapsed Time & Counting Hours)
 - Example: Plan A's 401(k) excludes per diem employees from the match. Eligibility is 1st of month following 6 months of service. Sally is hired as per diem on 6/1/2025. She accepts a full-time position on 1/31/2026. She has met the service and entry date requirements based on ALL of her service and is eligible immediately on 1/31/2026.
 - Service while part of an excluded class IS taken into account!

Pay-Period Match Calculation Pitfalls

Examples of Payroll System Oddities and Limitations to be aware of.

- Some payroll systems will calculate a "Pre-Tax Match" and a "Roth Match" depending on what the employee is contributing.
 - Match must be calculated based on the sum of pre-tax and Roth 401(k).
 - NOTE: ALL Match is "pre-tax" because the employee is not taxed on the amounts when funded.
 - 3% Pre-Tax + 3% Roth is identical to 6% Roth for purposes of calculating matching contributions.
- Many payroll systems using this presentation nevertheless formulaically ensure that the sum of the two codes is accurate.
 - "Simpler" payroll systems sometimes treat as a 2nd match due to systems limitations and the match can be doubled if they contribute PT and Roth (which happens!).
 - Or bigger ones too if set-up is not correct. It happens!

Pay-Period Match Calculation Pitfalls

Examples of Payroll System Oddities and Limitations to be aware of (cont.).

- Participants may have two separate entries on a payroll run (even if there is one single check).
 - Examples include a) bonuses/commissions paid on the same pay-day as regular wages; b) separate entries for different cost sharing departments (ADP).
 - Payroll register will include 401(k)/403(b) and match on only one entry (e.g., regular pay), **especially** when election is a flat dollar amount, but no 401(k) or match on the 2nd entry (even if one paycheck).

Pay-Period Calculation vs. Annual Calculation of Match

The following is a typical calculation of Matching Contributions for an employee paid monthly (this is not an operational issue, just something for employees to be aware of to avoid if possible):

Pay-Period Detail						
Pay-Period	Gross Comp	401(k)	As a % of Pay	As a 4.00% Match*	As a % of Pay	Missed Match
1/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
2/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
3/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
3/31/25 (Bonus)	15,000.00	-	0.00%	-	0.00%	600.00
4/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
5/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
6/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
7/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
8/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
9/15/2025	10,000.00	2,400.00	24.00%	400.00	4.00%	
10/15/2025	10,000.00	1,900.00	19.00%	400.00	4.00%	
11/15/2025	10,000.00	-	0.00%	-	0.00%	400.00
12/15/2025	10,000.00	-	0.00%	-	0.00%	400.00
	135,000.00	23,500.00		4,000.00		1,400.00
Year End Recap of Pay-Period Calculation						
	Actual	S/H/B	Missed			
Total Match	4,000.00	5,400.00	1,400.00			
Total Pay	135,000.00	135,000.00				
Match as % of Pay	2.96%	4.00%				

Payroll Bridges

Regular remittance of data to (Recordkeepers) was previously limited to just the actual pay-period contributions for allocation/funding to participant accounts.

Recordkeepers in 2025 can do far more for clients due to advancements in technology:

- Track eligibility and payroll deduction elections (and therefore automatic enrollment).
- Mail annual notices to anyone who has met eligibility (and terms with balances).
- Track vesting.

Each of these services requires the transmission of full census data (addresses, emails, mobile phones, hours, DOH/DOB) every pay-period.

Payroll Bridges

What is a "bridge"?

- Payroll processing firm sends data directly to a Recordkeeper.
- As opposed to downloading an Excel/CSV file from payroll and then uploading that file to the Recordkeeper.
- Bridges are more secure (auditors/internal controls).

180 Bridge vs. 360 Bridge

- 180 Bridge = data transmitted *ONLY from* the payroll provider (e.g., ADP) *to* the Recordkeeper (e.g., Empower).
 - Always includes contributions data for funding; generally, would also include demographic data.
 - One small step-up from just downloading Excel/csv file and uploading it to the Recordkeeper's website (but again better internal controls).

360 Bridge = same as 180 bridge, PLUS:

- Payroll deduction contribution elections updated on payroll.
- Any new loans are added to payroll (and deductions stopped when repaid).

Payroll Bridges

How much do they cost?

- Bridges are frequently very expensive.
- If changing payroll providers make sure you ask about the cost of adding or maintaining a bridge set-up.
- 180 Bridges are generally not worth a high investment.
 - 360 bridges alleviate a lot of work especially in large organizations so may be worthy of a significant investment.

New Catch-Up Rule #1: "Super Catch-ups"

- Increased payroll deduction contribution limits for those individuals who attain the ages of 60 to 63 in the calendar year.
- First effective January 1, 2025.
- It is optional to include, but most did.
- Check with your compliance provider to make sure your Plan includes this provision, and your payroll company to make sure it is available!
- **The following chart summarizes the new limits for 2025.**
 - Green row = "Super-Catch-up" (150% of the regular catch-up).

Age attained in Calendar 2025	Applicable Year of Birth - 2025	Catch-up Limit	Total Elective Deferrals
Age 49 or younger	1976 or later	\$0	\$23,500
Between 50 and 59	Between 1966 and 1975	\$7,500	\$31,000
Between 60 and 63	Between 1962 and 1965	\$11,250	\$34,750
Age 64 and older	1961 or earlier	\$7,500	\$31,000

New Catch-Up Rule #2: Mandatory Roth Catch-ups

Participants with Social Security Compensation in excess of \$145,000* in Year 1 must contribute any catch-up contributions as Roth in Year 2.

- * The limit for 2025 will not be released until October 2025.
- Anyone over the limit in 2025 will be subject to these rules January 1, 2026.
- Examples: >\$145K* in 2025 = Mandatory Roth in 2026; >\$145K* in 2026 = Mandatory Roth in 2027, etc.
- Social Security Wages is W-2 Box 3.
 - Soc. Sec. wages is ~ Gross Wages less pre-tax deductions under a 125 Plan (health, dental, vision).
 - Payroll deduction 401(k) contributions do NOT reduce Social Security wages.

Payroll companies are reprogramming!

- Is payroll system a side-car to a larger business operation? If so, may not be as proactive in reprogramming.

Auto Enrollment – How to Avoid Common Pitfalls

Be very careful with rehired employees.

- Plan should have a policy concerning whether or not a rehire a) resumes at the prior contribution rate; b) re-subjected to the auto enrollment procedures. Frequently administrative in nature and programmed into recordkeeping set-ups.
- Rehires is a very common source of Auto Enrollment failures.

Disparity between Recordkeeper payroll deduction elections and payroll systems (applies even if no auto enrollment).

- **Best practice** (moot if 360 bridge): *Every* pay-period, make sure that any elections made on the Recordkeeper website are added to payroll.
- **Best practice** (even if 360 bridge): Perhaps once a quarter, perform a complete audit of elections on Recordkeeper vs. what is on payroll (Excel Vlookups should be efficient).
- Universal Rule: If two datasets must contain identical data, and you do not regularly verify, eventually they get out of sync.

Auto Enrollment – How to Fix Mistakes

The IRS has very detailed steps concerning corrections of Auto Enrollment mistakes.

- Mistakes include either a) Participant who should have been auto-enrolled; or b) Participant should have been Auto Increased; *but was not*.
- The process is complicated, and you should work with your compliance providers for assistance. However, it is important to be aware of these methods which involve time-sensitive notices.
- These corrections are similar (but not identical) for non-Auto-Enrollment issues like:
 - Participant initially elects to contribute 5% but that is never implemented.

Auto Enrollment – How to Fix Mistakes

Scenario 1: Corrections discovered prior to the extended due date of the 5500 for a Plan Year (even if no extension filed).

- E.g., Includes a failure that begins in February 2024, and is identified/corrected in September 2025 (perhaps during audit).
- NO required Employer Contribution to address the Participant's missed opportunity to contribute.
 - E.g., other IRS corrections require the employer to contribute up to 50% of what the employee *would have contributed*, even though the money not contributed is in their personal checking account.
- 100% of the match that would have accrued is ALWAYS required to be deposited *plus a gains adjustment*.
- NOTE: A Notice with very specific disclosures must be provided at least 45 days from the date on which correct deferrals begin (or the participant opts out).

Auto Enrollment – How to Fix Mistakes

Scenario 2: Corrections discovered AFTER the window described on the previous slide:

- The Employer must contribute 25% of the "Missed Deferral." For example, if an Employee s/h/b Auto Enrolled at 4% of pay, the corrective contribution paid by the Employer is 1% of pay.
- Again, 100% of the missed match must be funded.
- Both contributions must be adjusted for investment gains.
- NOTE: A Notice with very specific disclosures must be provided at least 45 days from the date on which correct deferrals begin (or the participant opts out).

Auto Enrollment – How to Fix Mistakes

What if the 45-day notice is missed?

- The Employer Contribution to make up for the "Missed Deferral" is *increased* to **50%**.
- 100% of any Missed Match is required (same).
- Gains adjustments on the above are also required (same)

Most Important thing to Remember:

- There is an important notice that is due; and
- Consult your compliance advisors!
- Both are true regardless of why there was a "Missed Deferral" due to Auto Enrollment, or not implementing an affirmative election.

Student Loan Payment Matching Provisions

SECURE 2.0 Act added the ability to "match" Student Loan Payments (SLP's) as though they were payroll deduction 401(k) (or 403(b)) Contributions.

- Example: The Plan has a match of 100% of the first 4% of pay contributed and includes a match for SLP's. Participant A has Compensation of \$100,000, contributed 0% as 401(k), but has \$4,000 of student loan payments for 2025. Match is \$4,000.
- Example: Same as above except the Participant DOES contribute \$4,000 as 401(k) via payroll deduction. Match is STILL \$4,000 because this is NOT a second match.

If Parents take out loans for their dependent or spouse, those loan payments are also eligible for the SLP Match.

Student Loan Payment Matching – Implementation

- If Matching Contributions are calculated/funded solely at year-end, SLP's are simply added to payroll deduction contributions to determine the match.
- If Matching Contributions are calculated/funded each pay-period throughout the year, the IRS has clarified that plan administrators are permitted to perform an annual "true-up" to take into account SLP's.
 - Not required to obtain SLP data throughout the year!
- Shortly before the end of the Plan Year:
 - Send an "SLP Data Form" to Participants
 - Require them to document the sum of all SLP's during the year.
 - Optional: Require them to attach documentation (*recommended to prevent abuse*)
 - Impose a "due date" for the information (3 months after year-end is deemed reasonable by IRS but definitely facts/circumstances (e.g., 1 month with weekly reminders).

One Big Beautiful Bill – Overtime & Tip Deduction

The new provision is an individual deduction and should NOT affect Contribs Compensation

- MOST Plans (in our experience) use W-2 Box 1 as the starting point (Federal Taxable Wages).
- Overtime and Tips are still included in Box 1 of W-2 (and boxes 3 (SS) and 5 (MC)).
- Qualifying individuals take a deduction on their Form 1040.
 - *It is not an exclusion from income.*
- Therefore, Plans using W-2 Definition of Compensation will see no change in Contribs Comp.
- However – some plans use “Wages for purposes of income tax withholding.”
 - The IRS has been directed to update form W-4 for 2026 to allow Employees to estimate their qualifying overtime and tips.
 - Draft just released 2 weeks ago: [Draft W-4](#) (see page 5)
 - Employers will use this form W-4 to adjust their withholdings.
 - Modifications to Form W-4 and withholding procedures does NOT amend the law in a way that excludes tips and overtime from the withholding definition.
 - Thus, Contribs Comp will not be affected.
 - Presumably the IRS/Congress would never let these rules reduce plan benefits in any event.

One Big Beautiful Bill – Overtime & Tip Deduction

[Summit is not an accounting firm but you should make sure you ask the right questions surrounding the following if they apply to you]

Super Important Points – Overtime

- Only mandatory overtime under FLSA is eligible.
 - If State is more generous, excess not eligible for deduction.
 - OR Employer might pay overtime for hours over 37.5 Hours per week.
 - Certainly makes payroll reporting/coding more challenging
- Only the “half” in “time and a half” is eligible
 - \$10/hr regular; \$15 for OT; Just \$5 is excluded.
- OT paid to salaried/exempt is NOT eligible.

Super Important Points – Tips

- Limited to industries that historically received tips (IRS to release a list).
- As an example of the IRS Concern, a CPA cannot negotiate a tip as part of their fee to prepare a 1040 just to exclude income.
- Truly meant for service businesses such as restaurants, cleaning service at hotels, etc.

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