Should We Include Government-Mandated Coronavirus PTO When Calculating Company Contributions?

Facts

We have several employees who have had to take time off from work either because of a loss of childcare or to care for affected family members due to the coronavirus. As a result of recent legislation, they qualify to receive compensation during their leave from work.

Question

Should we withhold 401(k) deferrals from that government-mandated paid time off? Are we required to include that pay when we calculate company contributions?

Answer

To start, a quick note about the recent legislation that's causing so many questions right now. The CARES Act provides several direct retirement-plan-related relief provisions, and we have covered it pretty extensively on our website. The Families First Coronavirus Relief Act (FFCRA) is a little different in that it does not focus directly on company-sponsored retirement plans. Instead, its focus is on providing relief in the form of compensation when employees must take leave as a result of the coronavirus. While not retirement plan specific in its provisions, the FFCRA does impact your retirement plan administration and operation as we'll explore below.

Now, on to something that will feel familiar! To answer the initial question above, the first place to look is your plan document. The plan document must define the compensation you should use for plan purposes, including specifications regarding any compensation that can/should be disregarded. One of the most common definitions of plan compensation is gross compensation. Barring any specific exclusions written into the plan document, the paid time off your employees receive via the FFCRA is eligible plan compensation. Similar to other types of PTO, this means participants can defer and receive employer contributions on these dollars.

Employee 401(k) Contributions

Since FFCRA paid leave is, under most circumstances, plan compensation, your participants' 401(k) deferral elections should be applied to that pay just like any other "regular" pay. If a participant normally defers a flat dollar amount from each paycheck, the same dollar amount should continue to be withheld regardless of whether a given check is comprised completely or partially of FFCRA pay. Similarly, if a participant elected to defer a percentage of pay, that percentage should be applied to any FFCRA compensation.

With that said, a participant is generally free to stop deferring at any time, and the FFCRA does not change that. It's not hard to imagine a participant in this circumstance might want to temporarily stop deferring to have more cash available. Although most plan documents allow flexibility in how participant can request changes to their deferral elections, we always suggest that you get the request in writing, even if it's just a simple email. The reason is that when a company does not properly withhold deferrals, it is known as a missed deferral opportunity and can result in the company having to make additional contributions to correct the mistake. By getting the request to stop deferrals in writing, it limits the potential for misunderstanding down the road. We also recommend that you respond to the request in writing to confirm exactly when deferrals will stop and what the participant should do when s/he is ready to start contributing again.

Employer Contributions

Similar to regular types of paid leave, the PTO you provide to participants who are on FFCRA leave must be included with their other eligible compensation when calculating employer matching, safe harbor contributions, and any profit sharing contributions you might make to the plan.

Even though the Small Business Association Payroll Protection Program loans can be used to cover the cost of retirement plan contributions, we understand that many business owners are taking a hard look at all costs, including company contributions to the retirement plan. To that end, it might be possible to amend your plan to prospectively exclude PTO or other forms of pay from the plan's definition of compensation. This can be a useful technique in reducing costs, but it comes with several warnings and caveats.

First, if you have a safe harbor 401(k) plan, this change can only be made at the start of a subsequent year. This is because, generally speaking, mid-year amendments that would serve to reduce benefits are prohibited in safe harbor plans.

Discretionary employer contributions are more flexible and can allow mid-year changes to the definition of compensation if made prospectively. But even here, there's more to consider, and other plan provisions will impact whether you can make the change now or whether it must wait until the beginning of the next year. For example, if your plan provides for a discretionary profit sharing contribution that requires participants to be employed on the last day of the year to share in it, it is likely possible to amend the plan's definition of compensation to exclude PTO at any point prior to the last day of the year since that is the date participants actually become entitled to the contribution. Similarly, if your plan provides a discretionary match that is required to be calculated separately for each pay period, you can likely change the definition of pay to be used for future pay period match calculations. However, if the contributions are determined on a full year basis (rather than separately for each pay period) and there are no separate requirements to share in the contributions, the definition of pay currently in use must continue through the end of the year.

Beyond that, when a plan excludes certain forms of compensation (such as PTO), it becomes subject to what is called the compensation ratio test at year-end. The objective of that test is to ensure the definition of pay is not being manipulated in a way that is more detrimental to non-highly compensated employees. Although not a foregone conclusion, it is likely that a larger percentage of employees receiving FFCRA PTO are non-HCEs. As a result, excluding that form of pay would likely make it difficult to pass the compensation ratio test. For that reason, if you are thinking of making this type of a change, it's important to consider the demographics of the employees most likely to be impacted.

Depending on the significance of these PTO payments, especially when taken in combination with other economic factors, it may be necessary to look at other options for reducing the cost of company retirement plan contributions. Options may include reducing or suspending discretionary contributions. You may also consider suspending your safe harbor matching contributions for the rest of the year. If so, we've got additional information for you here and here.

Related Resources

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