

Benefits Alert

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FICA early inclusion for 2020 taxes in non-qualified pension plans

Depending on the results of the November 2020 election, potential changes in tax policy may cause plan sponsors to revisit their strategy regarding payment of taxes on non-qualified pension plan benefits.

We speculate here regarding possible increases in Federal Insurance Contributions Act (FICA) tax and why they may create interest in the “early inclusion” option under Internal Revenue Code §3121(v) for sponsors of and participants in non-account balance (i.e., defined benefit) non-qualified deferred compensation plans, also commonly referred to as supplemental executive retirement plans (SERPs) or “Top-Hats.”

In addition to maintaining the current payroll tax rules and rate for Social Security (OASDI) on earnings up to the annual maximum, former Vice President Biden has pledged to also subject wages above \$400,000 to the 12.4% payroll tax (6.2% paid equally by the employee and the employer). Using 2020 as the baseline, earnings between \$137,700 and \$400,000 would be exempt. The payroll tax would “restart” at accumulated pay exceeding \$400,000. The \$262,300 pay that is exempt from payroll tax has been referred to as the Social Security “doughnut hole,” borrowing from terminology associated with the Patient Protection and Affordable Care Act (ACA).

While many believe the above-described increases are contingent upon not only a Democratic win of the White House, but also a “sweep” for the 117th session of Congress (last seen in the 111th Congress), it should be noted that the proposed increase in the Social Security payroll tax has been in the public domain, and a Republican-controlled Congress would face the same federal tax policies and tax revenue shortfalls. These tax policy issues are precipitated by the Treasury Department’s [announcement](#) of a \$3.132 trillion budget deficit and [federal debt](#) of \$26.945 trillion for the federal fiscal year ended September 30, 2020.

Accordingly, non-qualified defined benefit pension plan sponsors may consider making use of the “early inclusion” FICA rule on or before December 31, 2020, in an attempt to lessen the future tax burden of their higher-income employees.

This can be accomplished, under the advice of tax counsel, by applying the FICA tax to such employees’ benefits in a year (i.e., 2020) when the earnings subject to such tax is capped at \$137,700. Because there are some risks associated with this “early inclusion” method, the potential tax savings would need to be weighed against the probability of such risks when making a determination regarding this option.

The 2021 Social Security taxable wage base will be \$142,800, increasing 2021 payroll tax by \$316.20 to \$8,853.60 for the employee and the employer (not including Medicare tax). For more information, please contact your Milliman consultant.

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