

## S Corporations: Why the Owners' W-2s Matter for Retirement Plan Contributions

As a CPA, you can help S-corporation owners understand a point that is frequently overlooked: how much an owner is paid in W-2 wages (not distributions) largely determines how much can be contributed to a retirement plan for him or her.

S-corporation payments to shareholder-employees are generally split between W-2 compensation and pass-through distributions. While distributions can be tax-efficient from an employment-tax perspective, shareholder-employees must still be paid reasonable compensation for services performed, and distributions generally do not count as "compensation" for qualified plan contribution purposes. As a result, an owner who minimizes W-2 wages may also be unintentionally limiting retirement savings opportunities.

### Why W-2 wages drive retirement contributions.

For S-corp shareholder-employees, plan compensation is generally based on compensation reported on the shareholder-employee's Form W-2 (as defined by the plan and limited by the applicable compensation cap under 401(a)(17)). This compensation is used to determine elective deferrals in a 401(k) plan, employer contributions, allocations under cross-tested or new comparability designs, and may materially affect benefits and contribution levels in a defined benefit plan. If W-2 wages are too low, the owner may not be able to maximize retirement benefits, even if the business has ample profitability.

### 2026 limits as context.

For 2026, the elective deferral limit for 401(k) plans is \$24,500, with additional catch-up contributions potentially available. Total defined contribution annual additions are limited to \$72,000 (excluding catch-ups). Compensation taken into account is generally limited to \$360,000.

For example, an owner with \$70,000 of W-2 wages can defer up to \$24,500, but total annual additions for the participant cannot exceed 100% of compensation, and employer contributions may be further limited by the plan's formula, nondiscrimination rules, and deduction limits. In a typical owner-only or pro rata profit-sharing structure, the owner generally cannot reach the \$72,000 annual-additions limit without significantly higher W-2 wages.

### Balancing tax efficiency and retirement goals.

The planning challenge is not simply to minimize W-2 wages. Instead, it is to strike an appropriate balance between employment tax efficiency (lower W-2, higher distributions) and retirement plan optimization (higher W-2, lower distributions). When advising S-corporation owners, retirement planning should be considered as part of overall compensation strategy. A focus solely on minimizing W-2 wages can inadvertently undermine the client's ability to maximize tax-advantaged retirement contributions.



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