

DAVIS-BACON PLANS

(Prevailing Wage Plans)

Updated 10-4-08

A) History of Davis-Bacon Act

- 1) This is a Depression era law (1931) that was designed to prevent unfair labor practices for work involving nonunion employees.
- 2) Any contractor bidding on government work projects in excess of \$2,000 must pay workers a “prevailing wage.”
- 3) This Act is governed by the Department of Labor.
- 4) While contributions and wages must comply with the Davis-Bacon Act, where applicable, there is no exemption from any other qualified plan rules. Consequently, when employer contributions contain Davis-Bacon dollars, or taxable compensation includes Davis-Bacon wages, any related qualified plans must comply with the normal rules pertaining to
 - a) Individual participant contribution limits (“annual additions limits”),
 - b) Coverage tests, and
 - c) Nondiscrimination rules.

B) Rules

- 1) Prevailing wage compensation has two parts:
 - d) the prevailing hourly wage --- a minimum basic hourly rate of cash payment, paid at least weekly, and
 - e) the prevailing wage fringe benefit --- which may be paid in the form of either
 - a) contributions to a fringe benefit plan, or as
 - b) additional cash wages.
- 2) Fringe benefits include benefits payable due to medical needs, disability, death, retirement, injury, illness, unemployment, vacation or holiday pay.
- 3) The “prevailing” wage is a function of geographic location and class of laborer.
- 4) There is no safe-harbor definition of ‘compensation’ that allows a qualified plan to ignore the part of compensation that represents the “prevailing hourly wage” if it is paid through W-2 pay.
- 5) Davis-Bacon dollars contributed to a retirement plan must be deposited at least quarterly.

C) Typical case for one employer

- 1) When not on Davis Bacon projects, regular pay might be \$14/hour.
- 2) When on a Davis Bacon project,
 - a) Minimum taxable wage must be \$21 / hour, while
 - b) Fringes must be \$10 (and these fringe dollars can be spent on fringe benefits or paid in W-2 wages).

D) Advantages to an Employer putting Davis-Bacon dollars into a qualified plan as opposed to putting them on the W-2.

- 1) Can reduce workers' compensation premiums paid by the employer.
- 2) Can reduce FICA taxes (for both the employer and the employee).
- 3) Permits the qualified plan to apply the Davis-Bacon dollars toward other minimum requirements for purposes of coverage and nondiscrimination rules.
- 4) Reduces worker compensation used for nondiscrimination purposes, thus further reducing required qualified plan contributions.

These advantages are illustrated by the following example:

COMPARING OVERALL COSTS --- PUTTING THE DAVIS-BACON FRINGE ON THE W-2 VS. PUTTING IT IN A QUALIFIED RETIREMENT PLAN		<u>Line</u>	Putting Davis-Bacon Fringe on the <u>W-2</u> A	Putting Davis-Bacon Fringe in a Qualified <u>Plan</u> B	Savings Related to Just This One <u>Employee</u> C
Regular W-2 pay	1	28,000	28,000		
Prevailing hourly wage	2	3,500	3,500		
Prevailing wage fringe added to W-2	3	5,000	0		
Total W-2	4	36,500	31,500		
Employer share of FICA taxes	5	2,792	2,410		
Prevailing wage fringe benefit to retirement plan	6	0	5,000		
Workers' comp premium as a percent of W-2 6.00%	7	2,190	1,890		
Company contribution to retirement plan 15.0% (or Davis-Bacon contribution, if more)	8	5,475	5,000		
Company total for this employee --- in pay, FICA, prevailing wage, workers comp, and retirement plan	9	46,957	40,800	6,158	
Notes	a) In this example, the employee is working a quarter of the year on Davis-Bacon projects. b) Putting the wage fringe into the retirement plan lowered the employee's compensation used in calculating the FICA tax, workers' comp, and the contribution to the retirement plan. c) Putting the wage fringe into the retirement plan allows a comparable contribution, as a percent of pay, to the owners of the business. d) Typically, the employer will also save on general liability and umbrella insurance, by reducing its W-2 wages.				

E) Some problem areas:

- 1) There can be problems if Highly Compensated Employees (HCE's) also get prevailing wage dollars contributed to the qualified plan. If the amounts for the HCE happen to be a higher percent of compensation than for any other employees, there is the potential for violation of nondiscrimination rules in qualified plans.
- 2) Due to the immediate eligibility and full vesting requirement, Davis-Bacon dollars are normally put in a separate fully vested account within the plan, adding slightly to the complexity of plan administration.

F) Coverage and nondiscrimination Rules for qualified plans

- 1) Although employees covered by collective bargaining can be ignored for testing qualified plans, there are no Davis-Bacon exclusions.
- 2) Contributions to a Davis Bacon account within a qualified plan can also be counted toward satisfying
 - a) top-heavy minimum 3% requirements,
 - b) "cross-testing" minimum contribution requirements, and
 - c) 401(k) safe-harbor minimum 3% non-elective requirements.

G) Plan design

- 1) Many employers simply put the Davis-Bacon contributions into their qualified defined contribution plans, in a fully vested account that is not in any way tied to other plan contributions.
- 2) Some employers, instead, take the approach that each participant in the plan will get an employer contribution that is a function of pay and/or participant contributions, but then *apply* the Davis-Bacon contributions toward this amount. In other words the participant under this scenario gets an employer contribution equal to the greater of
 - a) the amount he would have received under the basic operation of the plan, or
 - b) the required Davis-Bacon contributions.
- 3) Regardless of which of these two methods is used (item (1) or (2) above), the Davis-Bacon contributions are almost always fully vested.
- 4) Some employers traditionally choose to deposit the Davis-Bacon contributions to a totally separate plan --- separate from all other participant and employer retirement contributions. However, this increases costs, and, from a communication point of view, probably makes it a little harder to utilize item (2) above. Now that individual limits and maximum contribution deductions can be reached all within a single plan, most Davis-Bacon dollars will, in the future, simply be deposited to discretionary profit sharing plans.

H) Annualization

- 1) By providing immediate eligibility and full vesting for Davis-Bacon contributions, a plan can avoid the need for annualization. Most all qualified plans receiving Davis-Bacon dollars try to avoid annualization.

- 2) The following is an example of “annualization” as illustrated by Amy Cavanaugh of McKay Hochman Co., Inc. in Question 1 of the BenefitsLink.com Q/A column on this subject:

”For example, assume that a contribution for an employee under a money purchase plan is calculated to be \$2,000. Assume also that Davis-Bacon fringe compensation for this individual is \$1,500, based on 500 hours of Davis-Bacon work. And assume the employee worked a total of 1,000 hours of service. In order for the contractor to meet its obligation with respect to the Davis-Bacon wages, only \$1,000 of the \$2,000 contribution can be funded with Davis-Bacon fringe benefit dollars. The other \$1,000 would need to be contributed by the employer.”

In this example, the portion of the plan contribution attributed to Davis-Bacon work is $(500 \text{ hours} / 1,000 \text{ hours}) \times \$2,000 = \$1,000$. Consequently, only \$1,000 of the \$2,000 employer plan contribution can be funded with Davis-Bacon fringe benefit dollars.

- 3) By fully vesting the Davis-Bacon dollars, all \$1,500 of the Davis-Bacon dollars can be applied toward the \$2,000 plan contribution, saving the employer \$500.

I) Other References and Resources

- Davis-Bacon Act is at Title 40 U.S.C., Chapter 31, Subchapter IV, sections 276a to 276a-5. It consists of only several pages, which can be found using <http://www.irs.gov/taxpros/article/0,,id=98137,00.html>
- The “Davis-Bacon and Related Acts Home Page” of the DOL is at <http://www.dol.gov/esa/programs/dbra/index.htm> .
- There is supposed to be something called the Department of Labor’s “Davis-Bacon Resource Book” (11/2002), according to Amy Cavanaugh of McKay Hochman Co.
- BenefitsLink.com has a Q/A section on Davis-Bacon plans at http://benefitslink.com/modperl/qa.cgi?db=qa_davisbacon .