

COMPARISON OF SAFE HARBOR NONDISCRIMINATORY DEFINITIONS OF COMPENSATION

The Treasury regulations under Code §415 prescribe three alternative definitions of compensation. The general 415 definition of compensation (for purposes of Code §415(c)(3)) *includes* elective deferrals to a 401(k) plan, a SARSEP, a 403(b) plan or a SIMPLE IRA plan, and pre-tax contributions to a cafeteria plan, a 457 plan or a qualified transportation fringe benefit plan. The two “alternative” 415 compensation definitions are “net” of these pre-tax amounts. Therefore, for 415 purposes, if the plan uses one of the alternative definitions, it must be increased for elective deferrals.

For *nondiscrimination* purposes, the Code §414(s) regulations consider the three 415 definitions as safe harbor testing definitions of compensation. However, an employer may modify any of the three alternative definitions by “including” or “excluding” elective deferrals (except 457 plan contributions) and remain within the nondiscrimination safe harbor.

This Comparison refers to these definitions as:

- (a) The “415 compensation” (current income) definition. See Treas. Reg. §1.415(c)-2(d)(2).
- (b) The “Federal income tax wage withholding” (Code §3401(a)) definition. See Treas. Reg. §1.415(c)-2(d)(3).
- (c) The “Form W-2” (Box 1) definition. See Treas. Reg. §1.415-2(d)(4).

The following items are includible in all 3 definitions: wages, salaries, fees for professional services, and “other amounts received” (cash or noncash) for personal services rendered in the course of employment *to the extent includible in income*, including commissions on sales, commissions on insurance premiums, bonuses, fringe benefits and reimbursements (or expense allowances) under a non-accountable plan.

The “current income” safe harbor definition, as prescribed by Treas. Reg. §1.415(c)-2(d)(2), actually is a modification of the general 415 compensation definition prescribed by Treas. Reg. §1.415(c)-2(b) and is less inclusive. A plan may modify the “current income” safe harbor definition to *include* items 2, 5, 6, 10 and 11 described below. See Treas. Reg. §§1.415(c)-2(b) and -2(c)(1). The chart shows treatment under the alternative definitions of specified items *assuming* the plan does *not* modify the definition.

The 415 definition may or must include specified amounts of post-severance compensation. See Treas. Reg. §1.415(c)-2(e).

Checklists/Worksheets

<u>Item</u>	<u>415 Compensation (Current Income Definition)</u>	<u>Federal Income Tax Wage Withholding (Code §3401(a))</u>	<u>Form W-2 (Box 1)</u>
1. Salary reduction amounts (Code §§ 125, 401(k), etc.)	<u>Include.</u>	<u>Exclude.</u>	<u>Exclude.</u>
2. Employee's receipts pursuant to an unfunded nonqualified plan.	<u>Exclude.</u>	<u>Include.</u>	<u>Include.</u>
3. Tips.	<u>Include.</u>	<u>Include</u> , but <u>exclude</u> noncash tips and cash tips less than \$20/month.	<u>Include</u> , but <u>exclude</u> noncash tips and cash tips less than \$20/month.
4. Fringe benefits.	<u>Include</u> all amounts includible in income.	<u>Include</u> all <i>except</i> items specifically <i>excluded</i> under §3401(a): benefits/ payments excludible from income under §§74(c), 117, 132, 127, 129.	<u>Include</u> all amounts includible in income.
5. Amounts paid under accident and health plans (which are <i>includible</i> in income).	<u>Exclude.</u>	<u>Exclude</u> medical reimbursement under a self-insured medical plan within §105(h)(6).	<u>Include.</u>
6. Employee's moving expense.	<u>Exclude.</u>	<u>Exclude</u> amount <i>deductible</i> under 217.	<u>Include.</u> But plan may <i>modify</i> the definition of compensation to <i>exclude</i> deductible moving expenses. <i>See 1.415-2(d)(11)(i).</i>
7. Cost of group term life insurance in <i>excess</i> of \$50,000.	<u>Include.</u>	<u>Exclude.</u>	<u>Include.</u>
8. Amounts realized from exercise of non-qualified stock option or when restricted stock or property becomes fully transferable or no longer subject to substantial risk of forfeiture.	<u>Exclude.</u>	<u>Include.</u>	<u>Include.</u>
9. Amounts realized from sale or exchange of stock acquired under a qualified stock option.	<u>Exclude.</u>	<u>Exclude.</u>	<u>Exclude.</u>
10. Value of a non-qualified stock option included in income in the year in which granted.	<u>Exclude.</u>	<u>Include.</u>	<u>Include.</u>
11. Amount includible in income upon making §83(b) election.	<u>Exclude.</u>	<u>Include.</u>	<u>Include.</u>

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