

Compensation Communication



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Note that the plan document ultimately controls, so the actual definition must be carefully reviewed to correctly determine inclusion or exclusion of any compensation element.

COMPENSATION GUIDE

This guide is intended as a quick reference summarizing the four widely used definitions of compensation in plan design:

1 W-2 Wages

The amount of compensation listed on a participant's W-2 in Box 1 ("Wages, tips, other compensation"). Generally, this includes all earnings, minus pre-tax retirement and benefit deductions, plus taxable benefits.

2 Section 415 Compensation

Generally, this includes all taxable compensation (e.g., salary, bonuses, commissions) and excludes items not currently included in taxable income (e.g., nontaxable fringe benefits, worker's compensation, and nontaxable group term life insurance).

3 Simplified Section 415 Compensation

This is generally identical to Section 415 Compensation, though it excludes certain types of compensation that are often reserved for highly compensated employees (e.g., taxable moving expense reimbursements and nonqualified deferred compensation).

4 Section 3401(a) Wages

Generally, this includes all wages within the meaning of Code Section 3401(a), plus amounts that would be included in wages but for an election under Code Section 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(B), 402(k), or 457(b).

Compensation of Owners

Note that owners who are considered "self-employed" under the tax code generally will have compensation based on earned income.

Sole Proprietor

Earned Income

Partner

Earned Income

S-Corp Owner

Plan definition; pass-through income is not counted

C-Corp Owner

Plan definition; No pass-through income

For limited liability entities (LLCs, LLPs, PLLCs, etc.) – the owners are treated in accordance with the entity's tax election. For example, owner of an LLC that elects to be taxed as a partnership will be treated the same as partners.

Compensation	W-2 Wages	Section 415 Compensation	Simplified Section 415 Compensation	Section 3401(a) Wages
Wages, Salaries, Overtime, Bonuses, Commissions	Included	Included	Included	Included
Tips	Cash tips included, unless <\$20 per month	Included	Included	Cash tips included, unless <\$20 per month
Differential Wage Payments (to Military Service Members)	Included	Included	Included	Included
Non-taxable Reimbursements	Excluded	Excluded	Excluded	Excluded
Taxable Reimbursements	Included	Included	Included	Included
Pre-tax Elective Deferrals to Qualified/403(b) Plan	Excluded (but generally added back under plan)	Included	Included	Excluded (but generally added back under plan)
Pre-tax Deferrals to §125 Plan	Included	Included	Included	Included
Pre-tax Contributions to Non-qualified Plan	Excluded	Excluded	Excluded	Excluded
Taxable Portion of Premiums for Group Term Life Insurance	Included	Included	Included	Excluded
Nonqualified Stock Options	Included	Included at grant, excluded at exercise	Included at grant, excluded at exercise	Included
Amounts from the Sale or Disposition of Qualified Stock Options	Excluded	Excluded	Excluded	Excluded
Nonqualified Plan Distributions	Included	Excluded	Excluded	Included
Deductible Moving Expense	Generally excluded if paid to third party; included if paid to employee	Excluded	Excluded	Generally excluded
Non-deductible Moving Expense	Included	Excluded	Excluded	Included
Taxable Sick/Disability Pay	Included	Included	Included	Included
Worker's Compensation	Excluded	Excluded	Excluded	Excluded
Taxable Fringe Benefits	Included	Included	Included	Included, unless specifically excluded under Section 3401(a)
Non-taxable group-term life, dependent care, education assistance, fringe benefits	Excluded	Excluded	Excluded	Excluded
Medical Benefits from Employer Provided Contributions	Included	Excluded	Excluded	Included
Includable § 105(h)- Amounts Paid to Highly Compensated Individuals Under a Discriminatory Self-Insured Medical Expense Reimbursement Plan	Included	Excluded	Excluded	Excluded
Tax-favored meals or lodging under IRC §119	Excluded	Excluded	Excluded	Excluded
Foreign Earned Income under IRC §911 foreign earned income	Included	Included	Included	Included
Amount taxable on § 83(b) election	Included	Excluded	Excluded	Included
Amount taxable upon property vesting	Included	Excluded	Excluded	Included
Severance Pay	Excluded	Excluded	Excluded	Excluded