



**Becky Achten**

Employee Benefits Specialist  
406.896.4615  
Billings  
rlachten@hollandhart.com



**Beth Nedrow**

Partner  
406.896.4635  
Billings  
enedrow@hollandhart.com

# Don't Be Fooled! Compensation Definitions Are Tricky!

**Insight — April 1, 2019**

Contributions to your 401(k) plan are calculated as a percentage of an employee's compensation. Seems simple, right? Not so fast. The definition of "compensation" can actually be quite tricky to apply and can lead to errors that are costly to fix.

Let's start with the myriad definitions you might use. Many qualified retirement plans are required to use a definition of compensation that meets the nondiscrimination requirements of Code Section 414(s). The IRS allows several standard definitions that will meet that requirement:

- Code 415 compensation (the "long list")
- Code 415 compensation with standard exclusions (the "short list")
- W-2 wages
- Withholding wages

Each of these definitions has unique inclusions and exclusions. And when you add the optional modifications that employers might choose, the possible combinations are numerous. The complexity only multiplies when you consider how payroll systems are set up to identify various types of pay.

So ask yourself, what definition of compensation does our plan use, and have we set up the correct pay codes in our payroll system to apply it?

*But wait, there's more...*

Some other things to consider when designing compensation:

- Timing of Payment – Should compensation be included based on the year paid or the year earned?
- Post-Severance Compensation – Should compensation include accrued paid time off that is paid after termination of employment? What about severance paid on the last day of employment?
- Differential Pay – Is the company providing payments to employees who are absent for military service? If so, it may be required to be included in plan compensation.
- Nonqualified Deferred Compensation – If the Company has a nonqualified plan, is the deferred compensation being included or excluded appropriately?

Failing to follow the terms of the plan, like not using the correct compensation, can result in an operational failure. We can help! A simple (but thorough) review of the plan compensation provisions, compared to

what payroll codes are included for plan purposes, can insure proper administration and avoid costly corrections.

*For more information about our employee benefits practice, please visit [hollandhart.com/employee-benefits](https://hollandhart.com/employee-benefits).*

---

*Subscribe to get our Insights delivered to your inbox.*

*This publication is designed to provide general information on pertinent legal topics. The statements made are provided for educational purposes only. They do not constitute legal or financial advice nor do they necessarily reflect the views of Holland & Hart LLP or any of its attorneys other than the author(s). This publication is not intended to create an attorney-client relationship between you and Holland & Hart LLP. Substantive changes in the law subsequent to the date of this publication might affect the analysis or commentary. Similarly, the analysis may differ depending on the jurisdiction or circumstances. If you have specific questions as to the application of the law to your activities, you should seek the advice of your legal counsel.*