

CO-OP RETIREMENT PLAN

Definition of “Compensation”

The Co-op Retirement Plan’s definition of “Compensation” changed on January 1, 2009. Participating employers will first feel the practical effect of this change on April 1, 2009, when employer, employee, and administrative contributions begin to be calculated as a percentage of *current* Compensation (rather than the old method, which required contributions to be made as a percentage of prior year compensation). This document will describe the new definition and list several common amounts included in the definition. It will then highlight certain differences between the old and new definitions.

New Definition

Definition. The most noticeable aspect of the new definition is that the starting point – or baseline – has changed. The new “Compensation” definition begins with wages subject to federal income tax withholding, within the meaning of Tax Code Section 3401(a). We will refer to this below as “**Withholding Wages.**” The definition **adds** back in pre-tax deferrals and other salary reduction amounts, such as 401(k) non-Roth deferrals and Section 125 Cafeteria Plan/Flexible Spending Arrangement contributions. The new definition then **subtracts** deferred compensation payments *received* by highly compensated employees (“HCEs”). For 2009, an HCE is an employee who had compensation from the employer in excess of \$105,000 in 2008 or was a five percent owner at any time during the year or any preceding year. The IRS may annually adjust the \$105,000 amount. To recap, the new Compensation definition equals:

$$\begin{array}{r} \text{Withholding Wages} \\ + \\ \text{Pre-Tax Deferrals and Salary Reduction Amounts (such as those listed above)} \\ - \\ \text{Deferred Compensation Payments Received by HCEs} \end{array}$$

Why the Change? First, United Benefits Group decided to adopt a “safe harbor” definition that will necessarily be considered nondiscriminatory and will avoid the need and cost to perform nondiscrimination tests of the definition. Second, Withholding Wages – which are determined each payroll period and not simply at the end of the year when preparing Form W-2s – is more compatible with a current compensation system.

Current Compensation. Beginning April 1, 2009, employer, employee, and administrative contributions will be calculated as a percentage of current “Compensation” and contributed immediately after that Compensation is paid or made available to an employee (such as through direct deposit). The contributions will not necessarily be the same amount each payroll period or month, but the new online portal will perform the necessary calculations as a percentage of the Compensation.

Common Amounts Subject to Withholding

Here are some common types of wages included in Withholding Wages:

- (1) Regular pay, salary, commissions, and bonuses;
- (2) Vacation, severance, and sick pay;
- (3) Roth 401(k) Plan contributions;
- (4) Nonqualified deferred compensation distributions (though, as described above, they will be excluded from “Compensation” to the extent paid to an HCE);
- (5) Many taxable fringe benefits (see below for exceptions);
- (6) Taxable medical or disability benefits; and
- (7) “Nonqualified” moving expenses (those not deductible by the employee).

Contrasting the New and Old Definitions

Definition. As noted above, the starting point has changed. The old definition began with wages reported in Box 1 of a participant’s Form W-2. Like the new definition, it then **added** back in pre-tax deferrals and other salary reduction amounts. Unlike the new definition, it then **subtracted** three particular amounts: (i) deferred compensation payments received by all employees; (ii) moving expenses paid by a participating employer; and (iii) non-cash payments.

Current vs. Prior Year. Previously, the compensation received for a calendar year became a “Wage Base” on April 1 of the following calendar year. That Wage Base remained consistent throughout the succeeding 12-month period and served as a basis for monthly employer, employee, and administrative contributions.

Examples. Withholding Wages is a slightly narrower term than W-2 Box 1 Wages. In other words, some items reported in W-2 Box 1 are not subject to federal income withholding, such as:

- (1) The taxable portion of employer-paid group term life insurance coverage, which is the cost of coverage greater than \$50,000;
- (2) If, and only if, properly elected by a participating employer (which requires timely notice to be given to employees), the personal use of an employer-provided vehicle will be subject to taxation but not federal income tax withholding.
- (3) Payments from an education assistance program, dependent care assistance plan, health savings account, or Archer medical savings account;
- (4) Discriminatory reimbursements under a self-insured medical plan;
- (5) Additional fringe benefits, such as employee discounts, employee achievement awards, and qualified transportation fringe benefits; and
- (6) Non-cash tips and cash tips less than \$20 in a month.

Closing

The definition, common types of Withholding Wages, and examples of differences between Withholding Wages and W-2 Box 1 wages, are described in general terms and are not all-inclusive. Most accountants and payroll providers will have a comfortable familiarity with what amounts are included in Withholding Wages. If you have questions about any particular items, however, please do not hesitate to call United Benefits Group at **1-800-816-5535**.