FLSA-878

January 17, 1983

This is in response to your letter concerning the application of Section 3(m) of the Fair Labor Standards Act (FLSA) to payments made by employers to certain profit-sharing plans. The profit-sharing plan payments in question are made on an employee's behalf as a result of his/her election to reduce his/her salary under a cash of deferred arrangement as described in Section 401(K) of the Internal Revenue Code (Code). You request our opinion on each of the following issues:

1. Whether such payments are generally includable in wages under section 3(m).

2. Whether such payments are not excluded from wages under section 3(m) merely because the payments may be invested, pursuant to the employee's election, in employer securities, where the securities are purchased on a national securities exchange at fair market value and the employee has the right to vote the securities, and

3. Whether such payments are not excluded from wages under section 3(m) merely because the plan reimburses the employer for direct expenses properly incurred by it on behalf of the plan.

It is our understanding that Section 401(k) of the Code provides that an employee may elect to have a portion of his/her regular wages paid by the employer to the employee's account under a profit-sharing plan rather than receive direct payment of total wages. Under Section 401(k). payments made to a qualified profit-sharing plan on an employee's behalf are not included in the employee's gross income for Federal tax purposes at the time such payments are made. In addition, employers are not required to make payments under the Federal Insurance Contributions Act (FICA) or the Federal Unemployment Tax Act (FUTA) on the employee's elective contributions.

Section 401(k)(2)(C) of the Code provides that the employee's right to his/her accrued benefit derived from his/her elective contributions must be nonforfeitable. However, as provided in section 401(k)(2)(B), the benefits are not distributable to participants or their beneficiaries earlier than the date of an employee's retirement, death, disability, separation from service, hardship, or attainment of age 59 1/2.

The Internal Revenue Service (IRS) imposes taxes on any "disqualified" person, who engages in a prohibited transaction with respect to a qualified pension plan. The provisions regarding prohibited transactions are contained in Section 4975(c)(1) of the Code.

In accordance with the FLSA, Section 531.40 of 29 CFR Part 531 provides that where an employer is directed by an employee to pay a sum for the benefit of the employee to a third party, such payment will be considered equivalent as payment to the employees, if the employer does not directly or indirectly derive any profit or benefit from the transaction.

In response to the first issue, it is our opinion that payments made by an employer on behalf of an employee to any profit-sharing plan which qualifies under Section 401(k) of the Code may be considered as wages under Section 3(m) of the FLSA. We believe such plans meet the requirements of 29 CFR Part 531.40, in that the employees involved have the option of receiving a portion of their wages directly in cash or as contributions to their profit-sharing accounts. In addition, the nonforfeitability provisions contained in section 401(k)(2)(C) unconditionally entitle the employee

(or his/her beneficiary) to the accrued benefits at some future date. Further, we feel the prohibited transaction provisions contained in Section 4975(c)(1) of the Code discourage situations in which an employer or any person acting in such employer's behalf would derive benefit or profit from the assets of the plan.

With regard to the employer's tax benefit under this arrangement, we are not inclined to view a situation where an employer is not required to pay FUTA or FICA taxes on payments made on the employee's behalf as providing a direct or indirect benefit to the employer within the meaning of these terms under the FLSA.

With respect to the second issue, we would regard payments made on behalf of employees to a profit-sharing plan which invests either solely or partially in the employer's securities to be wages under Section 3(m) of the FLSA to the extent that the IRS recognizes such investments as permissible investments under Section 401(k)of the Code.

In response to the third issue, we would not consider payments made to a 401(k) plan as excludable from wages based on the fact that such plan provides reimbursement to the fiduciary for direct expenses properly incurred on behalf of the plan.

These determinations apply solely with respect to qualified plans under Section 401(k) of the Code. Profit-sharing plans which do not meet the qualifications of this section would have to be studied on an individual basis in order to determine whether conditions made thereto would constitute wages under Section 3(m) of the FLSA.

We wish to point out that the payments made in an employee's behalf under section 401(k) must be included in such employee's regular rate of pay for the purposes of computing overtime pay.

We trust the above is responsive to your inquiry.

Sincerely,

William M. Otter
Administrator