

Nonqualified Deferred Compensation Plans: Building on the Foundation

Presented by:

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Agenda

- What is a 457 Plan?
- Why Choose a 457 Plan?
- 457 Overview
- Sections 409A and 457(f)
- Administration & Compliance Issues
- Other Areas of Discussion

What is a 457 Plan?



- A “Nonqualified” deferred compensation plan that is maintained by not-for-profit and governmental organizations
- It is subject to the rules of Internal Revenue Code Section 457 and its regulations
 - Eligible Plans – 457(b)
 - Ineligible Plans – 457(f)



Why Choose a 457 Plan?



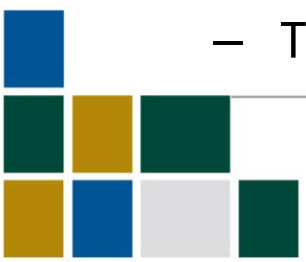
- To attract and retain employees
- A method of deferring income and the tax on such income to a specific future date
- It is designed specifically for a key individual or select group of individuals to provide for deferral of income above and beyond amounts provided under the organization's other retirement plans provided to all employees
- Not-For-Profit organizations may only provide nonqualified deferred compensation through 457 plans



457 Overview



- Requirements of a 457(b) Plan
 - Plan must be in writing
 - Must include requirements for participation, contributions and limits, distributions and form of benefit payment
 - Optional provisions, if any, must be included in plan document
 - Must comply in form and operation
- 457(b) Characteristics
 - Tax deferred plans
 - Limited to select group of highly compensated and management employees
 - Unfunded plan may use a Rabbi trust but assets are subject to employer's creditors
 - Treated as Top Hat Plan





- 457(b) Contribution Limit
 - Same limits as 401(k) and 403(b) deferrals (\$18,000)
 - Not aggregated with contributions to 401(k) or 403(b) plans
 - Reduced only by deferrals to other 457(b) plans
 - Age 50+ catch up is not permitted in not-for-profit plans
 - All 457(b) plans of employer treated as one plan
 - *Beware:* Employer contributions are treated as elective deferrals and reduce deferral limits





- Excess Deferrals
 - Distribute by April 15 of year following calendar year of excess
 - If April 15 deadline is missed then:
 - 457(b) plan becomes a 457(f) plan
 - Excess deferrals are double taxed in the year of deferral and the year of distribution





- 457(b) Distributions
 - Severance from employment
 - Age 70 ½ while still working
 - Unforeseeable emergency
 - Small account balances
 - Distributions usually not subject to 10% early distribution tax



457 Overview

- 457(f) Plans – Ineligible Plans
 - Contribution above annual 457(b) limits
 - For executives and high paid
 - Contributions must be subject to substantial risk of forfeiture
 - Amounts can be taxable before participant is eligible for distribution
 - Must be in writing
- 457(f) contributions may be taxed when:
 - Deferred
 - Vested (no substantial risk of forfeiture) or
 - Paid

Sections 409A and 457(f)

- Internal Revenue Code Section 409A requirements in addition to 457(f) requirements
 - Compensation is subject to a **substantial risk of forfeiture** if it is subject to performance of substantial future services or occurrence of a condition related to the purpose of the compensation and possibility of forfeiture is substantial
 - Timing of election by employee to defer compensation as well as election of time and form of payout is crucial
 - Election must be specified before the beginning of the year in which services related to deferred compensation are to be performed
 - If election for first year of plan, may be made within 30 days of initial eligibility
- Section 409A does not apply to Section 457(b) plans

Sections 409A and 457(f)



- Distributable events are limited to the following:
 - Separation from service
 - Disability
 - Death
 - A specified date or schedule of dates
 - Change in ownership or effective control of employer, or in ownership of a substantial portion of employer's assets
 - Unforeseeable emergency



Administration & Compliance Issues

- Permitting catch up contributions in a 457(b) non-governmental plan
- Exceeding contribution limits in 457(b) and failing to distribute by April 15
 - Excess contributions subject to income tax in year of deferral and year of distribution
- Rollovers
 - 457(f) and 457(b) nongovernmental plans not eligible for rollover
 - Exception rollover of 457(b) plan to another organization's 457(b) plan

Administration & Compliance Issues

- All parties must review and understand agreement, particularly timing of distribution
- Negotiating new employment agreements impacting deferred compensation and overlooking 457 plan
- Failing to execute 457 documents or elections



- Results of 457(b) Plan Compliance Issues
 - Plan becomes subject to 457(f)
 - Since a 457(b) plan does not contain a substantial risk of forfeiture, all amounts for **all individuals** covered under the plan become immediately taxable in the year of the violation





- **Most important and often overlooked Forms**
 - Will result in serious tax consequences to the individual and employer
 - 457(b) election to postpone distribution
 - If plan permits, employee upon termination of employment may elect to delay distribution until age 70 ½
 - Failure to elect results in immediate taxation at termination of employment even if the individual does not take a distribution



Administration & Compliance Issues

- Most important and often overlooked Forms

**457(b) PLAN
POSTPONEMENT OF DISTRIBUTION ELECTION**

To the Plan Administrator of the _____ 457(b) Plan ("Plan"):

Re: _____, Participant

In accordance with the Plan, I elect to postpone distribution of benefits. I have received an explanation of my distribution election rights under the Plan, the financial effect of my election and my right to postpone distribution from the Plan. Considering these options, I have elected to postpone distribution until the following distribution date (Choose (a), (b), (c) or (d)):

(a) (Specify) _____.

(b) _____ following the close of the Plan Year in which (Choose (1) or (2)):

(1) I attain Normal Retirement Age under the Plan; or

(2) _____.

(c) April 1 following the close of the calendar year in which I attain age 70½.

(d) April 1 following the later of the close of the calendar year in which I attain age 70½ or incur a Severance from Employment.

[Note: In the blank space after (a) or after (b), insert the distribution date you are electing. The date must be fixed or determinable.]

I understand I may not reconsider this election and that this election is subject to the Plan Administrator's consent which the Plan Administrator may withhold for any reason.

Dated this _____ day of _____, 20_____.

Participant's Signature



- **Most important and often overlooked Forms**
 - Department of Labor Form 5500 Exemption Letter
 - If filed with the DOL within 120 days of adoption, plan is exempt from annual Form 5500 filing requirement
 - Late filing of Form 5500 may be subject to a penalty of \$1,100 per day for late filing
 - May voluntarily file under Delinquent Filer Voluntary Compliance Program (DFVC) to pay a reduced penalty



Administration & Compliance Issues

- Most important and often overlooked Forms

FORM 5500 EXEMPTION LETTER

CERTIFIED MAIL RETURN RECEIPT REQUESTED

Top-Hat Plan Exemption
Employee Benefits Security Administration
Room N-1513
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, D.C. 20210

Re: 457(b) Plan

To Whom It May Concern:

The Employer is filing this notice on 457(b) Plan pursuant to Department of Labor Regulation § 2520.104-23. The Employer maintains the Plan primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees. The Plan currently covers one employee.

The Employer's address is: _____
and the Organization's Employer Identification Number is:

Very truly yours

Administration & Compliance Issues

- 457(f) plan issues
 - Invalid substantial risks of forfeiture
 - Non-competes
 - Entitlement must be conditioned on performance of substantial future services or occurrence of a condition that is related to the purpose of the compensation
- Elective salary/bonus deferrals
 - Government presumptions
 - A rational person would not forego compensation and subject it to a substantial risk of forfeiture
 - Presumed not to have a valid substantial risk of forfeiture

Administration & Compliance Issues

- Severance benefits paid upon voluntary termination extended over more than 2 ½ months after year end
 - Is considered deferred compensation
 - Payout is Guaranteed
- Severance arrangements will be bona fide if
 - Payable upon **involuntary** termination
 - Payment does not exceed two times salary capped at \$530,000 for 2015
 - Paid within two years from year of termination

Other Areas of Discussion

- Health and welfare 5500 filings and wrap documents
- More frequent IRS/DOL compliance initiatives
- All 403(b) plans will be required to be restated in full

Contact Information



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