NON-QUALIFIED DEFERRED COMPENSATION PLANS

What you need to know

WHAT ARE THEY?

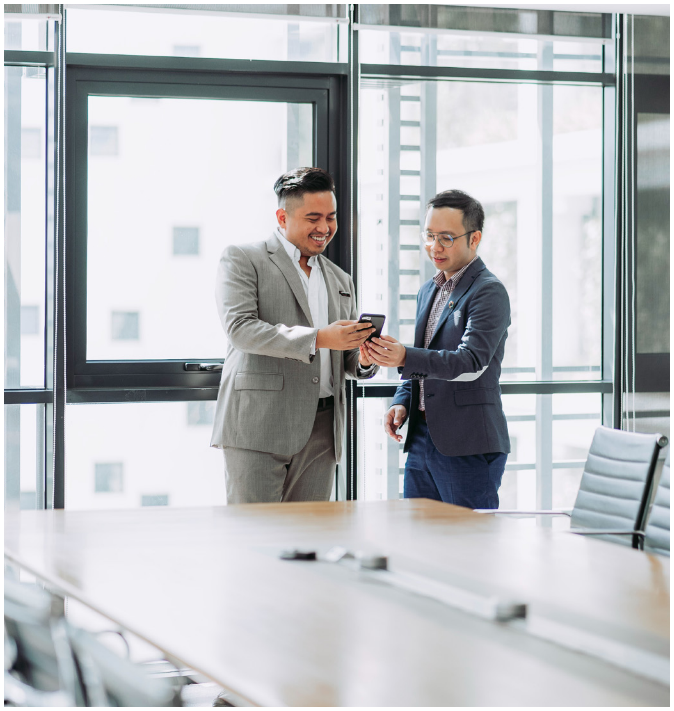
Nonqualified deferred compensation (NQDC) plans are a type of arrangement employers can establish to provide benefits for a select group of employees. In these plans, the employer is agreeing to pay the employee a specified benefit upon completion of specified criteria. Qualified plans (i.e., 401(k) plans, cash balance plans) have annual compliance testing and reporting requirements that do not apply to NQDC plans. Qualified plans may limit the benefits that can be provided or may not work to meet the specific objective the employer is trying to achieve. An NQDC plan is an alternative to a qualified plan that may fit the employer's needs—either on its own or in addition to a qualified plan.

409A, 457(f) and 457(b) plans are considered top-hat plans. This means they can only be offered to "a select group of management or highly compensated employees." This may appear discriminatory, but the benefits within these plans must also be subject to a substantial risk of forfeiture, which makes them inappropriate for rank-and-file employees.

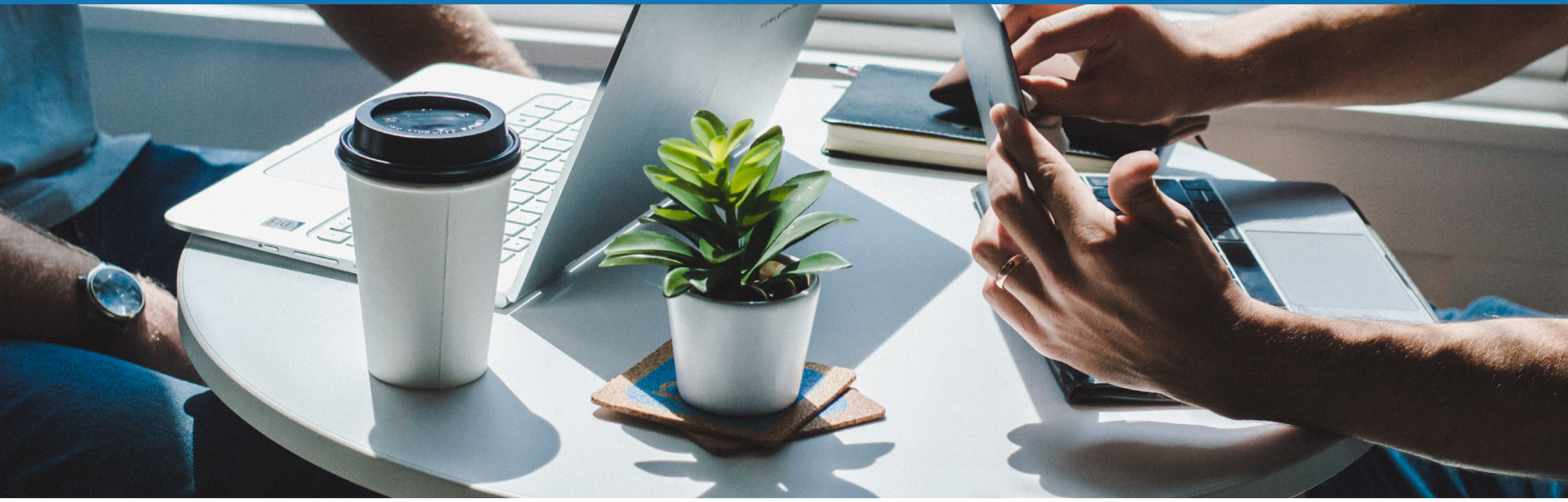
NQDC plans are "unfunded" plans; there is no requirement to hold the assets in trust. The assets belong to the employer until there is no longer a risk of forfeiture and become payable to the participant.

Eligibility, Funding, and Taxation

- **Eligibility –** These plans can be offered only to a select group of management or executives. There is no minimum age or service criteria to meet.
- **Funding –** Contributions are generally designed to be discretionary. Employees may be allowed to elect to defer into the plan as well.
- **Taxation –** The employer will take a deduction for employer contributions in the year the employee receives the assets and pays income taxes. No deduction is permitted upon allocation.



NQDC plans are sometimes designed with "golden handcuffs" in mind to retain valued employees in important roles within the organization. Other times, they are designed as a reward for those who meet defined objectives or stay with the organization through retirement.



DIFFERENT TYPES OF NON-QUALIFIED PLANS OFFERED AT EGPS

409A plans

409A plans are available to for-profit entities, typically corporations, as well as churches. They are usually used as an additional benefit/incentive for key executives. There are no limits to the amount of compensation that can be deferred (either by the participant or employer) in these plans.

457(f) plans

457(f) plans are very similar to their 409A cousin, except they are established for not-for-profit organizations. These plans are generally employer-funded only (no employee elective deferrals allowed), but they are often used in conjunction with a 457(b) plan for the deferral component.

457(b) plans

457(b) plans are established by either not-for-profit organizations or by state or local governmental entities. Annual contributions are limited for each participant ($19,500 for 2021) and are often designed for employee deferrals only. Governmental plans are not "top-hat" plans, so they can be offered to all employees and have several differences compared to tax-exempt employer 457(b) plans.

A GOOD FIT?

Could an NQDC plan be a good fit for you or your clients? The main benefits include:

- Plan features designed to retain key employees
- Unlimited contributions allowed for highly compensated employees
- No compliance testing or annual reporting requirements

Various rules regarding vesting, taxation, and distribution timing exist for each plan type. Reach out to EGPS to learn more about these plans and if establishing an NQDC could be a good fit for you or your clients. We're here to help!