



Retirement Plan Tax Strategies for Executives of Tax-Exempt Organizations

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§457 DEFERRED COMPENSATION PLANS FOR TAX-EXEMPT ORGANIZATIONS

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§457 DEFERRED COMPENSATION PLANS

- Deferred compensation = legally binding right to compensation in one taxable year that is or may be paid to the employee in a later year
- §457 Plans available to executives & management of tax-exempt entities – “Top Hat” Group
 - For §501(c)(3) Organizations' select group of management or highly compensated employees – stricter standard than a HCE dollar limit
 - Facts-and-circumstances determination
- Employer asset ownership – Assets subject to organization's creditor claims
 - Rabbi Trust - funds are subject only to judgment creditors and/or insolvency or bankruptcy creditors

§457 DEFERRED COMPENSATION PLANS

- Two types of §457 plans for tax-exempt. Either qualifies under §457(b) or “falls” under §457(f).
- Eligible §457(b) - Participants are taxed on amounts deferred under a §457(b) plan in the taxable year in which such compensation is paid to the participant or other beneficiary
 - These plans are popular because
 - Deferral of compensation without requiring such amounts to be subject to a substantial risk of forfeiture and
 - Are not subject to requirements of §409A.
 - Contribution employee/employer combined limit of \$16,500 in addition to 403(b) and/or 401(k) plan limits

§457(F) PLANS

- §457(f) – These plans are called “ineligible” plans
- The advantage of a §457(f) plan is that there is no limit on amounts that can be deferred under such plans.
- The downside is that amounts deferred under §457(f) plans are taxable when amounts are no longer subject to a substantial risk of forfeiture (SRF), whether or not such amounts are actually received by the participant.
- Is a SRF if:
 - Entitlement to the compensation is conditioned on the performance of substantial services or
 - The occurrence of a condition related to the purpose of the compensation, and the possibility of forfeiture is substantial.

§457(F) PLANS

- 457(f) plans are subject to 409A - 409A imposes strict requirements on nonqualified deferred compensation, including restrictions as to the:
 - Timing of deferral elections,
 - Limits on distribution events, and
 - Constraints on a participant's ability to accelerate or further delay distribution of deferred amounts.
 - Failure to comply with 409A has serious tax consequences
 - Immediate taxation of amounts sought to be deferred
 - 20% penalty and interest on such amounts
- Note that 409A does not apply to amounts that are deferred and vested on prior to 12/31/2004 so long as the plans are not materially modified after 10/3/2004

§457(F) PLANS

- Substantial risk of forfeiture (SRF) issues:
 - The PV of the amount must be materially greater than the PV of the vested amount the participant otherwise could have elected to receive
 - A noncompetition restriction is generally not a SRF
 - Post-termination consulting agreement depends on the regularity of the performance as well as time spent
 - Elective salary deferrals and bonus deferrals can never be made subject to a SRF beyond the date or time the salary would otherwise have been received

§457(B) PLANS

- §457(b) Plans - much simpler and easier to administer!
- Employee and/or employer can contribute an annual maximum of \$16,500 in 2011 in addition to amounts deferred under §403(b) and/or 401(k) plan
- Special section §457 catch-up - a participant's last 3 years ending before the participant attains normal retirement age, the plan ceiling is an amount not in excess of the lesser of —
 - (A) Twice the dollar amount 2011 \$16,500, or
 - (B) The underutilized limitation

§457(B) PLANS

- (See Appendix 2 for §457(b) plan design information)
- Need a plan document
- No Form 5500/audit - just one time one page Top-hat filing with the DOL – See Appendix 1
- Exempt from the fiduciary responsibility (and most other) provisions of ERISA
- Form W-2 / FICA reporting when amount not subject to SRF
- No discrimination testing
- No determination letter
- Any investment the employer permits can be used for the plan

§457(B) PLANS — PLANS DISTRIBUTIONS

- Distributions — Amounts will not be made available to participants or beneficiaries earlier than
 - The calendar year in which the participant attains age 70 ½
 - Severance from employment
- Other distributions
 - Unforeseeable emergency
 - RMD rules of 401(a)(9)
 - Small in-active accounts
 - QDRO

§457(B) PLANS — PLANS DISTRIBUTIONS

When must a plan commence distributions?

- Amounts deferred under a 457(b) plan will be includible in gross income when made available on or after the participant's severance of employment.
- The participant may elect to defer commencement of distributions under the plan if the election is made after a permissible distribution event has occurred and prior to the time the amounts would be made available.
- An one-time additional election to defer commencement of distributions payable to a participant under the plan will not cause the amounts to be made available provided the election is made before commencement of such distributions.

§457(B) PLANS - RMD

- The minimum distribution rules and regulations provide some latitude in defining the required beginning date.
- Generally if you are not a 5% owner, distributions are required to begin not later than the April 1st following the later of the end of the year in which you reach age 70 1/2 or terminate employment.
- Although the first distribution must be made by the applicable April 1, later payments must be made on or before December 31 of each distribution year.

§457(B) PLANS - UNFORESEEABLE EMERGENCY

- A plan must define an unforeseeable emergency as a severe financial hardship of a participant or beneficiary that results from:
 - An illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent;
 - A loss of the participant's or beneficiary's property "due to" casualty;
 - Other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary.

§457(B) PLANS - UNFORESEEABLE EMERGENCY

- If other conditions are met, an unforeseeable emergency could include:
 - A need to rebuild the participant's or beneficiary's home following damage to it not covered by insurance;
 - An imminent foreclosure on the participant's or beneficiary's primary residence;
 - The participant's or beneficiary's imminent eviction from his or her primary residence;
 - A need to pay medical expenses or for prescription drugs; or
 - A need to pay the funeral expenses of the participant's or beneficiary's spouse or dependent.

§457(B) PLANS - DISTRIBUTIONS OF SMALL AMOUNTS

- A participant may receive an in-service distribution of an account of small amounts up to \$5,000 provided:
 - The participant's total account balance is no more than \$5,000;
 - No amount has been deferred under the plan for the participant during the two-year period that ends on the date of distribution; and
 - The plan paid no prior distribution to which this special rule applied.

APPENDIX 1

Sample Top-Hat Filing

SECTION 457(b) DEFERRED COMPENSATION PLAN

TOP-HAT PLAN DECLARATION

BY THE PLAN ADMINISTRATOR

Address

E.I.N.

The _____, being the Plan Administrator for the _____ Section 457(b) Deferred Compensation Plan (Plan), does hereby declare that the Plan is maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees. In addition, the _____, the employer, maintains only one plan described in Department of Labor Regulations Section 2520.104-23(d). Furthermore, ___ employees are covered under the Plan.

Date: _____

On behalf of Plan Administrator:



APPENDIX 2

§457(b) Plan Design Overview

§457(B) PLAN DESIGN OVERVIEW

<i>Item</i>	<i>Non-Profits</i>
1. Eligible employees	Top-hat group
2. Asset ownership	Employer
3. Employer's creditors	Yes
4. Basic contribution limits ER&EE	\$16,500
5. Increased elective deferrals/§457 catch-up deferrals	Yes
6. Coordination of deferrals	No
7. Age 50 catch-up	No
8. Low-income saver's tax credit	No
9. Section 402(f) notice	No

§457(B) PLAN DESIGN

<i>Item</i>	<i>Non-Profits</i>
10. Constructive receipt rule	Yes
11. Flexible distributions	No*
12. Loans	No
13. QDRO rules	Yes
14. RMD rules	Yes
15. Severance from employment	Yes
16. Tax reporting form	W-2

* Must make irrevocable elections at severance from employment and can make only one additional election of a set future distribution date.

§457(B) PLAN DESIGN

<i>Item</i>	<i>Non-Profits</i>
17. Rollover	No
18. Trustee-to-trustee transfers	Yes
19. Termination of plan	Yes
20. EPCRS	Not yet
21. De minimis payouts	Yes

457(B) OR (F)?

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WHICH PLAN(S) TO IMPLEMENT

- Determine objective of plan
 - Supplemental Retirement
 - Handcuffs
- Determine source and amount of \$\$
 - Employer
 - Employer
 - Combination

GETTING STARTED

- Plan Document
 - Effective date
 - Eligibility
 - Contributions/Benefit
 - Vesting/CAUTION on 457(b)
- DOL Filing
- Deferral Agreement

INVESTMENTS

- 457(b) investments similar to 401(k) or 403(b)
 - Typically participant directed
 - Long time horizon
- 457(f)
 - Typically shorter time horizon
 - Amount of funding may not justify daily record keeping costs
 - Often paid from operating cash flow

ONGOING OPERATION

- 457(b) similar to 401(k) or 403(b)
- 457(f) depends on investment option and who controls