

Nonqualified Deferred Compensation Rules for Tax Exempt Employers Have Changed Dramatically In the Past Year

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INTRODUCTION

- Legal background.
- What has changed?
- What can be done now?

IRC § 457(F)

- Taxable when no longer “subject to a substantial risk of forfeiture”.
- Inside build-up is tax-deferred.

“SUBSTANTIAL RISK OF FORFEITURE”

- Cliff vesting
- Rolling risk of forfeiture
- Non-compete
- Not “readily ascertainable”

IRC § 409(A)

- Rolling risk of forfeiture elections had to push out distribution date at least five years.
- Distribution only upon certain specified circumstances; e.g., stated date, or termination of employment.
- No acceleration of stated payout date.
- Punishment for violation.
 - 20% excise tax.
 - Deferred compensation is includable in income when it is no longer “subject to a substantial risk of forfeiture.”

409A regulations say that the following do not constitute a “substantial risk of forfeiture:”

- Non-compete.
- Rolling risk of forfeiture.
- Not readily ascertainable.

IRS NOTICE 2007-62 (JULY 23, 2007)

- 409A definition of ‘substantial risk of forfeiture’ will be applied to §457(f) plans.
- IRS may apply these rules prospectively.

IRS NOTICE 2007-62 (JULY 23, 2007)

ERISA effectively requires that nonqualified deferred compensation be limited to a “select group of management or highly compensated employees.”

IRS NOTICE 2007-62 (JULY 23, 2007)

- Carefully define your goal
 - Tax deferral?
 - Incentive compensation?
 - Supplemental retirement?
 - Golden handcuffs

MAXIMIZE “QUALIFIED” ARRANGEMENTS

- 401(a) Defined contribution
- 401(a) Defined benefit
- 403(b) or 401(k) Elective deferral
- 457(b)

457(F) PLANS

- Cliff vesting
- Distribution or tax withholding and tax deferred inside build-up after vesting

TAXABLE BONUS PAYMENTS

Taxable bonus payments coupled with employer provided after-tax vehicles

- Annuities
- Life Insurance
- 457(f) Account