

Today's Webinar will begin shortly

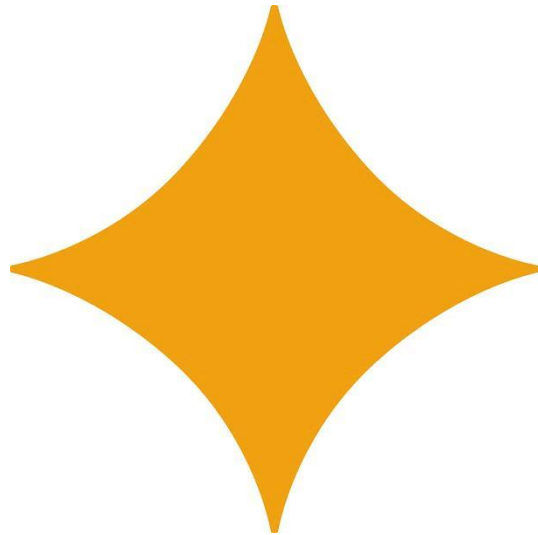
Please register today for our next Trucker Huss Webinar:
Family-Forming Benefit Plans — ERISA and Tax Considerations
Date: November 14, 2023– 9:00 AM PT / 12:00 PM ET

Family-forming benefit plans have grown in popularity among employers. These benefits can be offered in various ways, such as through the expansion of fertility benefits in major medical plans, fertility health reimbursement arrangement (HRAs), adoption assistance plans, and surrogacy plans. We will discuss important ERISA and tax issues that employers should consider when adopting these benefits.

Topics will include:

- Types of family-forming benefits subject to ERISA
- Compliance obligations under the Affordable Care Act (ACA) and the Consolidated Appropriations Act (CAA)
- Federal tax treatment of benefits provided under these plans
- Recent court cases

Deferred Compensation for Tax Exempt Organizations:



Scott E. Galbreath, J.D., LL.M. (Tax)

October 31, 2023

Housekeeping Items

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Introduction

- ♦ Unique Circumstances & Motivation
- ♦ Unique History
- ♦ EOs v. Govs
- ♦ 457(b) v. 457(f)
- ♦ Common Mistakes
- ♦ Excise Taxes



Unique Circumstances-Motivation

- ✦ No deduction needed by Gov or EO
- ✦ Motivation is to provide for retirement for employees
- ✦ And to compete with private sector for good employees
 - > Including Executives
 - > Lack of equity techniques is distinct disadvantage
- ✦ Special Considerations for EOs
 - > Private inurement
 - > Excess Benefit Transactions of (c)(3) or (c)(4)
 - > Code section 4960 21% excise tax
 - On compensation in excess of \$1M
 - Excess parachute payment



Qualified Plan Limits Are Limiting

- ✦ The amount of compensation that can be considered in a qualified plan is limited under Code section 401(a)(17) to \$330,000 in 2023;
- ✦ The amount of elective deferrals into a 401(k)/403(b) plan is limited under Code section 402(g). For 2023:
 - > \$22,500 if under age 50
 - > \$30,000 with catch-up
- ✦ The amount of additions under a DC plan is limited under Code section 415
 - > \$66,000 for 2023

★ TRA'86:

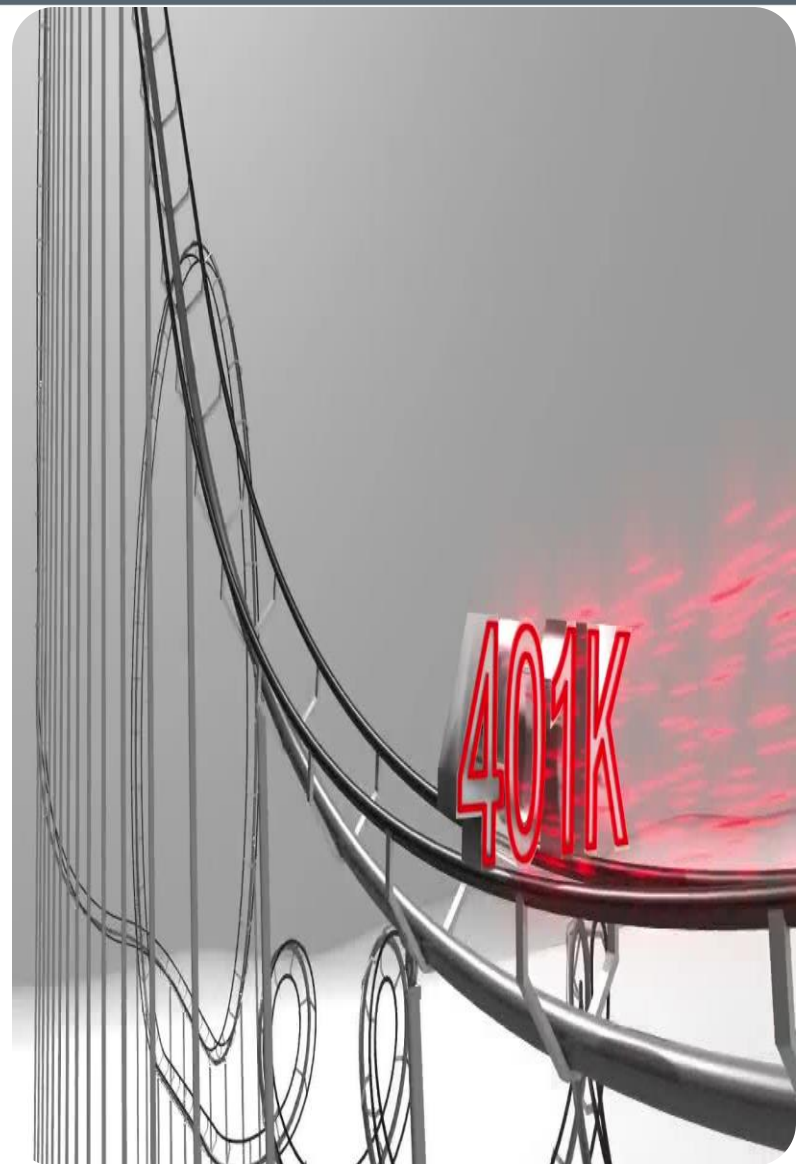
- > Took away 401(k) plans from tax exempt organizations
- > Made Section 457 plans available to tax exempt organizations (not churches)

★ 1996 SBJP Act:

- > Brought back 401(k) plans for EOs (not govs)
- > But had to be coordinated with other elective deferrals 457, 403(b).

★ 2001 EGTTRA:

- > 457 no longer coordinated with other elective deferrals: 403(b), 401(k), SEP or SIMPLE
 - Except when calculating catch-up during last three years before retirement must coordinate deferrals before 1/1/2002



Similarities EOs and Gov 457(b) Plans

★ Technically are not Qualified Plans

- > Not 401(a)
- > No determination letter
- > No pre-approved documents
 - Can seek private letter ruling
 - EOs treated more like nonqualified plan
 - Govs more like qualified plans



★ Written plan requirement

★ No coverage or nondiscrimination testing required

★ Salary reduction or employer contributions permitted

- > But aggregate subject to annual dollar limit (\$22,500 in 2023)
 - Contributions count against limit when vested

★ Both can provide for 3-year catch up

Vesting And Annual Dollar Limit

★ If contributions are vested when made

- > Then the amount deferred is counted for limit in year deferred

★ If not vested when made

- > Then counted when become vested (no longer subject to substantial risk of forfeiture) and must adjust for gain or loss.
- > Ex. Defer \$4,000/yr for last 5 years, not vested until year 5, when total account with gain is worth \$23,000. In year 5 \$23,000 is considered the deferral. \$500 is an excess deferral as it exceeds \$22,500.
 - Must be distributed.

★ Elective deferrals must be vested

3 Year Catch-Up Amount

- ✦ In any of the last 3 years before NRA under plan:
 - > Total contribution is lesser of:
 - 2 X Elective deferral amount (\$45,000 in 2023); or
 - Annual Dollar limit plus the "Underutilization Amount"
- ✦ Underutilization Amount is:
 - > Maximum allowable elective deferrals in prior years minus elective deferrals for prior years actually made
 - Disregarding Age 50 catch-ups if permitted (Gov only)
 - For years prior to 2002 still coordinated with other plans
 - Aggregate contributions count

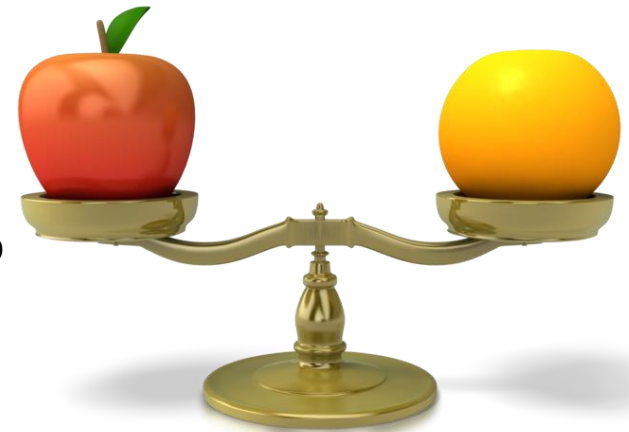
✦ Example:

- > Deferred \$10,000 in each of last 3 years
 - 2020 limit of \$19,500 - \$10,000 = \$9,500
 - 2021 limit of \$19,500 - \$10,000 = \$9,500
 - 2022 limit of \$20,500 - \$10,000 = \$10,500
 - Total Underutilization is \$29,500



Differences EO and Gov 457(b) Plans

- ✦ EOs taxed when paid or otherwise made available
 - > Govs only when paid
- ✦ EOs may permit one additional election to defer distributions
 - > After making initial election
 - > If made before distributions begin
- ✦ Govs are exempt from Title I of ERISA
- ✦ Over last several years Gov 457(b) plans are becoming much more like 401(k) plans
 - > Must have exclusive benefit trust
 - > Automatic enrollment permitted
 - > Can permit participant loans
 - > Elective deferrals can be on Roth basis
 - > In-service distribution after age 59 ½ permitted
 - > Can have Age 50 catch up in addition to last 3 year catch up
 - > Can accept rollovers from 401(k) or 403(b) plan
 - > Can be rolled over into another plan or IRA
 - > Better correction available for Govs
 - > SECURE 2.0 removed first day of month rule for deferrals effective for 2023 tax year





EO 457 Plans and ERISA

- ★ DOL maintains an EO 457 plan is subject to Title I of ERISA
 - > Requires exclusive benefit trust-unless select group
- ★ But 457 says for EO, title to assets must remain sole property of EO
 - > (1998 Act changed for governments but not EOs)
 - > Therefore, EO plan can't have exclusive benefit trust
- ★ Thus, EO cannot cover all employees
 - > Can only cover a select group of management or highly compensated employees (top hat group)
 - Not the Code section 414(q) definition of HCE
 - > Limits usefulness to only executive compensation
 - > Can use a rabbi trust to help secure the benefit

Rabbi Trust

- ✦ Named after first IRS letter ruling approving technique
 - > ER established irrevocable trust designed to hold assets of nonqualified plan for purposes of paying future plan obligations
 - > Trustee can use assets only for 2 purposes:
 - 1. Pay benefits when due under plan
 - 2. Hold for creditors when ER is insolvent
- ✦ Restricts ER from using trust assets for other purposes
 - > Other expenses, expansion
 - > As long as ER is solvent participants will get benefits

FICA Taxes

- ✦ FICA = 6.2% S.S. (up to limit) and 1.45% Hospital Insurance (Medicare)
- ✦ EE withholding and ER match
- ✦ Additional .9% EE withholding only
 - > On EE wages over \$200,000 (\$250,000 joint) for the year
- ✦ Special rules for Nonqualified Deferred Compensation
 - > Special timing rule
 - > Nonduplication rule

Special Timing & Nonduplication Rules

♦ Special timing rule

- > NQDC is taxed on later of services or vesting

♦ Nonduplication Rule

- > If already taken into account under special timing rule
 - Neither contribution nor earnings subject to FICA tax on payment
- > If not, then both contribution and earnings on distribution

FICA Example

- ✦ Ex. EE's 2023 salary is \$200,000 and electively defers \$15,000 to 457(b) plan account where he is 100% vested
 - > Subject to FICA in 2023
 - No additional S.S. but 1.45% Medicare
 - Not .9%
 - > Paid in 2030 when grew to \$30,000
 - > None subject to FICA on payment under nonduplication

Correction of Failures

- ✦ Effect of Failure Gov:
 - > 457(b)(6)-Disqualifying operational failures of gov 457(b) plan will be considered to not meet 457(b) as of the first day of first plan year beginning more than 180 days after the IRS notifies Gov of the failure
 - Unless self-corrected before 1st day of such plan year
- ✦ EO: Ceases to be 457(b) on first day doesn't meet
 - > Code says if fail 457(b) become 457(f)
 - All employees taxed to extent vested
 - Subject to 409A
 - Probably violate 409A
 - Additional election will generally violate
- ✦ Technically no EPCRS
 - > Rev. Proc. 2021-30 for Govs on “provisional basis outside EPCRS”
 - > Closing Agreement not Compliance Statement
 - > Says generally won't enter into agreement for EO 457 plans
 - Unless covering NHCEs and operated like a QP
 - However, closing agreements are not exclusive to EPCRS
- ✦ SECURE 2.0 self-correction of eligible inadvertent failures does not apply

Ineligible Plans: Section 457(f)

- ✦ 457(f)- if aren't eligible plan under 457(b), then taxed when no longer subject to a substantial risk of forfeiture
 - Conditioned upon:
 - Substantial future services, or
 - A condition related to purpose of compensation
 - If can voluntarily quit and get paid, then currently vested
 - Creates phantom income
- ✦ Thus, generally good idea to distribute when vested
 - Principal taxed in year of lapse of risk
 - Investment earnings earned after vesting taxed when received
- > Generally, are subject to Code section 409A

Substantial Risk of Forfeiture

- ♦ Elective deferrals of current compensation
 - > In themselves not a SROF
 - > Proposed Regs
 - If present value at vesting is at least 125% of current compensation then SROF if:
 - Election to defer must be made in writing prior to year earned
 - SROF conditioned on at least 2 years of service
 - For an account balance plan with predetermined earnings rate or interest the present value is the account balance
 - Example- ER makes a 30% matching contribution upon vesting of elective deferrals if EE is still employed after 2 years.

Extension of Vesting Date

- ✦ Same 125% present value rule
- ✦ Can extend the vesting date, to avoid taxation, if:
 - > Written extension signed at least 90 days before original vesting date;
 - > Vesting date is extended for at least 2 years; and
 - > Present value of benefit at end of extended vesting period is 125% of would-be original vested account balance
- ✦ Proposed regulations do not address graded vesting
- ✦ Must be careful, if deferring payment as well due to Section 409A

457(f) Plan Advantages

- ★ No limit on amount
- ★ No required vesting schedule
- ★ EOs can use rabbi trust to help secure benefit
- ★ Can be a useful tool for executive compensation

Code section 409A

★ Requirements:

- > Written document
- > Deferrals and subsequent deferrals
- > Distributions
 - Separation from service
 - Death
 - Disability
 - Change in control
 - Specified date
 - Unforeseeable emergency
- > Prohibits acceleration
- > 6 month delay for termination of Specified Employees
- > If violated:
 - Taxed when no longer subject to forfeiture
 - Plus additional 20% federal tax (CA additional 5% tax)
 - Bonus rate interest from vesting

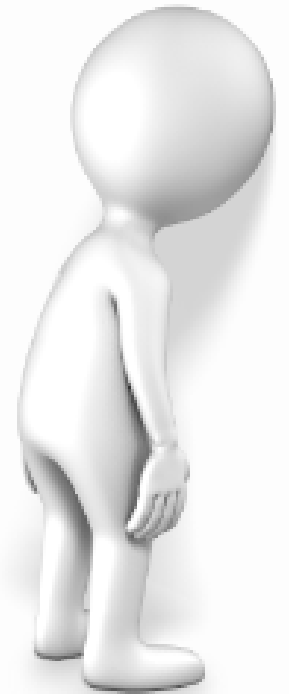


Escaping 409A and 457(f)

- ✦ By Plan design
- ✦ 409A Short-term deferral rule
 - > If paid within the later of:
 - > 2 ½ months after the end of the year in which it vests; or
 - > 2 ½ months after the end of the employer's tax year in which it vests
 - > Not considered deferred compensation
- ✦ Also escapes 457(f)
 - > Taxed when paid

Common Mistakes

- ✦ Confusing Gov plan for EO plan
- ✦ Confusing (b) and (f) plans
- ✦ Including more than the top hat group
- ✦ Monthly elective deferral rule
- ✦ Excess deferrals
- ✦ FICA taxes
- ✦ SROF for 457(f) plan
- ✦ Keeping plan document amended
 - > RMD age increase



4958 Excise Tax on Excess Benefit Transactions

- ★ 501(c)(3) or (4) organizations
- ★ Excess Benefit Transaction
 - > Economic benefit provided
 - > To Disqualified Person
 - > In excess of value paid for it
- ★ 25% excise tax on DQ
- ★ 10% on organization manager who knowingly participates
- ★ 200% on DQ if not timely corrected
 - > By IRS notice of deficiency or assessment of 25% tax

Excessive Compensation

- ✦ Unreasonable compensation paid to an Executive will be an excess benefit transaction
- ✦ Can get rebuttable presumption of reasonableness:
 - ✦ Arrangement approved in advance by authorized body
 - ✦ After obtaining and relying on appropriate data
 - ✦ Document terms, vote, data relied on, and how conflicts of interest were handled
- ✦ Organization Managers get safe harbor from 10% tax
 - > If rely on written opinion of professional as to reasonableness
- ✦ 457(b) and (f) benefits are transactions upon vesting

4960 Excise Tax on Compensation over \$1MM

- ★ 21% tax on EO if pay:
 - > Compensation >\$1MM
 - To a covered employee
 - 5 highest paid in year; or
 - > Excess Parachute Payment
 - Paid on involuntary termination
 - Exceeds 3 times base amount (5-year average compensation)
- ★ 457(b) and (f) benefits count when vested



Conclusion

- ♦ 457 Plans aren't so scary
 - > When drafted and operated correctly
- ♦ Best way to avoid mistakes:
 - > Work with competent legal counsel
 - > All players should understand terms
 - > Check operations periodically



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