Should you consider offering a Nonqualified Deferred Compensation Plan and why?

What is a Nonqualified Plan?

As part of a Total Rewards benefit package, a nonqualified plan is an important offering for your company's Most Valuable Employee group and falls under IRS Code 409A.

For Highly Compensated Employees (HCEs), it can provide tax-deferred wealth accumulation and retirement savings, while addressing issues found within the qualified plan offering.

For employers, it can be a cost-effective tool for recruiting, rewarding, and retaining key talent while aligning employee objectives with organizational goals. ***Better yet, it allows for selectivity in eligibility.***

Benefits of a Plan?

There are four general areas where a plan can benefit both the business and the plan participant.

1. 401K plan is not meeting the needs of your Most Valuable Employees (HCEs)

Example: an HCE making $250,000 who wants to save 20% ($50,000); Due to 401K contribution limits ($19,000 for 2019), this is not possible without an alternative plan made available.

Tax Deferred Savings Goal 20% of $250,000	$50,000
2019 401(k) Contribution Limit	**$19,000**
Nonqualified Contribution to Meet Savings Goal.	**$31,000**

In this example, your Most Valuable Employee is $31,000 shy of his/her desired tax-deferred savings goal. Even if the employee were age 50 or older, they would still be $25,000 shy of the savings goal if using the $6,000 catch-up provision offered by the 401K plan.

2. Your 401K has failed nondiscrimination testing (ADP/ACP tests)

Safe-Harbor plans are an alternative but can be costly to the organization as they must provide contributions to all employees not just HCEs. Furthermore, this does not solve the HCE's need to save their desired amounts beyond the 401k plan limits.

3. Provide additional Incentive Bonus to your Most Valuable Employees

Adding bonus features to a nonqualified plan can help align executive compensation with the company's performance and at the same time preserve cash and equity.

4. You are having trouble recruiting talented C-level executives.

One solution would be to sweeten the offer without resorting to cash or stock options. For example, you can build retention so the HCE is required to remain employed for 5 years or more to reap their benefit. ***This is also known as Golden Handcuffs.***

Planning Considerations

Nonqualified Plans can be powerful and beneficial tools when utilized correctly but may not be appropriate for all business types.

Particularly with a pass-through entity. A plan may still be beneficial in these situations, but careful consideration should be taken to examine the plans impact on the owners' taxes.

Deferred compensation is at risk with a start-up company. Executives are unsecured creditors with respect to the future payout of their deferred compensation accounts. If the long-term viability of the company is a concern, then alternatives to a 409A plan should be considered.

Choosing the right partner is key. At Deferral.com, plan administration is not simply recordkeeping but a commitment to the plan's successful operation. The strength of our firm lies in our experienced professionals and best of class systems.

Call us today and we can help you explore these alternatives.

About Us

Deferral.com, a division of American Financial Systems, Inc. (AFS), is a recognized leader in providing technology solutions and plan services for nonqualified supplemental executive benefit programs.

We work in tandem with plan consultants and advisors to deliver highly effective nonqualified executive benefit programs, which play a key role in an employer's efforts to recruit, retain and reward their most valuable executives.

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