

# Commco Comments

Timely Information Updates for Employers and Retirement Plan Sponsors

## Nonqualified Deferred Compensation Plans

A nonqualified deferred compensation (NQDC) plan is an arrangement between an employer and an employee to defer the receipt of currently earned compensation. While NQDC plans do not have the tax-favored benefits of qualified retirement plans, most NQDC plans do not have to comply with the participation, vesting, funding, distribution, and reporting requirements that apply to qualified plans. This makes NQDC plans a flexible form of employee compensation, allowing you to tailor a plan to both your and your employees' needs.

### Funded vs. Unfunded Plans

NQDC plans fall into two broad categories – funded plans and unfunded plans:

**Funded plans:** An NQDC plan is funded if assets have been irrevocably and unconditionally set aside with a third party for the payment of NQDC plan benefits (for example, in a trust or escrow account) and those assets are beyond the reach of both you and your general creditors. In other words, if participants are guaranteed to receive their benefits under the NQDC plan, the plan is considered funded. Funded plans are generally subject to ERISA requirements, and provide limited opportunity for tax deferral.

**Unfunded plans:** With an unfunded plan, you don't formally set aside assets to pay plan benefits. Instead, you either pay plan benefits out of current cash flow ("pay-as-you-go") or you earmark property to pay plan benefits, with the property remaining part of your general assets, subject to the claims of creditors. Unfunded plans are much more common than funded plans because they provide greater opportunity for tax deferral, and are subject to few ERISA requirements. To avoid ERISA, participation in unfunded NQDC plans generally must be limited to a select group of management or highly compensated employees. Such plans are commonly referred to as "top-hat plans."

### Advantages of NQDC Plans

- Helps attract and retain key employees.
- Can supplement a qualified retirement plan.
- Flexible – can be offered to a select group of employees.
- Unfunded NQDC plans are subject to fewer requirements than qualified retirement plans.
- Unfunded NQDC plans provide opportunity for participants to defer taxes.
- Can provide potentially unlimited benefits.
- Employer controls timing and receipt of employees' benefits.



### Disadvantages of NQDC Plans

- Generally no tax deduction until employees recognize income.
- Unfunded plans provide little security to employees, just a promise to pay future benefits (use of a rabbi trust can protect against "change of heart" or a change in control).

## WIN A \$25 GIFT CARD

to your choice of  
Starbucks or  
Regal Cinemas!

To be entered into the  
drawing, email  
quiz@thecommerce.com  
with the correct answer  
to this question:

Is a "top-hat plan"  
funded or unfunded?



Retirement & Investment Services  
An Independent Registered Investment Advisor

Continued on page 2...



Retirement & Investment Services  
An Independent Registered Investment Advisor

5440 S.W. Westgate Drive, Suite 110  
Portland, OR 97221  
www.thecommmco.com

tel 503 203 8585  
fax 503 203 8590  
toll 800 203 8510

Congratulations to our most recent gift card winner: Elena K. of Northwest Medical Equipment Distributors, Inc.

For answers to previous issues' questions, log on to [thecommmco.com/answers](http://thecommmco.com/answers)

Securities offered through



Continued from page 1...

What do **HRCI Credit and New York Cheesecake with Huckleberry Compote** have in common?

They're both reasons to attend Commerce Concepts, a series of educational events designed for employers, HR professionals, and benefits coordinators!

Visit **our website** to be added to the invitation list.



- Funded plans secure benefits, but are subject to ERISA requirements and offer little tax benefit.
- NQDC plans can benefit employees of partnerships, S corporations, and sole proprietorships, but generally not the owners.
- NQDC plans are subject to the complex requirements of IRC Section 409A

Want to learn more about Nonqualified Deferred Compensation plans that can supplement your existing 401(k)? Visit [www.thecommmco.com](http://www.thecommmco.com) for resources, charts, and other helpful information!

Plan Type	Coverage	Taxation	ERISA	Creditor Protection
Unfunded (and informally funded)	Limited to select group of management or highly compensated employees	Benefits generally taxed when paid	Very limited application	Benefits subject to claims of employer's creditors
Funded	Any employee may be covered	Benefits generally taxed when vested <sup>1</sup>	ERISA applies <sup>2</sup>	Benefits protected from employer's creditors <sup>2</sup>

<sup>1</sup>: See our Secular Trusts and Annuities article at [thecommmco.com/feature-nqdc](http://thecommmco.com/feature-nqdc), for more information.

<sup>2</sup>: Employee secular trusts may not be covered by ERISA. If not, then whether benefits under these plans are protected from the claims of the employer's creditors may depend on state law.

Source: Forefield, Inc.