Section 457(f) Rescue Plan

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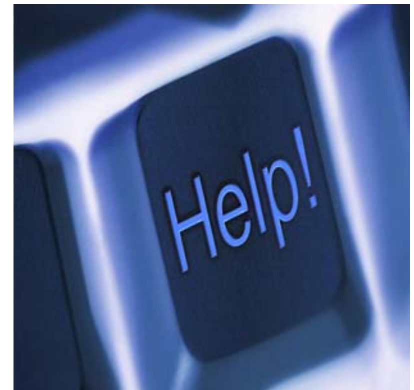
457 RESCUE PLAN

The 457f regulations were promulgated 24 years ago to promote parity for non-profit organizations with respect to deferred compensation plans available to for-profit companies. 457(f) deferral opportunities are unlimited, but there must be a substantial risk of forfeiture in existence for at least 2 years to defer taxation. Most common plans include a vesting schedule, in addition to:

- When there is no longer a substantial risk of forfeiture, the 457(f) deferral is taxable
- Plan must discriminate in favor of select group of management or highly compensated employees
- Plan must give notice of its existence to the Department of Labor
- FICA taxes are due the latter of when services are performed or when there is no substantial risk of forfeiture
- Finally: Plan must be designed in accordance with the new deferred compensation rules under IRC Section 409A which are:

1. Restrictions on the timing of elections to defer compensation
2. Restrictions on when plans can make distributions
3. Restrictions on funding



If a plan does not comply, the executive(s) is subject to significant tax penalties. The consequences of non-compliance include ***cumulative*** post 2004 deferred compensation income (plus earnings) and an additional 20% tax and interest on income taxes as if the deferred compensation had been reported in income rather than deferred in prior years (underpayment rate plus 1%).

The reality is that Sec. 457(f) plans must meet the requirements of ***BOTH*** Sec. 457(f) and Sec. 409A (409A does not change requirements of 457(f)). There are several ***differences*** between Sec. 457(f) and Sec. 409A. Of particular note: "Substantial risk of forfeiture" is defined quite differently under the two sets of rules. You must understand this difference in order to determine whether your Sec. 457(f) plan is subject to the new rules, and if so, how it is affected. For example, some Sec. 457(f) plans allow a rolling risk of forfeiture. But with the Sec. 409A impact the plan can no longer automatically provide for payouts upon the rolling vesting date, because vesting is not a permissible distribution event. Perhaps the most popular covenant is the “non-compete” language. This has also fallen under IRS scrutiny. As currently proposed the elimination of the non-compete provisions will once again subject accumulated savings to immediate taxation in the event of early termination.

If your Sec. 457(f) plan is subject to the new rules, then the plan benefits will be subject to income taxes on the ***EARLIER*** of:

- The date on which the amounts are no longer subject to a substantial risk of forfeiture under the terms of the plan.
- The date on which the plan does not comply with the terms of the new rules under Sec. 409A.

Anticipating the ramifications, advisors have recommended 457f plan document changes that include shortening the vesting date to as little as two years. Many plans have already modified the documents.

Short term cliff vesting is the equivalent to a simple bonus plan

Attempting to solve the early forfeiture riddle by accelerating the vesting schedule destroys the intent of a long-term tax advantaged savings plan. Furthermore, early distribution of employer sponsored funding negates the objective of "golden handcuffs". The regulatory changes effectively limit the value of employer sponsored deferred compensation plans for non-profit organizations.

It is bad enough that under 409A participants must decide how much to defer a year before compensation distribution and then must wait a year before receipt of the funds if the plan is terminated. The additional elimination of "non-compete" language accelerated vesting causing immediate taxation of the total fund even though distribution of proceeds must wait a year. Sec. 409A graciously permits invading the 457f account to pull out the tax money. However, the participant must wait a year before withdrawal of the balance of the fund is permitted. This begs the question why would any organization want to continue operating a deferred compensation plan under these circumstances?

Fact: Many non-profit hospitals have opted to shut down 457f plans going to pure bonus programs.

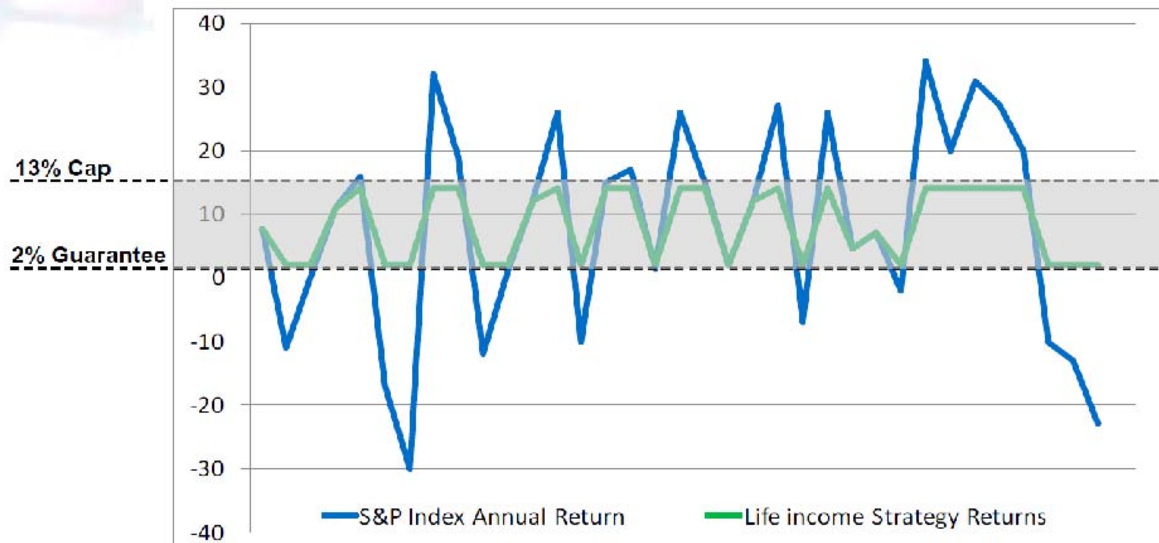
The Effect: Loss of tax advantaged savings component and loss of control of retention incentive.

Is there a viable alternative? Yes!

The Life Income Strategy:

- **New "unlimited" tax advantaged savings program: <u>no contribution limits</u>**
- **Provides equivalent or better tax advantaged savings potential**
- **Zero balance sheet liability**
- **Zero administration and actuarial expense**
- **Unlimited contributions either employer sponsored or personal**
- **Tax-deferred accumulations**
- **Tax-free distributions**
- **Guaranteed minimum return**
- **Automatic tax cost reforestation**
- **Does not require active management**

Life Income Strategy Crediting method:



68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 Year

Represents 34 years of S&P 500 returns

Represents the application of the Life Income Strategy over the same period (never goes negative)

Action Plan

Steps Necessary to Restore Deferred Compensation and "golden handcuffs"

Terminate current 457f plan

A) Do not make current year contribution of employer sponsored funds.
B) Project complete account balance payout.
C) Permit access to tax money for individuals required to pay taxes on account balance (due to elimination of "non-compete" languages if it is necessary).
D) Determine each participant's approximate payout in advance.

Life Income Strategy Orientation

Establish a series of Life Income Strategy orientation presentations. Explain that employer contributions will be subject to a REBA if the employee has not met current vesting requirements.

A. Participation in the REBA (Restricted Executive Benefit Agreement) is mandatory for non-vested participants…otherwise contributions will be suspended.

B. Voluntary contributions are unlimited.

C. Participants can avail themselves of an opportunity to restore lost taxes paid on early annual plan distributions.

SUMMARY

The Life Income Strategy is a powerful, yet simple alternative to employer sponsored government regulated and restricted tax advantaged savings plans.

The elimination of employer responsibility and liability as well as administration and balance sheet expense is a very positive action.

Individual control of the retirement fund no longer subjected to employer creditors provides comfort to participants. Significant program advantages encourage greater personal participation. The Life Income Strategy provides todays investment market downside protection compared to current mutual funds that have suffered through two major economic downturns.

The Life Income Strategy demonstrates a very high probability of excellent long-term consistent results. The Life Income Strategy is unique in that it restores lost personal tax cost, grows tax deferred, pays lifetime income tax-free and ultimately provides a substantial inheritance to the heirs of the program participant.

Note: The Life Income Strategy is also an excellent alternative to 457b plans. Monies accruing in mutual funds are subject to the same financial market pressures plus the personal deferrals are subject to employer creditor claims. 457b plans funded by mutual fund companies have been around for so long they are accepted as the norm. That is because there simply weren't any alternatives. The Life Income Strategy also permits unlimited contributions and does not require active management…no more dartboards.