GuideStone®

457(f)

Deferred Compensation Plan Administration Manual

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This information should not be considered tax or legal advice. GuideStone stands ready to assist your organization as you work with your legal and tax advisors by providing resource information that you and your advisor may find beneficial.

DEFERRED COMPENSATION PLANS

This manual will address 457(f) deferred compensation plans offered by non-qualified church-controlled organizations (NQCCOs) such as hospitals, universities, etc., that are exempt from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and top-hat plans of tax-exempt employers subject to ERISA.*

PURPOSE OF MANUAL

GuideStone Financial Resources of the Southern Baptist Convention® (GuideStone®) has prepared this manual to provide plan administrators an overview of non-qualified deferred compensation (NQDC) arrangements and to help plan administrators better understand the intricacies of these types of arrangements. While we attempted to cover important points, there are many nuances in the regulations governing these plans, and it is impossible to cover every scenario. We recommend that you routinely review your plan to see if you are administering it accordingly. We also recommend that you consult your legal counsel regarding the operation and maintenance of the plan.

All employees of the employer involved in administering the NQDC arrangements should read through the *Basic Plan Document* and the employer's *Adoption Agreement* as well as any other documents related to plan provisions (such as policies or procedures). These documents are the key to proper administration of the employer's NQDC arrangement with GuideStone.

Failure to administer the plan properly could result in significant penalties for the participant.

*Note: For employers subject to ERISA, this manual will address only the top-hat exception to ERISA for non-qualified plans.

OVERVIEW OF 409A AND 457(f)

409A

Internal Revenue Code Section (Code section) 409A applies to NQDC arrangements. The IRS broadly defines compensation as deferred if the participant has a legally binding right during a taxable year to compensation that will be paid in a later taxable year. Deferred compensation is not restricted to plan contributions and therefore can include other arrangements like separation pay or incentive pay.

Thus, unless an exception applies, Code section 409A applies to NQDC plans of NQCCOs in addition to Code section 457(f). Balancing these dual requirements, 409A and 457(f), can be complex.

These regulations specifically exclude certain arrangements:

- 403(b) plans and 401(k) plans
- Non-taxable benefits
- Vacation, sick leave and disability pay
- 457(b) arrangements
- **Short-term deferrals (This is the exception most often used by NQCCOs and also by other tax- exempt employers whose plans are subject to ERISA.)**
- Grandfathered deferred compensation plans — non-qualified plans that existed prior to the effective date of Code section 409A (i.e., vested contributions prior to 2005). Because the accumulations had to be vested prior to 2005, very few 457(f) plans qualify as grandfathered deferred compensation plans.

Code section 409A makes all NQDC taxable in the year deferred unless it meets either of the following criteria:

- Subject to a Substantial Risk of Forfeiture (SRF)
- Meets the requirements set out in 409A

Code section 409A does not limit the amount of compensation that the employer or participant can defer or who can be included in the arrangements. Nor does it require participation, vesting or nondiscrimination standards as are found in retirement plans.*

*Note: For employers subject to ERISA, top-hat plans must limit participation to a “select group of management or highly compensated employees.” The Department of Labor (DOL) has not provided significant guidance on what constitutes a “select group of management or highly compensated employees.”

OVERVIEW OF 409A AND 457(f)

(CONTINUED)

457(f)

Code section 457 applies to NQDC plans established by state and local government and tax-exempt employers other than churches or qualified church-controlled organizations (QCCOs). Two types of NQDC plans are subject to Code section 457: (1) an eligible 457(b) plan (covered in another manual) and (2) an ineligible 457(f) plan. Both of these types of plans are NOT available to a church or a QCCO.

Compensation deferred under a NQDC plan subject to 457(f) is included in the gross income of the participant or beneficiary for the first taxable year in which there is no SRF of the rights to such compensation. Thus, a key component in 457(f) deferred compensation plans is the design of the SRF.

IRS rules provide that the rights of a person to compensation are subject to a SRF if such person's rights to such compensation are conditioned upon the future performance of substantial services by the individual. Any amount deferred under a 457(f) plan that is not subject to a SRF (i.e., a vested amount) is included in current gross income (even if not actually received). Several IRS private letter rulings (PLRs), which apply only to the taxpayer requesting the PLR, provide that at least two years of service after the plan is put in place are required in order for future services to be considered "substantial." In addition, in proposed 457 regulations, the IRS indicated that in some instances the period for which substantial services must be performed may not be less than two years. Most practitioners have adopted this two-year standard.

As mentioned above, 409A also applies to **all** ineligible NQDC plans regardless of the employer's tax status. 409A applies to ineligible NQDC plans to which 457(f) applies, separately and in addition to the requirements applicable to such plans under 457(f).

In 2007, the IRS announced it anticipated issuing guidance regarding a SRF for purposes of 457(f) under rules similar to those set forth under 409A; however, late in 2016 the IRS released proposed regulations that are far more liberal than originally indicated.

The proposed regulations provide that an amount is generally subject to a SRF only if the entitlement to that amount is conditioned on the future performance of substantial services or upon the occurrence of a condition that is related to the purpose of the compensation (e.g., organizational goal). Whether an amount is conditioned on the future performance of substantial services is based on all of the relevant facts and circumstances, such as whether the hours required to be performed during the relevant period are substantial in relation to the amount of compensation. In other words, if an employee is required to work 20 hours a week for two years in order to receive $2,000,000, the service may not be substantial in relation to the amount of compensation. A SRF exists based on a condition related to the purpose of the compensation only if the likelihood that the forfeiture event will occur is substantial. For instance, if a university president is asked to increase enrollment by 20 percent over the next five years or the compensation in the 457(f) plan will be forfeited, and enrollment is routinely growing by 10 percent a year, the likelihood of forfeiture is probably not substantial.

SHORT-TERM DEFERRALS

Short-term deferral arrangements are an important exception to 409A.* Under a short-term deferral arrangement, the amount deferred must generally be received and/or taxed within two and one-half (2.5) months following the end of the calendar year in which the legally binding right to the compensation arises (i.e., the date the participant is assured of payment of the dollars) or within two and one-half (2.5) months following the end of the year in which the participant's SRF lapses. In this case, SRF must be defined as required in the regulations.

Most short-term deferral arrangements are established with a SRF requiring the participant to remain employed through a period of time that is at least 24 months from the date the arrangement is established. Under a short-term deferral arrangement subject to 457(f), there is generally no opportunity to defer, that is, no opportunity to delay the date of payment or taxation.

If the participant fails to satisfy the requirements of the SRF and the funds were notionally set aside for the participant in the plan, the participant has forfeited the right to obtain the money, and the funds will remain in the plan to fund future participants' arrangements or for plan expenses.

Upon establishing a short-term deferral plan with GuideStone, we will provide you with a *Basic Plan Document*, *Trust Agreement* (rabbi trust) and an enrollment form that you will need to put the arrangements in writing. The *Basic Plan Document* encompasses the foundational provisions. In addition to this document, a separate document or exhibit will need to be maintained to list who is eligible to participate in the plan, and another document will set forth the SRF, which documents the requirements to be met in order for each participant to receive the funds. The enrollment form will indicate the amount of employer contributions that will be remitted to the plan and how the employee wants those contributions invested. Contact your relationship manager if you have any questions about how to complete the forms.

As a plan sponsor, it is your responsibility to keep all documents related to the plan since its inception, including any resolutions, exhibits and forms. You should verify that your files contain all current and historical plan documents. GuideStone reserves the right to retain only an electronic copy of the plan documents for a reasonable period of time as determined by GuideStone in its policies and procedures and to destroy or otherwise dispose of any original documents or other materials related to the plan.

A rabbi trust is an optional document that may offer some level of security to the employee with respect to his or her non-qualified benefits. Under the rabbi trust, the funds are reachable by the employer's creditors in the event of the employer's bankruptcy or insolvency. Thus, the rabbi trust will protect an employee's investments from the employer's reach in most cases. However, if insolvency or bankruptcy occurs, the plan participants stand in line with other employer creditors. The IRS has ruled that the establishment of a rabbi trust would not in itself cause an NQDC plan to be considered funded for tax purposes, since NQDC plan assets are subject to the claims of creditors and are not set aside solely for the benefit of participants.

*Note: To qualify for this exception to 409A, the SRF should not apply to only participant deferrals or include a covenant not to compete. Either of these will require the plan to follow the 409A requirements.

ADMINISTRATION OF 457(f) SHORT-TERM DEFERRAL PLANS

1| Prior to enrolling participants in the plan

A. Your *Basic Plan Document* directs you to refer to a separate exhibit or document where you indicate by name or category of employee who is eligible to participate. It will be necessary to update the exhibit or document if a new participant or category of employee is added or becomes ineligible to participate.

B. Complete the appropriate enrollment form and Substantial Risk of Forfeiture exhibit. (GuideStone can provide you with a sample exhibit on which to document a SRF. These forms:

- Communicate enrollment information and SRF requirements
- Assist in the communication of contribution expectations between the employer and GuideStone
- Allow the participant to make an investment election and document the SRF, which is a key requirement in these plans

Note: For employers subject to ERISA, top-hat plans must limit participation to a "select group of management or highly compensated employees." The DOL has not provided significant guidance on what constitutes a "select group of management or highly compensated employees." Employers with a top-hat plan should consult with legal counsel regarding what constitutes a "select group of management or highly compensated employees."

2| Remitting employer contributions

Below is something you need to know regarding remitting contributions to GuideStone:

- Remit contributions according to the timing referenced on the enrollment form, if you chose to fund the plan up front. (You may choose to fund the plan only when the SRF lapses, but most employers set aside funds in the rabbi trust to fulfill their commitment to the participant.)

3| SRF

You should promptly notify GuideStone when the participant meets or fails to meet the SRF requirement. A failure to make a timely payment is an operational failure that can result in significant penalties and taxes and even subject the plan to Code section 409A, resulting in additional penalties and taxes.

A. Lapse of SRF:

Once the participant has met the SRF requirements, the employer must complete a *Notice of Triggering Event* form and send it to GuideStone. This form instructs GuideStone to distribute to the employer the funds that were set aside in the short-term deferral plan. The employer will then distribute the funds to the participant less any applicable taxes. The employer should report the distribution on a *Form W-2* for the appropriate tax year (i.e., generally the year of the payment).

B. Failure to meet SRF:

If the participant fails to meet the SRF requirements, then the employer must complete a *Notice of Forfeiture* form and send it to GuideStone. This form instructs GuideStone to pull the funds that were set aside in the short-term deferral plan and use them for future deferrals for other participants or to pay plan expenses.

Forfeited dollars will be returned to the employer if there are no longer any participants who are due payment under the plan.

Important: It is especially important that plans with vesting schedules notify GuideStone promptly when a participant terminates so GuideStone may remove non-vested amounts from participant accounts. Not doing so can mislead participants regarding the value of their account.

4| Employer changes*

Notify GuideStone immediately of changes or possibilities of changes in the following:

- 501(c)(3) status
- Ability to offer a church plan (i.e., level of control or association with a church or a convention or association of churches)
- Organizational or corporate structure
- Employer name

*Note: If your organization is no longer able to offer a church plan and therefore becomes subject to ERISA, the employer must redesign the non-qualified plan in order to be exempt from ERISA. Contact your relationship manager to discuss your NQDC plan options. If your organization's funding sources change to include a significantly lower ratio of funding from government sources or from goods and services offered to the general public, you may have other deferred compensation options available. Contact your relationship manager to discuss your situation.

Changes in any of the above can impact your plan or plans of related employers or other entities. Organizational or structural changes can include mergers, acquisitions, spin-offs, etc. Such changes frequently require plan amendments and can affect the administration of the plan. You may need to submit a new *Status Certification Form* and *Church Plan Eligibility Form* in the event of any organizational changes so GuideStone will be informed of possible impacts to your plan. Additionally, newly related organizations that wish to participate in your plan may need to submit other information so GuideStone can determine their eligibility to participate.

In addition, your plan permits a distribution on a Change of Control as defined in the *Basic Plan Document*, which results in a taxation and a distribution event.

If you undergo a reorganization or restructuring, you should contact your relationship manager at GuideStone for more information.

5| General administrative responsibilities

Both the employer and the recordkeeper/trustee of a plan have administrative responsibilities. The *Recordkeeping Services Agreement* addresses specific administrative responsibilities of the employer and GuideStone that involve plan administration.

6| Employer responsibilities

Some examples of plan administration activities associated with these duties include, but are not limited to, the following:

- Explaining the plan to eligible participants and answering their questions about the plan
- Having participants complete Deferral Agreement forms and sending a copy of the completed forms to GuideStone

- Maintaining documentation of the SRF
- Withholding employment taxes at the appropriate time (generally when amounts vest)
- Verifying and adjusting contribution amounts
- Notifying GuideStone promptly in the event of a participant's death, disability, lapse of SRF or failure to meet SRF
- Responding to requests for information from GuideStone about the plan or participants
- Keeping plan practices consistent with plan provisions and making timely amendments
- Notifying GuideStone prior to the date any amounts vest or a SRF lapses. (If notification cannot be completed prior to the date, you must notify GuideStone within 10 days following the lapse or vesting date.)
- Top-hat plans only: Filing a one-time notice with the DOL that the plan is exempt from ERISA reporting within 120 days of plan establishment

7| GuideStone services

Some examples of plan administration activities associated with these duties include, but are not limited to, the following:

- Establishing participant accounts
- Placing contributions in plan funds, as directed
- Preparing and distributing quarterly accounting statements to participants and employers
- Preparing and distributing written information for participants, participants' spouses, beneficiaries and their attorneys in the event of death or bankruptcy
- Establishing procedures to administer distribution of participants' accounts (including in the event of death or divorce)
- Making administrative rules in accordance with the plan

8| Distributions

You must notify GuideStone prior to the date any amounts vest or a SRF lapses. If notification cannot be made prior to the date, you must notify GuideStone within 10 days following the lapse or vesting date.

GuideStone will not track payment events. If timely payments are not made, the participant may face penalties. (See the "Consequences of violation" section of this manual.)

Upon notification that the SRF has been met, a single-sum payment will be distributed to the employer. The employer will then distribute it to the participant, taking into account any applicable taxes and generating the appropriate reporting such as the *Form W-2*.

If the SRF has not been met, the amount designated to the participant will be removed from their account and remain in the rabbi trust to be used for future deferrals or plan expenses.

9| Withholding and reporting

The following is general information regarding the taxation of NQDC arrangements. More information can be found on the IRS's website at *irs.gov/businesses/corporations/nonqualified-deferred-compensation-audit-techniques-guide*. While GuideStone cannot provide tax or legal advice, GuideStone is pleased to provide this information as a resource for your organization's NQDC plan. You should consult with your Payroll department or benefit counsel for more information and for the specific taxation rules applicable to your plans and organization. In addition, participants are urged to seek counsel from their own tax advisors regarding these complicated issues.

A. FICA

NQDC amounts are taken into account for FICA tax purposes at the later of when the services are performed or when there is no SRF with respect to the employee's right to receive the deferred amounts in a later calendar year. Thus, FICA taxes are due upon the lapse of the SRF or vesting event.

- If the employee is required to perform future services in order to have a vested right to the future payment (which is true in all short-term deferral plans), the deferred amount (plus earnings up to the date of vesting) is subject to FICA taxes when all the required services have been performed (i.e., when the SRF has lapsed).

- FICA taxes apply up to the annual wage base ($137,700 for 2020 and $142,800 for 2021, which may adjust annually) for Social Security taxes **and without limitations for Medicare taxes.**

B. SECA

- Income tax and self-employment (SECA) taxes generally apply at the time of distribution. A special rule allows retirement benefits received by a minister from a church plan after the minister retires not to be subject to SECA taxes. Ministers should consult a tax advisor regarding reporting distributions.

C. Non-duplication rule

Once contributions are taken into account for FICA as described above (i.e., at the later of (1) a lapse of SRF, which includes at vesting, or (2) when the services are performed), the non-duplication rule in the regulations provides that the earnings on the contributions are not subject to FICA. However, if the earnings are not reasonable, the non-duplication rule does not apply. In general, if the earnings are based on actual earnings on an investment, such as a mutual fund, the earnings will not be considered unreasonable.

D. Income tax withholding

When amounts become taxable at the lapse of the SRF, the employer should report the amount as includable income on the *Form W-2* for participants for the year of the payment (GuideStone will prepare the *1099- MISC* for beneficiaries). Employers should report the income for FICA. Employees subject to SECA should check with their tax advisor regarding the proper reporting.

Employers are required to withhold income taxes at the supplemental wages tax rate from NQDC amounts subject to 457(f) at the time the SRF lapses (see IRS Publication 15).

E. *Forms 990* and *990T*

Employers should consult with their benefit or tax counsel regarding whether any reporting on *Form 990* is required.

F. Special reporting for ERISA employers

Employers who are subject to ERISA, but who file a notice with the DOL within 120 days of the plan's inception, are exempt from ERISA's annual *Form 5500* reporting requirements.

10 | Consequences of violation

As explained above, in plans subject to Code section 457(f), generally, amounts must be taken into compensation for purposes of income tax and employment tax when the SRF lapses. A failure to take amounts into taxation in the appropriate year may subject amounts to underpayment penalties. In addition, such a failure to take the amount into taxation in time may cause amounts to be subject to Code section 409A. Code section 409A has harsh tax penalties for non-compliance. The IRS imposes penalties on the participant, and employment taxes may be due from the employer. This fact makes it imperative that both the employer and the participant understand the plan and the requirements of 409A.

A. Violations

While there are no specific documentation requirements for plans using the short-term deferral exception, if the plan were to become subject to 409A, violations may be due to the plan documents not being in compliance (documentation failure) or because certain actions violated both the plan and Code section 409A (operational failure). In either case, the participant will be responsible for the penalties, although the employer may be responsible for certain employment tax issues. GuideStone will work with you to provide compliant documents.

B. Taxes and penalties

In the case of violation of Code section 409A, the penalties could include:

- Taxation — Immediate taxation for the amount of the deferred compensation in question that fully vested to the participant. May require filing amended tax returns (possibly both state and federal).
- Penalty — An additional 20 percent penalty tax on the deferred compensation in question.
- Interest — Underpayment interest penalties plus 1 percent for each year in which there was an underpayment.

C. Application of the penalties

Penalties will be applied differently depending on the type of violation. For documentation failures, all participants will be affected. For operational failures, only the participant(s) involved will be penalized.

This information should not be considered tax or legal advice. GuideStone stands ready to assist your organization as you work with your legal and tax advisors by providing resource information that you and your advisor may find beneficial.

ANNUAL CHECKLIST FOR 457(f) PLAN SPONSORS

Sponsoring a 457(f) plan is a good way to supplement retirement savings for your employees. As a sponsor of a 457(f) plan through GuideStone, you should be aware of the following important operational aspects of sponsoring this type of plan:

Plan administration

- ☐ The plan must be operated in accordance with the terms of the 457(f) plan document. It is the plan sponsor's responsibility to ensure that the plan is operated under these terms until a prospective change is made to the terms of the plan and/or the internal policies and procedures (such as eligibility and contributions).
- ☐ Everyone involved in the day-to-day operation of the 457(f) plan should read the *Deferred Compensation Plan Administration Manual – 457(f)* and know how the plan should be operated.
- ☐ Failure to operate the plan in compliance with its terms may subject participants to immediate taxation and penalties.

Eligibility to participate

- ☐ Review your eligibility schedule (contained in a separate document or in your internal policies and procedures) to ensure the names, positions or categories of employees are current. Be sure to delete outdated information.

Document SRF

- ☐ Ensure you have a documented SRF.

Notification of satisfaction of SRF

- ☐ Immediately notify GuideStone of any participant satisfying his/her SRF. (This will ensure timely distributions to participants and assist you in reporting applicable employment and federal income taxes in the correct tax year.)

Tax withholding and reporting

- ☐ At the lapse of the SRF, withhold for both federal income tax (at the supplemental wage rate) and FICA and report on *Form W-2*. SECA employees should consult a tax advisor regarding proper reporting and can reference *Nonqualified Deferred Compensation Plan Special Tax Consequences.* (See the instructions for IRS *Form W-2* and IRS *Publication 15* for more information.)

The above list is not intended to be an all-encompassing list of items you must monitor as part of your fiduciary responsibility. This information should not be considered tax or legal advice. GuideStone stands ready to assist your organization as you work with your legal and tax advisors by providing resource information that you and your advisor may find beneficial.

APPENDIX — FORMS

1. *Notice of Triggering Event — Group*
2. *Notice of Triggering Event — Individual*
3. *Notice of Forfeiture*

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