Neutralizing 401(k) Refunds:
A Nonqualified Solution

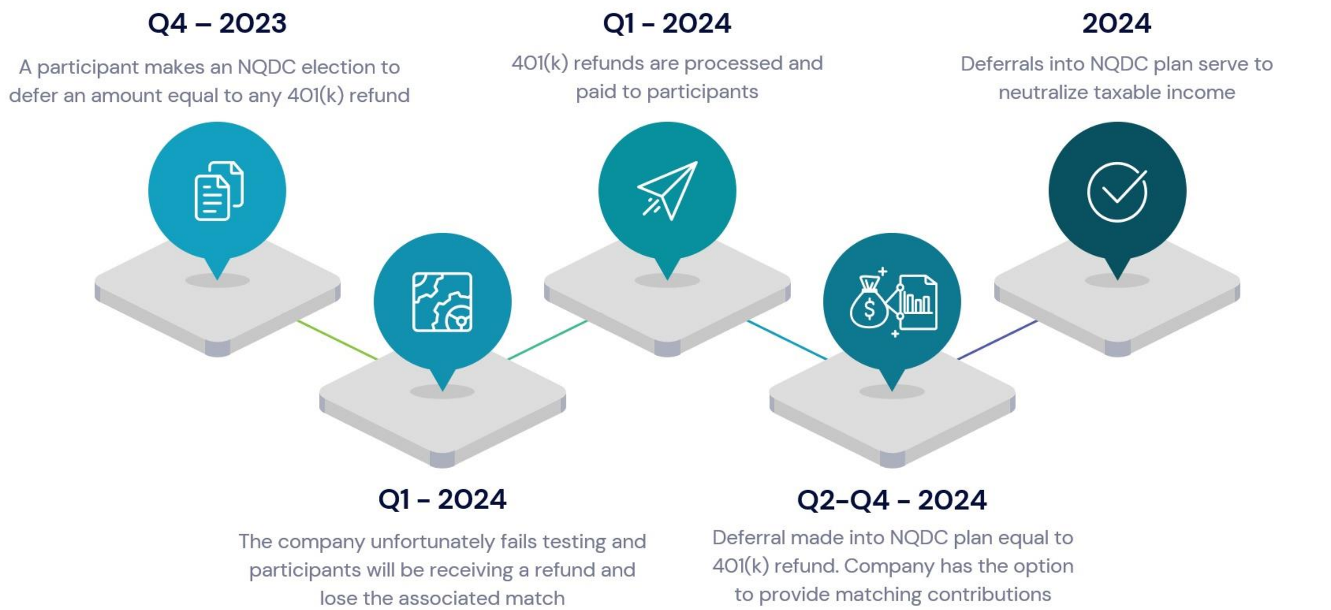
The Cause and Effects of 401(k) Refunds:

The Employee Retirement Income Security Act (ERISA) established two types of annual nondiscrimination tests that all 401(k) plans must pass to keep their qualified status. If the results of either test shows that deferrals from highly compensated employees (HCEs) are disproportionately high in relation to non-highly compensated employees (NHCEs), the plan fails the tests. To remedy this failure, an employer can refund the excess contributions to the HCEs. These refunds create two issues for participating employees:

1. Refund becomes an immediate, unplanned taxable event
2. Loss of potential match associated with the lost deferral into the 401(k)

The NQDC Solution:

An NQDC plan can be designed, or an existing plan amended, to allow eligible participants to defer salary equal to the refund. This “401(k) offset” deferral creates a tax neutral event in the year the refund occurs. Also, if the NQDC offers a matching contribution, the offset deferral could make up for, in part or in whole, lost matching contributions from the refunded 401(k) deferral. Additionally, the election could be made independent of other deferrals and can be as simple as checking a box during the annual enrollment.



If you have questions regarding nonqualified deferred compensation plans, please reach out to Michael Nolan, NolanM@nolanfinancial.com, or Kenton Quick, QuickK@nolanfinancial.com, or by phone at (888) 886-9128.