



## Individual Life Insurance

Nonqualified Deferred Compensation (NQDC)

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Minnesota Life Insurance Company  
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Nonqualified Deferred Compensation (NQDC)

# Foreword to counsel and specimen documents



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The foreword to counsel will provide a limited discussion about the tax and legal aspects relative to three NQDC plans: nonqualified executive deferral plans, nonqualified deferred bonus plans and nonqualified salary continuation plans. For a complete analysis that applies to a specific employer and individual, both tax and legal advice must be sought through a licensed and experienced attorney.

# Introduction

Nonqualified Deferred Compensation (NQDC) is an executive compensation strategy that provides executives<sup>1</sup> with a promise to pay benefits sometime in the future, while reducing their current taxable income. NQDC is effective when the company offers a qualified plan, such as a 401(k), and executives are limited in their qualified plan contributions. NQDC also allows for golden handcuffs – letting the company recover costs if the executive leaves before a particular date. It also allows companies to pick and choose which executives to offer a NQDC plan to.

## Structure

NQDC plans may be divided into two basic forms – nonqualified defined contribution plans and nonqualified defined benefit plans.

### Nonqualified defined contribution plan

A nonqualified defined contribution plan can be divided into two primary categories. These two primary categories are distinguished by the type of deferral that has been offered by the employer and selected by the executive. The executive might have the opportunity to defer his or her **salary** or to defer his or her **bonus** in order to reduce current income taxation.

When the employer has agreed to allow the executive to **defer his or her own salary**, the nonqualified defined contribution plan is referred to as a salary reduction plan, salary deferral plan or nonqualified executive deferral plan. In this **foreword to counsel and specimen documents** it is referred to as a ***nonqualified executive deferral plan***.

In contrast to the nonqualified executive deferral plan, the employer may have agreed to allow the executive to **defer a bonus** that the employer has offered to the executive. It is then referred to as a nonqualified deferred bonus plan or a bonus deferral plan. In this **foreword to counsel and specimen documents** it is referred to as a ***nonqualified deferred bonus plan***.

Additionally, a hybrid type of nonqualified defined contribution plan may also be implemented. The ***hybrid*** type allows **both executive salary deferrals and employer contributions** in the form of a bonus or a matching component.

In a nonqualified defined contribution plan, **the employee may be able to choose from various investment options, which will determine the rate at which these deferrals grow. The risk of how fast these deferrals grow is determine by the choices the employee makes.**

1. The term “executive” is used to specifically refer to highly compensated employees or management. Only highly compensated employees or management may participate in a NQDC plan arrangement. Please see the ERISA Application.

# Introduction section continued

## Nonqualified defined benefit plan

The nonqualified defined benefit plan is typically referred to as a salary continuation plan. In this **foreword to counsel and specimen documents** it is referred to as a **salary continuation plan**. This type of arrangement is structured so that the **employer promises to pay the executive** additional or supplementary compensation at a future time, for example, at the executive's retirement. The promise to pay may be a specific amount for a number of years, or it may be based on a formula that might be based on the executive's compensation and/or years of service. In contrast to the nonqualified defined contribution plan, the executive does not defer any salary or bonus into the salary continuation plan.

In a nonqualified defined benefit plan/salary continuation plan, **the employer is responsible for ensuring any assets used to back the promise to pay are able to provide the needed funds. If the assets are not able to cover the promise, the employer will need to make up the difference.**<sup>2</sup>

2. Because the employer is solely responsible for meeting the future payments of a salary continuation plan, the employer must plan that its assets grow sufficiently in order to provide an income stream that allows the employer to meet its future NQDC payments.

# Plan design

Virtually any type of business may establish a NQDC plan.<sup>3</sup> However, the specific tax characteristics of the organization must be considered. When a C corporation is involved, any highly compensated employee or management will be a potential candidate for a NQDC plan. These candidates may include both **owners** of the C corporation and **non-owners**, although owners receive a much lower income tax benefit. In contrast, for a flow through entity, **owners** of the entity are not good candidates. Partners in a partnership, employee-shareholders of an S corporation, members of a Limited Liability Company (LLC) and joint ventures will generally not gain any tax advantage through a nonqualified plan because income is taxed to that individual when received by the entity.

However, these plans may be effective for attracting, retaining, and rewarding executives who have no ownership interest. Additionally, a nonqualified plan may be established for various other individuals with characteristics similar to the executive type, such as independent contractors or outside directors.<sup>4</sup>

Certain businesses are more suitable for a NQDC plan. The executive will have more confidence in the plan if it is likely that the business may be in existence at the time that the promise must be fulfilled. Therefore, the business should possess the resources to continue into the future, including adequate funds for continued operations and to meet its NQDC obligations.

The NQDC plan must meet certain requirements imposed by the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC). Meeting these requirements accomplishes two critical objectives:

1. Relieves burdensome ERISA requirements for the employer.
2. Defers income taxation to the executive.

ERISA requirements must be met in order to allow the employer to avoid burdensome funding, vesting, and nondiscrimination procedures. The requirements imposed by the IRC must be met in order to defer income taxation to the executive.

3. See Rev. Rul. 60-31, 1960-1 C.B. 174, as modified by Rev. Rul. 70-435, 1970-2 C.B. 100.

4. See Rev. Rul. 60-31, 1960-1 C.B. 174, Case 3. See Rev. Rul. 60-31, 1960-1 C.B. 174, Case 3

# ERISA application

## Introduction

NQDC plans can accommodate many objectives. However, there are certain design parameters that must be observed to avoid burdensome ERISA requirements. Most NQDC plans can avoid a significant portion of the ERISA requirements imposed on qualified plans. NQDC plans need to meet one of three available exemptions:

- Government or church plan;<sup>5</sup>
- Excess benefit plan;<sup>6</sup> or
- Top hat plan.<sup>7</sup>

Typically, a NQDC plan must qualify for the top hat plan exemption, to avoid burdensome ERISA requirements. The **foreword to counsel** will focus on NQDC plans designed to meet the top hat plan exemption. To meet this exemption, the plan must meet both the select group and unfunded requirements. The select group of executives the employer chooses to participate in the nonqualified plan is known as the top hat group. Therefore, NQDC plans that meet this exemption are commonly known as top hat plans.

The **foreword to counsel** will primarily refer to the select group of executives who participate in the NQDC plan as participants. However, the general group that comprises the select group, **before** any participation in the NQDC plan is determined, will generally be referred to as executives.

Selecting a top hat group requires careful consideration. Executives in a top hat group are typically upper management employees who impact the profitability of the company. The top hat group may also consist of executives who are characterized as highly compensated employees.

In order to meet the top hat plan exemption, the plan must meet two primary requirements.

1. The NQDC plan must be implemented “primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.”
2. The NQDC plan must meet the unfunded requirements.

## Select group requirement

To qualify for the top hat exemption, the plan must be established and maintained by the employer primarily for the purpose of providing compensation to a select group of management or highly compensated employees.<sup>8</sup> The U.S. Department of Labor (DOL) proposed to define this term, “select group.” However, no regulations have been issued. One Internal Revenue Service (IRS) advisory opinion provides some direction, but ultimately cannot be used as authority. It suggests that a select group be comprised of a highly paid minority of the entire active workforce, as measured by a fixed minimum compensation amount.<sup>9</sup>

### a. Percentage limitations

It is critical to identify the number of executives who may be included in the select group eligible for participation in the NQDC plan. Therefore, the number of executives who were offered the NQDC plan must be compared to the total number of employees.

5. ERISA § 4(b)(1), 29 U.S.C. § 1003(b)(1), (2).

6. ERISA § 4(b)(5), 29 U.S.C. § 1003(b)(5).

7. ERISA §201(2), 301(a)(3), 401(a)(1); 29 U.S.C. § 1051(2), 1081(a)(3), 1101(a)(1).

8. DOL Regs. Sec. 2520.104-24.

9. DOL Adv. Ops. 92-13A, DOL Adv. Ops. 92-14A.

# ERISA application section continued

A 1983 court case held that plans offered to a number of executives that constituted less than 4.6 percent of all employees met the select group requirement.<sup>10</sup> Another court case can be used to define the upper limit of this percentage limitation for the select group requirement. A plan offered to a number of executives that constituted approximately 18.7 percent of all employees could not be eligible as a top hat plan.<sup>11</sup> The U.S. Fifth Circuit Court of Appeals arrived at a decision that might be an anomaly. It denied top hat status to a plan because the select group of management included all management employees, rather than a select group of management.<sup>12</sup>

Therefore, if the select group constitutes less than 4.6 percent of the entire workforce, and all other requirements are met, the NQDC plan will likely qualify as such. If the select group constitutes greater than 4.6 percent but less than 18.7 percent of the entire workforce, and all other requirements are met, the NQDC plan may be subject to scrutiny based on the facts and circumstances of the arrangement. If the select group constitutes greater than 18.7 percent of the entire workforce and all other requirements are met, the NQDC plan will likely fail.

## **b. Management or Highly Compensated Employees (HCEs)**

The next important requirement under the top hat exemption is the “management” or “highly compensated employee” concept. Executives in a top hat group must be part of a select group but must also qualify as management or HCEs. These employees are typically management who impact the profitability of the company or are employees who are usually in the highest paid levels of the company.

Rank and file employees cannot be included in the top hat group. Rank and file employees generally provide support services, are not highly compensated, do not influence the direction or management of the business or cannot influence the design of the NQDC plan.<sup>13</sup>

### **Management**

If the executive is clearly management, then the executive would be able to meet the management requirement. However, ERISA offers no definition of management. Therefore, the facts and circumstances of the client’s individual situation must be evaluated.

Some general guidelines might be used to define management. The employee will not qualify as management if the employee provides merely support services. Additionally, the executive should be in a position to influence the design and operation of the NQDC plan. The DOL provides some guidance in its informal advisory opinions. Generally, a select group of management would need to consist of individuals who have the “ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan taking into consideration any risks attendant thereto, and, therefore, would not need the substantive rights and protection of Title I” of ERISA.<sup>14</sup>

10. *Belka v. Rowe Furniture Corp.*, 571 F. Supp. 1249 (D. Md. 1983) (finding that the top hat exemption applied to a NQDC plan where the plan participants were 4.6 percent of the business’ total employees).

11. *Darden v. Nationwide Mutual Insurance Co.*, 922 F.2d 203 (4th Cir. 1991), *aff’g* 717 F. Supp. 388 (E.D. N.C. 1989).

12. *Carrabba v. Randall Food Markets*, 252 F.3d 721 (5th Cir. 2001).

13. DOL Adv. Ops. 92-13A (May 19, 1992); DOL Adv. Ops. 90-14A (May 8, 1990).

14. DOL Adv. Ops. 90-14A (May 8, 1990).

# ERISA application section continued

One court case indicated that certain positions could be considered members of management. These positions include: “order processing manager, assistant general manager, director of purchasing and personnel, assistant controller, fleet equipment manager, and assistant director of manufacturing.”<sup>15</sup> Please note that this list represents only a single court’s opinion and is not recognized as authority by the DOL. Executive participation in the plan does not have to be limited to a strictly narrow group of a company’s top executives. The plan may be allowed to include a broad range of management or highly compensated individuals as long as the nonqualified plan is not offered to “widely varying levels” of employees.<sup>16</sup>

## Highly compensated

The highly compensated requirement is not defined by ERISA. Therefore, the facts and circumstances of the specific situation must again be evaluated in order to determine whether an employee is highly compensated.<sup>17</sup>

In contrast to ERISA, the Internal Revenue Code (IRC) defines highly compensated in several sections. It is important to remember that the IRC does not define the highly compensated employee for ERISA or NQDC purposes. However, the compensation threshold in IRC Section 414(q) might be considered an initial guideline.<sup>18</sup> For 2023, this amount is \$150,000. This amount is indexed for inflation on an annual basis. Any analysis of the highly compensated requirement must take into consideration all facts and circumstances. Although compensation levels less than the \$150,000 compensation threshold could fail to meet the highly compensated test,<sup>19</sup> the definition of highly compensated could vary from location to location.

A level of compensation in a rural area with a low cost of living may not be equivalent to a level of compensation in an urban area with a high cost of living. Therefore, the \$150,000 threshold could be adjusted upward or downward depending on the actual circumstances. Also, please note that the \$150,000 threshold does not automatically qualify the executive for the highly compensated status. The DOL does not recognize the compensation threshold in IRC Section 414(q) as the definition of highly compensated.

## Vesting, participation, and fiduciary requirements

NQDC plans that fall under the top hat exemption escape many ERISA requirements. Section 201 of ERISA states that the participation and vesting requirements do not apply to an unfunded top hat plan that provides NQDC plans for a select group of management or highly compensated employees. Therefore, a properly structured unfunded NQDC plan affords the employer flexibility in the design of participation and vesting provisions.<sup>20</sup>

15. *Belka v. Rowe Furniture Corp.*, 571 F. Supp. 1249, (D. Md 1983).

16. *Demery, et al. v. Extebank Deferred Compensation Plan, et al.*, 216 F.3d 283 (2nd Cir. 2000), U.S. App. Lexis 13972, 24 E.B.C. 2095.

17. DOL Adv. Ops. 92-13A.

18. IRC Sec. 414(q)(1).

19. *Plazzo v. Nationwide Mutual Insurance Co.*, 697 F.Supp. 1437 (N.D. Ohio 1987).

20. ERISA §§ 201(1), 201(2), 201(7), 301(a)(1), 301(a)(3), 301(a)(9).



# The unfunded requirement

## General

The next requirement necessary to meet the top hat exemption is that the plan must be unfunded.<sup>21</sup> An unfunded top hat plan may avoid the ERISA vesting, participation, and fiduciary requirements as well as most reporting and administrative requirements.<sup>22</sup> If these ERISA requirements apply, the employer's ability to provide maximum tax benefits and resources to meet select executive's needs will be greatly limited.

The definition of unfunded is critical because it determines whether any assets purchased to plan for meeting the eventual obligations of the nonqualified plan will be considered plan assets subject to ERISA requirements. Generally, the employer may meet the unfunded requirement by not dedicating funds to pay plan obligations with any specific assets. Also, the arrangement must not place the funds beyond the reach of its creditors. It is critical that the employer does not give the executive any beneficial interest in any particular asset. If these guidelines are met, the plan will likely remain unfunded for ERISA purposes.<sup>23</sup>

The plan must be unfunded for both tax and ERISA purposes.<sup>24</sup> Although the unfunded requirement has not yet clearly been defined for ERISA purposes, there is some guidance in meeting the unfunded requirement for tax purposes.<sup>25</sup> This is relevant because the DOL has taken the position that it will generally consider a plan unfunded for ERISA purposes if it is deemed to be unfunded for tax purposes.<sup>26</sup> The DOL has suggested that the positions adopted by the IRS will be accorded significant weight in determining whether a plan is unfunded for ERISA purposes.<sup>27</sup>

## Case law

Several court decisions provide guidelines that should be followed to ensure an unfunded status.

In **Belka v. Rowe Furniture Corp.**,<sup>28</sup> the court found that although the employer had purchased life insurance, the NQDC agreement was not a funded plan. The court cited three primary reasons for its decision:

1. The Belka agreement specifically provided that the executive or his designee shall have **"no rights with respect to, or claim against,"** the life insurance policy proceeds.<sup>29</sup>
2. The executive benefits in **Belka** were payable upon retirement, disability, and death.<sup>30</sup>
3. The Belka court stressed that the life insurance funding the Belka agreement would fund the employer's liability only in rare circumstances.<sup>31</sup>

21. ERISA § 3(2)(A).

22. ERISA §§ 201, 401(a).

23. DOL Adv. Ops. 92-13A; DOL Adv. Ops. 91-16A; DOL Adv. Ops. 90-14A.

24. DOL Adv. Ops. 92-13A, 91-16A, 90-14A.

25. *Id.* (describing "unfunded" for ERISA purposes as somewhat consistent with "unfunded" for tax purposes).

26. *Id.*

27. *Id.*

28. 571 F. Supp. 1249 (D. Md. 1983).

29. *Id.*

30. *Id.*

31. *Id.*

# The unfunded requirement section continued

The Belka decision above clarified an earlier decision, *Dependahl v. Falstaff Brewing Corporation*,<sup>32</sup> which was helpful for planners of nonqualified plans because the *Dependahl* decision indicated that meeting the requirements of an unfunded plan would be difficult. The court in *Dependahl* held that a salary continuation plan, formally funded by a life insurance policy, that was owned by and payable to the corporation, was a funded plan for the purpose of ERISA.<sup>33</sup> Thus, the *Dependahl* plan was required to comply with the participation, vesting, fiduciary and other burdensome ERISA requirements as a funded plan.

In 1987, the Eighth Circuit in *Belsky v. First National Life Insurance Co.*,<sup>34</sup> addressed the informal funding of a salary continuation plan using life insurance owned by and payable to the corporation. The *Belsky* court further clarified the adverse decision in *Dependahl*, thus confirming the principles set forth in the *Belka* decision.

The *Belsky* court distinguished several important factors that caused the *Dependahl* agreement to be characterized as funded.

1. The *Dependahl* death benefit agreement specifically provided that the employer had secured the obligations by purchasing life insurance on the life of the executive.
2. The agreement also stated that the amount of the executive benefit equaled the difference between the insurance proceeds received by the employer at death and the premiums that the employer had contributed, plus 3 percent interest.
3. Unlike the *Dependahl* case, the agreement in *Belsky* did not require that the employer would purchase assets to finance the liabilities assumed in the NQDC agreement.
4. The plan in *Dependahl* merely provided death benefits, whereas the *Belsky* plan provided retirement and disability benefits in addition to the death benefits.<sup>35</sup>

The *Belsky* court concluded that under the existing circumstances the informal funding of a nonqualified plan with life insurance was not a funded plan for ERISA purposes.<sup>36</sup> The court gave much importance to the fact that the agreement in *Belsky* specified that the executive's legal status was the same as an unsecured general creditor.<sup>37</sup> Therefore, the court considered the plan unfunded.<sup>38</sup>

32. *Dependahl v. Falstaff Brewing Corporation*, 491 F. Supp. 1188 (E.D. Mo. 1980), *aff'd*, 653 F.2d 1208 (8th Cir. 1981), cert denied, 454 U.S. 968 (1981) and 454 U.S. 1084 (1981).

33. *Id.*

34. *Belsky v. First National Life Insurance Co.*, 818 F.2d 661 (8th Cir. 1987).

35. *Id.*

36. *Id.*

37. *Id.*

38. See also, *Darden v. Nationwide Mutual Insurance Co.*, 717 F. Supp. 388 (E.D.N.C. 1989) *aff'd*, 922 F.2d 203 (4th Cir.), cert denied, 502 U.S. 906 (1991); *Northwestern Mutual Life Ins. Co. v. Resolution Trust Corp.*, 848 F. Supp. 1515 (N.D. Ala. 1994).

# The unfunded requirement section continued

## Guidelines

Essentially, if the plan is deemed to be funded, it will be subject to the same ERISA rules that apply to qualified plans and the income tax deferral of the benefits will not be possible. The summary below lists general and minimum requirements that would indicate that life insurance policies are not plan assets for the purposes of ERISA, thereby meeting the unfunded requirement.

- The employer is named beneficiary and the insurance proceeds are payable only to the employer.
- The employer owns the policies and the policies remain subject to the employer's general creditors.
- The employer shall not be required to meet any plan obligations with proceeds from insurance policies, and any life insurance must be purchased with the employer's general revenue.
- The employer must avoid any use of a settlement option that would distribute money directly from the insurance company to the participant or beneficiary.
- Neither the participant nor his/her beneficiary has an interest or claim against the policies and the plan should describe the participants' rights as those of unsecured creditors.
- No representation is made to the plan participants that the policies will be used to provide benefits and the plan must avoid any language that suggests it is funded or secured.
- The plan benefits are not limited or governed by the insurance proceeds and the plan must not refer to any specific insurance as a financing vehicle or require the executive to purchase insurance in order to finance the obligation.
- Employee contributions to life insurance policies must be prohibited.<sup>39</sup>

39. DOL Adv. Ops. 93-14A; DOL Adv. Ops. 92-24A; DOL Adv. Ops. 92-02A.

# Informal funding with life insurance and best practices (notice and disclosure)

## Notice and consent requirements and best practices for Employer Owned Life Insurance (EOLI)

Under current law, death benefits from a life insurance contract paid to an employer are generally income tax-free under IRC Section 101. The Pension Protection Act of 2006 (PPA)<sup>40</sup> added sub-section (j) to Section 101. This sub-section covers the treatment of certain EOLI contracts. Under this provision,<sup>41</sup> death benefits will continue to be income tax-free only if the employer complies with the EOLI or Company Owned Life Insurance (COLI) best practices described below. The law also added special reporting and record keeping requirements for employers owning life insurance contracts. **The law applies to all life insurance policies issued or materially changed after August 17, 2006.**

### a. Employer best practices requirements

The best practices rules on COLI apply to the following plans:

- Key employee life insurance
- Endorsement method split-dollar life insurance
- Life insurance used to informally fund a NQDC plan
- Life insurance used to fund stock redemption or other entity purchase plans
- Other arrangements that involve business owned life insurance

Under these best practices rules for COLI, **death benefits will remain income tax-free** if certain notice and consent requirements are met (see next paragraph) **AND** if one of the following apply.

1. The deceased was an employee at any time during the 12-month period before death, or
2. The deceased was a director, or highly compensated employee at the time the contract was issued.

A highly compensated employee for this purpose is defined using the definition under the qualified retirement plans rules of IRC Section 414(q), [compensation of greater than \$150,000 for 2023 or a 5 percent owner], or under the rules of IRC Section 105(h) which includes any of the following: one of the highest paid 35 percent of employees, or one of the 5 highest paid officers, or a shareholder owning more than 10 percent in value of the stock of the employer, or

3. The death benefits are payable to the deceased's family or designated beneficiary or a trust established for them, or to the estate of the insured, or
4. The proceeds are used by the employer to purchase an equity interest of the business from a family member, beneficiary, estate of the insured, or trust.

The notice and consent provision requires the employer to **notify the employee in writing** of the employer's intent to purchase the life insurance, the maximum face amount, and that the employer will be the beneficiary of death benefits upon the employee's death. The employee must provide **written consent** to be insured and an acknowledgment that the insurance may continue after the employee terminates employment.

These rules also apply to other persons or entities who own a life insurance policy if they are related to the employer through the attribution rules of IRC Section 267(b) or 707(b)(1), or if they are engaged in trades or businesses with such employer which are under common control under IRC Section 52(a) or (b).

40. Pension Protection Act of 2006 (H.R. 4), as passed by the House on July 28, 2006, and as considered by the Senate on August 3, 2006.

41. IRC § 101(j).

# Informal funding with life insurance and best practices (notice and disclosure) section continued

Though the law does not state exactly how the employer should handle the notice and consent requirements, a sample document which could be used by an employer purchasing life insurance on an employee can be found in the appendix. Employers are advised to keep copies of signed notice and consent forms in their files.

## **b. Employer reporting and recordkeeping requirements – Pension Protection Act (PPA) of 2006**

The PPA also added IRC Section 6039I, requiring any owner of one or more EOLI contracts to file an annual return, indicating all of the following:

- The number of employees the employer has at the end of the year,
- The number of those employees insured under life insurance contracts at the end of the year,
- The total amount of life insurance in force at the end of the year under those contracts,
- The name, address, and taxpayer identification number of the employer and type of business the employer is engaged in, AND
- That the employer has a valid signed consent form for all insured employees, or if all consents have not been obtained, the number of employees for whom such consent was not obtained.

All of the above provisions related to EOLI or COLI apply to life insurance policies issued or materially changed after August 17, 2006. Material changes do not include Section 1035 exchanges. However, certain increases in the death benefit, other than through a contractual feature on the policy such as a cost-of-living rider, may be considered material changes. Clients should consult with a tax and legal advisor for application of these rules to any situation.

## **Informal funding – ERISA**

It is commonly recognized in the nonqualified benefits field that life insurance is a valuable tool that enables an employer to plan for the nonqualified benefits offered to its executives. However, all plans must be carefully drafted to avoid referencing life insurance in relationship to any benefit under the nonqualified plan itself.<sup>42</sup>

To avoid becoming a funded plan subject to ERISA and income taxation when life insurance contracts have been selected as the informal funding vehicle, the nonqualified benefits must be paid out of the general assets of the employer with the premiums being paid directly from the general assets of the employer.<sup>43</sup> Generally, any plan, properly structured, using life insurance policies as general assets to cover its financial obligations, is not a funded plan. A plan is considered to be unfunded if the general assets of the employer are the only source of informally funding the plan. These assets remain subject to the general creditors of the employer and may include life insurance, which is owned and payable to the employer.

42. Although a plan may be drafted to not be “funded,” communications to employees about promising informal investment assets and similar communication through plan administration could cause an “unfunded” plan to become “funded.”

43. Life insurance policies used to informally fund the nonqualified plan will be considered general assets of the corporation as long as they are not formally set aside to meet an individual employee’s plan benefits.

# Informal funding with life insurance and best practices (notice and disclosure) section continued

Split-dollar arrangements are sometimes implemented during a similar time frame as a NQDC plan.<sup>44</sup> Please note that when this is done, the split-dollar arrangement and NQDC plan are entirely unrelated and separate agreements. A federal decision in *Miller v. Heller*<sup>45</sup> held that a deferred compensation obligation that might be paid from the employer's split-dollar arrangement was not funded for ERISA purposes. The employer had the option, but not any obligation, to use the life insurance policies associated with the split-dollar arrangement to meet its obligation under the NQDC plan.

The court focused on two issues in making the determination of whether the plan was an unfunded top hat plan:

- The facts and circumstances including the terms of the plan documents, and
- The property remained corporate general assets.<sup>46</sup> The court concluded that the plan participant had no greater legal right than a general unsecured creditor without any rights to specific assets of the employer.<sup>47</sup>

The employer had not obligated itself to fund the split-dollar agreement or the deferred compensation agreement and did not dedicate specific assets for the benefit of the employee.<sup>48</sup>

44. It is important to note that properly implemented split-dollar life insurance plans and NQDC plans can be complementary in satisfying an executive's need for an income tax-free survivor benefit with the ability for income tax deferrals.

45. *Miller v. Heller*, 915 F. Supp. 651 (S.D.N.Y. 1996).

46. *Id.*

47. *Id.*

48. *Id.*

# Reporting requirements

## U.S. Department of Labor (DOL) disclosure letter

If a plan qualifies as a top hat plan, there are limited reporting and disclosure requirements.<sup>49</sup> The Secretary of Labor provides simplified reporting requirements for employee pension benefit plans that fall under the top hat exemption.<sup>50</sup> Plans that comply with these requirements are required to provide a written notice (usually a letter) providing the following information.

- The employer's name and address.
- The employer's IRS identification number.
- A statement detailing the number of employer's plans and the number of participants in each plan.
- A statement that the primary purpose of the plan is to provide deferred compensation to a select group of management or highly compensated employees.
- A statement that the employer will provide a copy of the agreement to the Secretary of Labor upon request.

## IRS – W-2 reporting

IRC Section 409A requires annual amounts associated with the NQDC to be separately reported. Annual deferrals must be separately reported on Form W-2 (wage and tax statement) or Form 1099 (miscellaneous income).

## Denial of claim for benefits

In addition to these reporting requirements, the employer must provide adequate notice in writing to any participant whose claim for plan benefits has been denied. The notice must give the specific reasons for denial and must be written in a manner calculated to be understood by the participant. The participant must be afforded reasonable opportunity for a full and fair review, by a named fiduciary, of a decision to deny a claim.<sup>51</sup> Failure to comply with this requirement will mean that full reporting and disclosure as required by qualified plans will have to be followed. Therefore, this requirement should not be overlooked.

49. See DOL Reg. § 2520.104-23(b).

50. Id.

51. DOL Adv. Ops. 81-11A.

# Tax considerations

## General – the unfunded requirement for income tax purposes

For income tax purposes, the plan designer must comply with certain requirements to avoid current income taxation to the executive.

If a nonqualified plan is unfunded and other requirements have been met, contributions to the plan will not be subject to current income taxation to the executives.<sup>52</sup> Generally, the employer may meet the unfunded requirement by refraining from dedicating funds to pay NQDC plan obligations. Additionally, the employer must not establish an arrangement that places the funds beyond the reach of its creditors.<sup>53</sup>

The unfunded component of a NQDC plan assists the executive in deferring current income taxation. If the unfunded requirements are not followed, the NQDC plan will be considered funded for income tax purposes (and most likely for ERISA purposes also). IRC Section 83 governs the taxation of funded NQDC plans.<sup>54</sup> The tax treatments of unfunded plans are now specifically governed by IRC Section 409A. Previous to Section 409A, NQDC plans evolved from revenue rulings, case law and general tax doctrines, such as the “doctrine of constructive receipt,” which are discussed below.<sup>55</sup>

It is important to note that Section 409A applies in conjunction with revenue rulings, case law, IRC sections and general tax doctrines applicable to NQDC plans. First, the Section 409A rules will be discussed. Second, the more general tax doctrine will be addressed.

## IRC Section 409A – American Jobs Creation Act (ACJA) of 2004

### a. General

On October 22, 2004, IRC Section 409A was passed into law under the ACJA.<sup>56</sup> The enactment of Section 409A marks the first time an IRC section has been dedicated specifically to NQDC.

The Section 409A is very broad and provides rules for issues such as:

- Elections to defer
- Permitted distributions events
- Elections to delay or change payment terms
- Many other new and specific rules

The legislation also prohibits certain abusive NQDC provisions that were sometimes promoted before the enactment of Section 409A and may have been drafted into a NQDC plan.

IRS Notice 2005-1 was issued on December 20, 2004, and provided limited guidance about IRC Section 409A.<sup>57</sup>

The proposed regulations provide more guidance into the rules for NQDC. The proposed regulations for IRC Section 409A were issued on September 29, 2005, and generally supersede Notice 2005-1.<sup>58</sup>

52. DOL Adv. Ops. 92-13A, 91-16A, 90-14A.

53. DOL Adv. Ops. 92-13A, 91-16A, 90-14A.

54. Treas. Reg. § 1.83-3(e) defines property to include a beneficial interest in assets, which are transferred or set aside from the claims of creditors of the transferor. The employee is taxed on the earlier of the date the employee's rights to the property became non-forfeitable or the date the employee may first transfer the property.

55. Rev. Rul. 60-31, 1960-1 C.B. 174.

56. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004).

57. IRS Notice 2005-1, 2005-2 IRB, December 20, 2004.

58. Proposed Regulations as set forth in 70 Fed. Reg. 57930 (Oct. 4, 2005).



# Tax considerations section continued

The proposed regulations are detailed and expansive. They extend some, but not all, of the transition relief for section 409A compliance.

IRS Notice 2006-79<sup>59</sup> was issued on October 4, 2006. Notice 2006-79 extends the time for which NQDC plans must be amended to December 31, 2007.

## **b. Effective date**

The NQDC rules are effective for deferrals made after December 31, 2004. However, the NQDC rules are also effective for deferrals made before January 1, 2005, if the NQDC plan has been materially modified after October 3, 2004.

## **c. Plans affected**

The new NQDC rules apply to all NQDC plans, including:

- Salary deferral plans
- Bonus deferral plans
- Salary continuation nonqualified plans; otherwise known as Supplemental Executive Retirement Plans (SERP)

Section 409A sets forth a broad definition of deferred compensation, applying to any plan, agreement, or arrangement, whether or not it is elective, except for:

- Tax-qualified retirement plans
- Tax-deferred annuities
- IRAs
- Simplified Employee Plans (SEPs)
- SIMPLE plans
- 457(b) plans
- Vacation, sick leave, disability, compensatory time, and death payment plans

## **d. Complying with Section 409A and amending current NQDC plans**

New NQDC plans need to comply with Section 409A. In addition, all current NQDC plans need to be reviewed by the client's attorney to make sure that they comply with the Section 409A. IRS Notice 2006-79 had extended the time for which NQDC plans must be amended to December 31, 2007. IRS Notice 2006-79 was issued on October 4, 2006.

## **e. Consequences for noncompliance:**

If the employer or plan fails to completely follow Section 409A, the amounts deferred will be subject to:

- 1) Current income taxation
- 2) 20 percent penalty tax
- 3) 1 percent interest penalty

<sup>59</sup> IRS Notice 2006-79, October 23, 2006.

# Tax considerations section continued

## **f. Election to defer**

(Please see Quick reference – NQDC rules – IRC Section 409A in the Appendix and IRC Section 409A.)

### **1. General Rules – election to defer**

The election to defer must generally be made before the year in which the income deferred will be earned and services are performed.

In the first year that a plan participant is eligible for participation or at the initial implementation of the NQDC plan, an election to defer may be made within 30 days of eligibility or for a new NQDC plan. However, if the employer has a current NQDC plan in addition to the new plan, this must be evaluated.

The IRS requires the aggregation of NQDC plans. NQDC plans of the same type should be aggregated for the purposes of determining when an election to defer must be made. These types are:

- Account
- Non-account
- Separation-pay
- Equity-based plans

Therefore, if an employer has a bonus deferral plan already in place and wishes to also create a new salary deferral plan, the 30-day election option for the new plan is not available because these are both account-type plans. The deferral of the salary for the new plan will not be available for the current year. The elections must be made in the current year and then the salary for the following year can be deferred.

Performance-based awards may be deferred six months before service ends providing that the period of service is at least 12 months. The Proposed Regulations for 409A have a specific definition of “performance-based.” If the NQDC plan fails the definition and elections should have been made earlier, the NQDC plan is in violation of IRC Section 409A.

### **2. Amount – election to defer**

If the specific amounts or percentages are not already elected and specified in the NQDC plan document, the plan participant shall complete a properly executed and timely submitted Election to Defer form. The form authorizes the deferral of all or part of the plan participant’s compensation and/or bonus earned during the period in which the plan participant participates in the NQDC plan.

The plan participant may not increase or decrease his or her deferrals for the current year. Any subsequent Election to Defer form that has been properly submitted to the employer/company will become effective as of the first day of the following year.

In no circumstance may a plan participant or the employer/company allow compensation already earned to be deferred.

### **3. Time and form of benefit payment – election to defer**

If the time and form of benefit payments are not specified in the NQDC plan document, the time and form of benefit payment must be specified on a properly executed and timely submitted Election to Defer form.

# Tax considerations section continued

Upon entering the plan, the plan participant must file a properly executed Election to Defer form that specifies the time and form of benefit payment and is timely submitted to the employer/company.

Any subsequent changes in the time and form of benefit payment must be communicated in a properly executed Election to Defer form that is timely submitted to the employer/company. The changes must be submitted at least one full year before the plan participant has the right to begin benefit payments and the benefit payments must be postponed for a minimum of five years.

## **g. Unforeseeable emergency – election to defer**

IRC Section 409A allows distributions on account of an unforeseeable emergency. The term unforeseeable emergency refers to a severe financial hardship to the plan participant resulting from an illness or accident of the plan participant, the plan participant's spouse, or a dependent (as defined in section 152(a)) of the plan participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

The IRS has accepted the principle that amounts deferred pursuant to an irrevocable election may be paid out in the event of financial hardship.<sup>60</sup> The IRS has provided that even an irrevocable election may be revoked in the event of unforeseen changed circumstances.<sup>61</sup> The IRS stated in relevant part:

**If the plan permits a participant (or the participant's beneficiary after the participant's death) to withdraw an amount of deferred compensation for a financial emergency, the plan must specify that the participant or beneficiary is allowed to withdraw funds only for an unanticipated emergency that is caused by an event beyond the control of the participant or beneficiary and that would result in severe financial hardship to the individual if early withdrawal were not permitted.**<sup>62</sup>

The IRS's position provides some relief to plan participants in a time of an unforeseeable emergency.

## **h. Change in the ownership (formerly change in control)**

**Change in control:** The following three situations are permitted distribution events according to the Final Regulations under 409A:

1. Change in ownership
2. Change in effective control
3. Change in ownership of a substantial portion of corporate assets

### **1. Change in ownership**

A change in the ownership of the corporation occurs if a person or a group acquires stock which, combined with previously owned stock, controls more than 50 percent of the value or voting power of the stock of the corporation.

60. Let. Rul. 8818035 (February 8, 1988); Let. Rul. 8818023 (February 5, 1988).

61. Id.

62. Let. Rul. 8321051 (February 18, 1983).

# Tax considerations section continued

## 2. Change in effective control

A change in effective control occurs if a person or group acquires, during a 12-month period, stock possessing 30 percent or more of the total voting power; or a majority of the board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the corporation's board of directors who were directors before the date of the election or appointment.

## 3. Change in ownership of a substantial portion of corporate assets

A change in ownership of a substantial portion of the assets occurs if a person or group acquires, within a 12-month period, assets of the corporation having a total gross fair market value equal to 40 percent or more of the total gross fair market value of all of the corporation's assets.

## IRC Section 83 – property transferable or not subject to a substantial risk of forfeiture

Section 83 will impose current income taxation on property transferred in connection with services performed when the property is transferable or is no longer subject to a substantial risk of forfeiture. The contributions in a funded plan are transferable or are no longer subject to a substantial risk of forfeiture and therefore are subject to IRC Section 83. In a funded plan the employer has typically made contributions to a trust or escrow account, or has made some other arrangement designed to shelter the funding vehicle from the employer's general creditors.

The properly structured NQDC plan represents an unsecured promise to pay compensation in the future and therefore is unfunded. Consequently, Section 83 does not apply to an unfunded plan because the mere promise does not meet the Section 83 definition of property.<sup>63</sup>

If the plan inadvertently becomes funded, for example, by designating certain rights in the funding vehicle to the participants, Section 83 will require income taxation at the time that the plan becomes inadvertently funded. The plan may minimize the possibility of current income taxation by making the executive's interest subject to a substantial risk of forfeiture.<sup>64</sup> When the executive's right to the plan assets is transferable or is no longer subject to a substantial risk of forfeiture, the executive will be required to recognize ordinary income under Section 83. Properly structured NQDC plans will not be subject to Section 83.

## 1. Constructive receipt doctrine

The constructive receipt doctrine must be a consideration whenever an executive has a right to compensation. Compensation is generally taxed when it is actually or constructively received.<sup>65</sup> If the executive is found to have constructive receipt over monies set aside, the executive will incur a current income tax liability.

63. Treas. Reg. § 1.83-3(e).

64. IRC § 83

65. Treas. Reg. § 1.451-1(a) provides the general rule that under the cash receipts and disbursements method of accounting (to which nearly all individual taxpayers are subject), items of income are includible in gross income when actually or constructively received. IRC § 451(a) provides that the amount of any item of gross income shall be included in gross income for the taxable year in which it was received by the taxpayer. Income, although not actually reduced to a taxpayer's possession, is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart for the taxpayer or otherwise made available so that he or she may draw upon it at any time, or so that it could have drawn upon during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Treas. Reg. § 1.451-2(a). The position of the Service on the doctrine of constructive receipt as applied to deferred compensation arrangements is discussed primarily in Rev. Rul. 60-31, 1960-1 C.B. 174. This ruling concludes that a mere unsecured non-assignable promise to pay compensation does not constitute income under the cash method of accounting.

# Tax considerations section continued

This doctrine is primarily concerned with the timing of any receipt of compensation. It asks the question, “When does the executive have the right to receive the compensation?”<sup>66</sup> If the executive has the right to receive compensation free of any conditions, then it must be included in income at that time.<sup>67</sup> Therefore, the nonqualified plan agreement must be structured so that the executive has not actually or constructively received any income during employment.<sup>68</sup>

Revenue Ruling 60-31 provides the basic rules required to avoid the doctrine of constructive receipt. The Ruling emphasizes that a mere promise to pay, not represented by notes or secured in any way, will not be regarded as constructively received for a cash basis taxpayer.<sup>69</sup> Constructive receipt will apply to the extent that funds are actually credited to the taxpayer or set apart for him or her to draw upon at any time, resulting in current income taxation.<sup>70</sup>

Constructive receipt will generally not allow a taxpayer to avoid current income taxation by entering into an agreement to delay receipt of money that has already been earned, and which the taxpayer currently has a right to possess. For example, there have been several rulings involving deferral of salary, rather than deferral of a bonus, which expressly state that the deferral election applies only to compensation earned after the election.<sup>71</sup> Essentially, the executive must make an election to forego income **before** performing any of the services for which compensation is received. Importantly, each nonqualified plan must be evaluated on its specific factual situation in order to determine whether the doctrine of constructive receipt applies.

Here are some general guidelines to avoid constructive receipt.

- The election to defer payment of compensation must be made before the beginning of the period of service for which the compensation is payable.
- **The plan must define the timing method for payment for each distribution event (additional requirements may need to be met if the plan provides for payment of benefits in the case of an unforeseeable emergency).**
- The participants must have the status of general unsecured creditors.
- The plan must state that the parties intend for the arrangements to be unfunded for tax purposes and for purposes of Title I of ERISA.

66. IRC § 451; *Belka v. Rowe Furniture Corporation*, 571 F. Supp. 1249 (Md. 1983).

67. *Id.*

68. Rev. Proc. 71-19 generally stands for the proposition that the election to defer compensation must be made before the beginning of the period of service for which the compensation is payable. Private Letter Ruling 8418070 (January 30, 1984) attempted to define “period of service” as the employee’s tax year. Thus, the election ordinarily must be made by the December 31 immediately preceding the calendar year period of service for which the compensation is payable. This is often not a problem in the case of the elective deferral of salary or a bonus under a calendar year salary or bonus deferral plan.

69. Rev. Rul. 60-31.

70. *Id.*

71. Let. Rul. 9014048 (January 8, 1990), Let. Rul. 8637085 (June 16, 1985) (Refusing to rule on amounts deferred within 30 days after participant joined the plan if amounts deferred were earned before the election).

# Tax considerations section continued

## 2. Economic benefit doctrine

Where the doctrine of constructive receipt asks “when” the benefit is received, the economic benefit doctrine asks “what” has currently been received. Even though a taxpayer may have constructive receipt of income, there may be no actual economic benefit. When the employee receives a measurable current economic benefit, the benefit should be included in income.

To avoid the economic benefit doctrine, the informal funding mechanism **must be independent** of the nonqualified plan agreement. A current economic benefit is capable of valuation where a contribution to the executive’s benefit is nonforfeitable, fully vested in the executive and secured against the employer’s creditors.

In **Douglas M. Goldsmith and Joan Goldsmith v. U.S.**,<sup>72</sup> there was an indication that the nonqualified plan agreement referred to the life insurance contract and the executive had significant control over the policy. These facts suggested that the executive was, at least in part secured, and therefore possessed a benefit capable of valuation. The court found that the executive received a current economic benefit.<sup>73</sup> The court ruled that the life insurance purchased by the employer provided a current and measurable economic benefit of value to the executive.<sup>74</sup>

Nonetheless, commentators have criticized the **Goldsmith** decision because **Goldsmith** is inconsistent with prior case law and regulations. It has not been followed in subsequent cases. Two private letter rulings issued after the **Goldsmith** decision indicate that the IRS is not applying the economic benefit theory as defined in the **Goldsmith** decision.<sup>75</sup> Arguably, the Revenue Act of 1978 nullified the **Goldsmith** decision. The act provided that the income tax rules and judicial decision in effect on February 1, 1978, would control the taxation of deferred compensation.

Despite the controversy over the **Goldsmith** decision, a nonqualified plan agreement must not refer to the life insurance contract. Additionally, the executive must not have any control over the assets that are used by the employer to plan for its eventual obligation or used to informally fund the arrangement. A properly structured nonqualified compensation agreement should not provide the executive with a current economic benefit.

72. Douglas M. Goldsmith and Joan Goldsmith v. U.S., 78-1 USTC 83 (1978).

73. Id.

74. Id.

75. Let. Rul. 7907088, 11-17-78; Let. Rul. 7907092, 11-17-78.

# Planning for the nonqualified plan benefit obligation – informal funding

## General

A prudent employer will want to plan for its future obligations to pay benefits under the nonqualified plan agreement upon the executive's retirement, disability or death. Although the plan must be unfunded in order to obtain the preferable tax and ERISA treatment, the employer should consider an informal method to meet its obligations under the plan. Any informal funding device should be structured so that it meets the future retirement, disability or death obligations under the plan. Additionally, any informal funding must be reliable and strengthen the business's financial status. Informal funding for the executive's nonqualified benefits helps the employer maintain its financial stability.

Merely believing that the obligation might be fulfilled with future assets and/or earnings would not encourage confidence in the plan design. Additionally, the future liability could prove catastrophic for the business when payments become due. Therefore, the employer should begin planning for the obligation by informally funding it on at least an annual basis. The money the employer uses to informally fund the plan needs to be applied to a properly designed vehicle to plan for the obligations promised by terms of the nonqualified plan. Importantly, the executive may decide to defer some compensation into the NQDC plan itself. However, the executive is not deferring compensation into the informal funding arrangement used to by the employer to plan for its obligation.

## Options for informal funding

The employer is free to use any source to informally fund its obligation to pay retirement benefits and/or survivorship benefits to the executives. The following briefly summarizes four primary options.

### a. Life insurance

Life insurance is a preferred method to informally fund the liability accrued due to the promise to pay retirement benefits and/or survivorship benefits under the terms of the NQDC plan. Permanent life insurance provides cash value accumulation on an income tax-deferred basis.<sup>76</sup> If life insurance is not used to informally fund the plan benefit, the employer will likely invest its assets to informally fund future benefits in a taxable investment. The employer will be taxed on the income generated by the assets as the income is earned.

When retirement benefits become payable to the executive, the employer may meet its nonqualified benefit obligations by accessing the cash value of the life insurance on a tax-advantaged basis through withdrawals and loans. Keep in mind that loans and withdrawals will reduce both the surrender value and death benefit. Additionally, if the company chooses to hold the policy until the insured's death, the employer is not taxed on the death benefit received, which assists with cost recovery (subject to the alternative minimum tax for C corporations<sup>77</sup>). At the time of the executive's death the employer may use death benefit proceeds from the life insurance policy as a source of funds to pay the survivors of the deceased executive the survivor benefit (if any) promised under the NQDC plan itself. However, the employer must not be obligated to use the life insurance policy proceeds to meet this obligation.

<sup>76</sup> IRC § 7702. If the life insurance contract complies with the definition of life insurance as defined in IRC § 7702, the increase in the cash value will not be subjected to current income taxation. Let. Rul. 8028104.

<sup>77</sup> IRC Sec. 55(a)(2).

# Planning for the nonqualified plan benefit obligation – informal funding section continued

The employer is the owner and beneficiary of the life insurance policy. The IRS has reiterated its positions that the mere purchase of life insurance policies or annuity contracts to fund a benefit does not accelerate taxation as long as the employer is the owner and beneficiary of the policy.<sup>78</sup>

## **b. Annuities**

Generally, an annuity is not an attractive device to informally fund a nonqualified plan. The Tax Reform Act of 1986 eliminated the tax-deferred accumulation of an annuity when not owned by a natural person.<sup>79</sup> A business (corporation, partnership, etc.) will be taxed annually on the accumulation inside the annuity contract.

## **c. Taxable investments**

Taxable investments, such as taxable accounts or assets, may provide a source to informally fund a NQDC plan. Although the business may receive an acceptable rate of return from these investments, there are two disadvantages:

1. Taxable accounts or assets do not accumulate growth on a tax-deferred basis.<sup>80</sup> This may cause considerable reduction in the accumulation.
2. Taxable accounts do not provide a death benefit. The second distinction is critical because many NQDC plans provide a pre-retirement death benefit. If a death occurs, the business will need to find a considerable amount of funds to meet the promise. Both distinctions are important and must be thoroughly evaluated.

Taxable investments do provide two advantages over the use of life insurance in certain situations:

1. For those plans where the obligation of the employer to pay out the benefit is a short duration, taxable investments may be more efficient than a permanent life insurance contract.
2. For employers with plan participants who are not eligible for life insurance, due to health reasons, the use of taxable investments may be appropriate.

## **d. No planning for retirement payments**

Merely believing that the obligation might be fulfilled with future assets and/or earnings may not encourage confidence in the participants of the plan. Additionally, the future liability could prove catastrophic for the business when payments become due. Therefore, the employer should begin planning for the obligation and informally funding it on at least an annual basis.

78. Rev. Rul. 68-99, 1968-1 C.B. 193 and Rev. Rul. 72-25, 1972-1 C.B. 127; Let. Rul. 9030011 (April 25, 1990), Let. Rul. 8949059 (September 12, 1989), Let. Rul. 8946031 (August 21, 1989), Let. Rul. 8803040 and Let. Rul. \*235 8607031 (purchasing whole-life insurance policies on the lives of plan participants), Let. Rul. 9035063 (June 6, 1990).

79. IRC § 72(u).

80. IRC 101(a).



# General tax implications

## Employer tax impact

The following briefly outlines some primary tax consequences. It is important to note that the accountant and/or tax advisor must review and calculate actual tax consequences.

When examining the tax consequence of a NQDC plan, the informal funding vehicle must be distinguished from the nonqualified plan benefits promised to the executive(s). The informal funding vehicle possesses distinct tax characteristics from the NQDC plan itself.

### a. Deferrals/contributions

Any deferrals into a nonqualified plan are not income tax deductible.<sup>81</sup> Therefore, contributions will be nondeductible until such time as the executive receives plan benefits.<sup>82</sup>

### b. Premium payments

Premium payments by the employer may not be deducted for income tax purposes.<sup>83</sup> Section 264 of the IRC provides in relevant part:

No deduction shall be allowed for (1) premiums paid on any life insurance policy covering the life of any officer or executive, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

Therefore, the employer will not receive any deductions for premiums paid on policies. Life insurance used to informally fund a nonqualified plan is an asset of the employer.

### c. Retirement benefit payments

The employer may take an income tax deduction for reasonable compensation paid in the year when that amount is actually paid to the executive.<sup>84</sup> All contributions will be nondeductible until such time as the executive receives plan benefits. The compensation paid must be reasonable and, thus, must meet the requirements specified in IRC Sections 162 or 212.

Section 404(a)(5) of the IRC states compensation paid or accrued ... "shall be deductible under this section in the taxable year in which an amount attributable to the contribution is includable in the gross income of employees ... participating in the plan."

In an informally funded plan, this rule means the employer takes a deduction in the year the retirement benefit is paid to the executive or to his or her beneficiary. This rule applies for any executive, including a shareholder-executive. However, the plan must benefit the participant in his or her capacity as an employee, not just as a shareholder. One of the tests used to determine if the benefit is a shareholder benefit is whether the benefit paid is considered reasonable compensation.

81. IRC § 451.

82. IRC § 162 states that the employer will receive an income tax deduction for compensation "paid or incurred during the taxable year." Since typically no compensation is being paid during the pre-retirement years, no current income tax deduction will be allowed. IRC § 404(a)(5) states that an amount is deductible by the employer in the year in which "the contribution is includable in the gross income of the employees."

83. IRC § 264.

84. IRC § 404(a)(5).

# General tax implications section continued

## **d. Survivor benefit payments from the nonqualified plan**

The payment of survivor benefits to the heirs of a deceased executive are deductible for income tax purposes as an ordinary and necessary business expense.<sup>85</sup>

Section 404(a)(5) of the IIRC states that compensation paid or accrued ... “shall be deductible under this section in the taxable year in which an amount attributable to the contribution is includable in the gross income of employees ... participating in the plan.”

The compensation paid must be reasonable and, thus, must meet the requirements specified in IRC Sections 162 or 212.

## **e. Withholding**

The Federal Insurance Contributions Act (FICA), consists of two types of taxes:

1. Old Age, Survivors and Disability Insurance (OASDI) – the official name for Social Security. This tax is paid by both the employers and employees, with a cap on taxation for applicable wages earned in 2022 of \$147,000.
2. Hospital Insurance (HI) – commonly known as Medicare. This again is paid by both the employer and the employee, but has no applicable wage cap.

Withholding for purposes of FICA and Federal Unemployment Tax Act (FUTA) taxes generally occurs at the time wages are actually or constructively received. The amount deferred under a NQDC plan is required to be taken into account for purposes of FICA or FUTA as of the later of:

- the date on which the services creating the right to that amount are performed, or
- the date on which the right to that amount are no longer subject to substantial risk of forfeiture.<sup>86</sup>

For instance, when an individual becomes vested in a plan, the NQDC benefit is no longer subject to a substantial risk of forfeiture. Once the amount has not been taken into account for FICA and FUTA purposes, that amount, nor income attributable to that amount, is treated as wages for purposes of FICA or FUTA.

## **f. Reasonable compensation**

Even if the requirements of Section 404(a)(5) have been fulfilled and the executive has reported the income for tax purposes, the employer’s deduction must still fulfill one more test to receive an income tax deduction. The payment made to the plan participant must qualify as an ordinary and necessary business expense under Section 162 of the IRC. For the purpose of these plans, the deduction is allowed if it is normally deductible as executive compensation. The payment must be reasonable in amount, it must be intended as compensation for services provided to the employer and it must not be an attempt to avoid the payment of a dividend to a shareholder.

The test of deductibility usually is based on the question of reasonable compensation. The determination of whether compensation is reasonable is a question of fact.

85. IRC § 162(a).

86. IRC §§ 3121(v)(2)(A) and 3306(r)(2).

# General tax implications section continued

Determination is based on:

- the nature, extent and scope of an executive's work
- the size and complexity of a business
- a comparison of salaries paid in businesses with a similar gross or net income
- the prevailing economic conditions
- a comparison of salaries with distributions to stockholders
- the prevailing rates of compensation for comparable positions and comparable concerns
- the salary policy of the taxpayer as to all executives
- in the case of a small corporation with a limited number of officers, the amount of compensation paid to the particular executives in the previous years.<sup>87</sup>

For the purpose of a nonqualified plan, the test of reasonableness is based on the services provided during the years of accrual. In other words, compensation paid during one's retirement years is spread over the period in which the plan agreement is in force to determine whether the total compensation for those accrual years was reasonable.<sup>88</sup> If the payments fail the reasonable compensation test, they are nondeductible, and any payments received by a shareholder are taxed as a dividend.<sup>89</sup>

## Participant tax impact

### a. Deferrals

One of the primary benefits of a nonqualified plan is that it allows the employer to award additional future compensation without current income taxation to an executive.

Thus, the employer can provide deferred benefits on a pre-tax basis. Deferrals into a nonqualified plan are not subject to income taxation.<sup>90</sup> Consequently, the executive may defer compensation to lower income taxation.

### b. Retirement benefit payments

Retirement benefit payments to the executive under the terms of the nonqualified plan will be subject to ordinary income taxation at the time received. To avoid income taxation on the entire amount of the benefit in a lump sum, the plan may be structured to spread out the benefit payments over a period of years. The benefits that the executive receives in each year will be subject to ordinary income tax in that year.

### c. Survivor benefit payments

Survivor benefit payments to the executive's heirs under the terms of the NQDC plan will be subject to ordinary income taxation.

87. *Mayson Manufacturing Company v. Commissioner*, 178 F.2d 115, (1949 CA 6).

88. Regs. § 1.404(a)1(b).

89. IRC § 316.

90. IRC § 451.

# Miscellaneous issues

## Plans for controlling or majority shareholder-executives

There are some special questions to be answered before establishing a nonqualified plan in which a majority shareholder is a potential plan participant. It has been suggested by some commentators that a majority shareholder risks income taxation of the current payments as a dividend. In *Casale v. Commissioner*, the nonqualified plan did not result in dividend income to the share-holder-executive, even though he owned almost 100 percent of the stock.<sup>91</sup> The IRS adopted the court's position in Revenue Ruling 59-184. In most situations, courts are not in favor of ignoring the separate corporate entity to reach a shareholder.<sup>92</sup> However, the tests for reasonable compensation are applied and, to the extent that compensation is in excess of these reasonable limits, dividend income is assessed against the shareholder.<sup>93</sup>

The cases which have considered the deductibility of salary continuation payments made in a controlling shareholder situation are split. In *Andrews Distributing Company, Inc.*, the court held that deferred compensation paid to the controlling shareholder-executive's widow was deductible because the shareholder was underpaid during his working years and because control of the business did not pass to the spouse receiving the benefits.<sup>94</sup>

In *Morse Signal Devices v. U.S.*, the court held that payments to the widow of the founding officer were not deductible because they benefited the widow, not the corporation.<sup>95</sup> Unfortunately, the IRS failed to further offer clarification in this area by issuing Rev. Proc. 80-22. This statement provides that no private letter rulings will be issued for unfunded salary continuation plans involving controlling shareholders.

## Crediting rate index for executive deferral and deferred bonus plans

The sponsoring employer may elect to allow participating employees to index their executive account to selected outside investments.<sup>96</sup> All employer and employee contributions will be credited to a hypothetical account that tracks the amount promised to the executive. The earnings or losses on the executive's hypothetical account will be adjusted accordingly.

The IRS addressed this issue in 1985 when a company established a book/hypothetical account to which amounts deferred by employees were to be credited.<sup>97</sup> Title to all assets informally set aside remained with the company and such assets were subject to the general claims of the company's creditors.<sup>98</sup> The IRS ruled that employees utilizing the cash method of accounting were not required to include the deferred amounts in income until the taxable year or years in which the deferred amounts were actually paid by the company, unless the amounts were otherwise made available at an earlier date.<sup>99</sup>

91. *Casale v. Commissioner*, 247 F.2d 440.

92. See *Minor v. U.S.* 85-2 USTC 9718, (9th Cir. 1985), (holding the controlling shareholders could defer 90. percent of the compensation which the corporation could deduct on payment to the controlling shareholders).

93. IRC §§ 162, 301 and 316; *Yeomans Distributing Co. v. U.S.*, 85-USTC 87, 566 (C.D. Ill., 1985), (extending the logic of *Casale* further in the taxpayer's favor).

94. *Andrews Distributing Company, Inc.*, 31 TCM 732 (1979).

95. *Morse Signal Devices v. U.S.*, 434 F. Supp. 85 (D.C.N.J., 1977).

96. See the Adoption Agreements for the deferred bonus and executive deferral plans provided in this foreword to counsel.

97. Let. Rul. 8607029 (November 15, 1985).

98. *Id.*

99. Let. Rul. 9030035 (April 30, 1990), Let. Rul. 9028096 (April 18, 1990), Let. Rul. 8406032 (November 7, 1983)

# Miscellaneous issues section continued

A similar ruling addressed a plan where the executive's hypothetical account was invested according to employee elections.<sup>100</sup> The plan provided for executive accounts to be credited with an income factor equal to the amount which the participant's accounts would have actually earned had the sponsor followed the employee investment selections. Employees could change investment choices; however, the employer was under no obligation to change the underlying investment vehicles.<sup>101</sup>

In Private Letter Ruling 9904023, the IRS approved a plan that allowed employees to choose investment in any of the following: United States Treasury Notes of a specified term, a fixed income fund, an equity fund, a money market fund, or life insurance. The IRS has issued several similar rulings.<sup>102</sup>

## Investment selection

Decisions regarding underlying investments associated with the NQDC plan should be made solely by the plan sponsor or employer. The executive should be confident that the employer will be able to meet its obligation under the NQDC plan without the executive's involvement in the underlying investments.

A nonqualified plan may not allow executives to direct or control the underlying investments associated with the NQDC plan. Any control of the underlying investments by the participant would create a greater risk that the NQDC plan is funded for ERISA and IRS purposes.

## Conclusion

The specimen documents provided below are intended to qualify as unfunded NQDC plans designed to allow the employer to provide supplemental income for retirement to its executives. NQDC plans involve tax, legal and accounting issues for the employer. By properly structuring the nonqualified plan the employer can maximize benefits provided to its executives.

100. Let. Rul. 9101011 (October 5, 1990).

101. Id.

102. Let. Rul. 9030036 (April 30, 1990) (Approving a plan that would allow employees to elect the type of securities in which amounts credited to their bookkeeping accounts should be invested. Investment selections could be changed twice a year); Let. Rul. 9015022 (January 11, 1990)(providing for deferred amounts to be credited with hypothetical earnings and losses with adjustments to the account calculated with reference to hypothetical investments designated by the employee unless the company chose to provide the employee with other reasonable investment alternatives or the company chose to have the adjustments calculated with reference to any other reasonable investment index); Let. Rul. 8804057 (November 4, 1987) (permitting employees to request that their accounts be deemed invested in a particular investment fund, however, the plan administrator had sole discretion to determine whether such account would in fact be deemed to be so invested or would be deemed invested otherwise).

# Nonqualified executive deferral plan provisions

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This is a specimen booklet for general information only and is intended to be exhibited to the client’s attorney for consideration. The specimen agreements are general agreements and must not be represented as adapted to the particular situation of any client. The laws of the various states may differ considerably, and all legal instruments must be prepared by the client’s attorney.

# Preamble

The company, by executing the attached Adoption Agreement, hereby establishes an unfunded Nonqualified Executive Deferral plan (Plan) for a select group of executives intended to meet the top hat exemption for Titles I and IV of ERISA. The Plan will allow eligible executives to defer a portion of their compensation not yet earned according to their executive deferral election forms. The Plan shall be binding on participating executives as well as any of the participant's successors who may become eligible to receive payments under the Plan such as a spouse or beneficiaries. Executives participating in the Plan will have no right, directly or indirectly, to anticipate, assign, sell or pledge any asset set aside to satisfy benefit obligations under the Plan. The assets used as a source to satisfy Plan benefits shall be available to the general creditors of the company.

## Article I

### Definitions

#### 1.01 Administrator

The party appointed by the company to administer the Plan as provided in Section 15 of the Adoption Agreement that will administer the Plan on behalf of the company. If no such appointment is made, the Compensation Committee of the Board of Directors of the company shall serve as the administrator. The party responsible for administration may engage a third-party administrator to provide essential Plan and accounting information.

#### 1.02 Adoption agreement

The written instrument that is attached to this Nonqualified Executive Deferral plan specifying the applicable elective provisions that applies to this Plan.

#### 1.03 Benefit distribution event

The date specified in the Adoption Agreement on which a participant's benefit is payable under the Plan. A participant shall have no right to receive payment of his or her benefit until reaching his or her benefit distribution date.

#### 1.04 Benefit payment

An amount an eligible participant or successor may receive at the specified benefit distribution event.

#### 1.05 Beneficiary

The participant's designated recipient of the Plan proceeds upon death.

#### 1.06 Change in the ownership

**Change in control:** The following three situations are permitted distribution events according to the Final Regulations under 409A:

1. Change in ownership
2. Change in effective control
3. Change in ownership of a substantial portion of corporate assets

# Preamble section continued

## **1. Change in ownership**

A change in the ownership of the corporation occurs if a person, or a group, acquires stock, combined with previously owned stock, controls more than 50 percent of the value or voting power of the stock of the corporation.

## **2. Change in effective control**

A change in effective control occurs if a person or group acquires, during a 12-month period, stock possessing 30 percent or more of the total voting power; or a majority of the board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the corporation's board of directors who were directors before the date of the election or appointment.

## **3. Change in ownership of a substantial portion of corporate assets**

A change in ownership of a substantial portion of the assets occurs if a person or group acquires, within a 12-month period, assets of the corporation having a total gross fair market value equal to 40 percent or more of the total gross fair market value of all of the corporation's assets.

### **1.07 Company**

The business entity specified in the Adoption Agreement which adopts the Plan. The term "company" shall also include any successor who by merger, consolidation, or purchase, or otherwise assumes the obligations of the Plan and any predecessor which has maintained this Plan.

### **1.08 Company contributions**

An amount as specified in Section 5 of the Adoption Agreement. Such amounts cannot yet have been earned by the participant at the time these amounts are automatically and completely allocated in their entirety to each participant's hypothetical participant account.

### **1.09 Compensation**

The total annual remuneration for employment received by an executive from the company.

### **1.10 Compensation committee**

A person or group of persons from the company that has the discretion to make decisions with regard to the Plan.

### **1.11 Code**

The Internal Revenue Code of 1986, as amended.

### **1.12 Crediting rate**

The rate at which Plan contributions will be credited or debited based upon the gains/losses of the index chosen by the company in the Adoption Agreement. The consequences of the crediting rate will be documented and tracked in the hypothetical participant account.



# Preamble section continued

## **1.13 Deferrals**

That portion of a participant's compensation which is deferred under the terms of the plan. Such compensation cannot yet have been earned by the participant at the time of the participant's election to defer.

## **1.14 Disability**

A participant shall be considered disabled if the participant is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the participant's employer.

## **1.15 Effective date**

The date on which the company's Nonqualified Executive Deferral plan or any amendment thereto becomes effective.

## **1.16 Election to defer form**

The written agreement between an eligible participant and the company to defer receipt by the participant of compensation not yet earned. Such an agreement shall state the deferral amount or percentage of compensation to be withheld from the participant's compensation, the date on which the agreement is effective, the distribution date for the benefit and the form and timing of the benefit payment.

## **1.17 Eligible executive**

The term eligible executive refers to a member of the general group that comprises the select group of management or highly compensated employees who has been identified as meeting the requirements to participate in the NQDC plan and has been designated by the company as eligible to participate in the Plan.

## **1.18 Entry date**

The date on which an executive commences participation in the Plan as determined by the company or compensation committee specified in Section 1 of the Adoption Agreement.

## **1.19 ERISA**

The Employee Retirement Income Security Act of 1974, as amended.

## **1.20 Executive**

The term executive refers to a member of the general group that comprises the select group of management or highly compensated employees before any participation in the NQDC plan has been determined.

## **1.21 Hypothetical participant account**

The hypothetical book account to which participant and company contributions may be credited.

# Preamble section continued

## **1.22 Nonqualified executive deferral plan (Plan)**

A Plan within the meaning of ERISA Section 201(2), the purpose of which is to permit a select group of management or highly compensated employees to defer receipt of a portion of compensation to a future date. The Plan, as set forth herein, shall include the Adoption Agreement and any administrative forms included by reference.

## **1.23 Participant**

An eligible executive who is an actually participating in the Plan.

## **1.24 Plan document**

The unfunded Nonqualified Executive Deferral plan as specified in the Nonqualified Executive Deferral plan-plan provisions- and the Nonqualified Executive Deferral plan- Adoption Agreement.

## **1.25 Plan year**

The twelve consecutive month period commencing January 1 and ending on December 31. The first Plan year shall commence on January 1 of the calendar year in which the Plan became effective.

## **1.26 Retirement benefit**

An amount an eligible participant or successor may receive at the specified retirement date or age.

## **1.27 Separation from service**

The severance of a participant's employment with the company for whatever reason.

## **1.28 Third-party administrator**

The party responsible for administration may engage a third-party administrator in order to provide essential Plan, accounting information, company reports and participant reports.

## **1.29 Unforeseeable emergency**

The term unforeseeable emergency means a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

## **1.30 Vesting**

The non-forfeitable portion of a participant's hypothetical participant account. The vested amount will always be subject to the creditors of the company.

# Preamble section continued

## Article II

### Eligibility

#### 2.01 Participation

Executives who meet the eligibility requirements set forth in Section 3 of the Adoption Agreement on the date the Plan is adopted by the company and have been designated by the company as participants in the Plan. The company may, at its sole discretion, designate the eligible executives to participate in the Plan. The company may, at its sole discretion, determine or make ineligible otherwise eligible executives at any time.

#### 2.02 Election not to participate

An otherwise eligible executive who has been designated by the company as a participant in the Plan may voluntarily elect not to participate in the Plan, subject to the approval by the Compensation Committee. The election not to participate in the Plan must be communicated to the company in writing.

#### 2.04 Entry date

The eligible executive will be allowed to start participating in the Plan as of the entry date designated by the company or the Compensation Committee.

## Article III

### Participant contributions

**3.01 Election to defer form – amount** (This section applies if the specific amounts or percentages are not already elected and specified in the plan document.)

The participant shall complete a properly executed and timely submitted Election to Defer form with the company authorizing the deferral of all or part of the participant's compensation and company bonus under the Plan earned during the period in which the participant participates in the Plan. The Election to Defer form shall also specify the portion of the participant's base pay and/or bonus amount to be deferred.

The participant must defer at least the minimum amount specified in Section 4 of the Adoption Agreement. In no event may any such election exceed the maximum deferral limitation in Section 4 of the Adoption Agreement.

Upon receipt of the Election to Defer form, the company shall withhold that portion of the participant's specified company bonus. The company shall have the right to refuse or hold any company bonus for any reasonable period of time necessary to facilitate administrative responsibility(s). The company shall have sole responsibility for calculating the participant's deferred amounts, withholding the appropriate amount and forwarding all contributions in a timely manner.

The participant may not increase or decrease his or her deferrals for the current year. Any subsequent Election to Defer form that has been properly submitted to the company will become effective as of the first day of the following year.

In no circumstance may a participant or the company allow compensation already earned to be deferred. All participant contributions will be subject to the company's creditors.

# Preamble section continued

**3.02 Election to defer form – time and form of benefit payment** (This section applies if the time and form of benefit payment elections are not already specified in the plan document.)

If the time and form of benefit payments are not specified in the plan document, the time and form of benefit payment must be specified on a properly executed and timely submitted Election to Defer form.

Upon entering the Plan, the participant must file a properly executed Election to Defer form that specifies the time and form of benefit payment and is timely submitted it to the company.

Any subsequent changes in the time and form of benefit payment must be communicated in a properly executed Election to Defer form that is timely submitted it to the company. The changes must be submitted at least one full year before the participant has the right to begin benefit payments and the benefit payments must be postponed for a minimum of five years.

## Article IV

### Company contributions

#### 4.01 Company contributions

The company may make discretionary matching or specific dollar amount contributions under the terms of the Plan. The amount of the company contribution and the requirements for eligibility for discretionary company contributions shall be determined by the company according to Section 5 of the Adoption Agreement. All company contributions shall be subject to the company's creditors.

#### 4.02 Vesting

Company contributions may be subject to a vesting schedule as determined in Section 6 of the Adoption Agreement

## Article V

### Benefits payments

#### 5.01 Retirement benefit payments

In the event the participant retires from employment upon attaining the retirement age specified in Section 10 of the Adoption Agreement, he or she shall be entitled to receive from the company a retirement benefit equal to the vested portion of the hypothetical participant account balance.

Such benefit payments shall follow the benefits payment provisions specified in Section 8, Section 9 and Section 10 of the Adoption agreement. The participant's vested balance of the hypothetical participant account shall be the amount to be paid out over the years and method selected.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 and Section 10 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the form of benefit payment. If Section 10 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the time of benefit payment.

## Preamble section continued

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **5.02 Survivor benefit (optional, please see Section 8 and Section 9 of the Adoption Agreement.)**

If the participant dies while employed by the company prior to attaining the retirement age as specified in Section 10 of the Adoption Agreement, the company shall pay to such individual or individuals as the participant shall have designated in a writing filed with

the company or, in the absence of such designation, to the estate of the participant, the amount of the survivor benefit in accordance with the terms specified in Section 9 and Section 11 of the Adoption Agreement.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 8, Section 9 and Section 11 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the form of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **5.03 Benefit – separation from service (optional, please see Section 8 and Section 9 of the Adoption Agreement.)**

In the event the participant terminates employment for reasons other than death, retirement or for cause, he or she shall be entitled to receive from the company a benefit. The amount of the benefit payment shall be the vested balance of the hypothetical participant account.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **5.04 Benefits – the participant’s attainment of a specified date (optional, please see Section 8 and Section 9 of the Adoption Agreement.)**

In the event of the participant’s attainment of a specified date specified in Section 11 of the Adoption Agreement, he or she shall be entitled to receive from the company a benefit payment equal to the vested hypothetical participant account balance.

Such benefit payments shall follow the benefits payment provisions specified in Section 8, Section 9 and Section 11 of the Adoption agreement. The participant’s vested balance of the hypothetical participant account shall be the amount to be paid out over the years and method selected.

## Preamble section continued

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 and Section 12 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the form of benefit payment. If Section 12 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the time of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **5.05 Disability benefits (optional, please see Section 8 and Section 9 of the Adoption Agreement.)**

In the event of the participant becomes disabled within the meaning as specified above, participant shall be entitled to receive from the company a benefit payment equal to the vested hypothetical participant account balance.

Such benefit payments shall follow the benefits payment provisions specified in Section 8 and Section 9 of the Adoption agreement. The participant's vested balance of the hypothetical participant account shall be the amount to be paid out over the years and method selected.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

Any benefit payment to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **5.06 Change in the ownership (optional, please see Section 8 and Section 9 of the Adoption Agreement and the section on Change in the Ownership in the Appendix.)**

If there is a change in the ownership of the company, the company shall pay to each participant an amount equal to the vested balance of the participant's hypothetical participant account, as determined on the date on which such change of control occurs.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

# Preamble section continued

## **5.07 Unforeseeable emergency (optional, please see Section 8 and Section 9 of the Adoption Agreement.)**

If the participant experiences an unforeseeable emergency, the company shall pay to the participant an amount not to exceed the cost of the unforeseeable emergency taking into consideration tax consequences. The payment for the unforeseeable emergency shall be limited to the vested balance of the participant's hypothetical participant account, as determined on the date on which such of the unforeseeable

emergency occurs. Such payment shall be made as soon as practicable after the date of the unforeseeable emergency occurs. Determination of the classification of an event as meeting the standard of an unforeseeable emergency shall be made at the sole discretion of the company or Compensation Committee and in complete accordance with IRS standards and definitions.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

Any benefit payment to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

## **Article VI**

### **Hypothetical participant accounts**

#### **6.01 Establishment of hypothetical participant accounts**

The administrator shall establish and maintain individual bookkeeping accounts on behalf of each participant participating in the Plan for purposes of determining each participant's accrued benefits under the terms of the Plan. Separate hypothetical participant accounts shall be established for each participant.

The company may exercise its discretion to make binding decisions with regard to Plan administration. Plan administration may be delegated to a competent third-party administrator. However, any such third-party administrator shall have no authority to make binding discretionary decisions without the written consent of the company that is beyond the scope of any contract into which the company and the administrator have entered.

#### **6.02 Allocation methods**

The participant's contributions shall be allocated to each participant's hypothetical participant accounts as deferred.

The company's matching or discretionary contributions, if any, shall be allocated to each participant's hypothetical participant accounts in accordance to Section 5 of the Adoption Agreement.

# Preamble section continued

## **6.03 Crediting rate**

All contributions to the Plan shall be credited in accordance with the crediting rate specified in Section 7 of the Adoption Agreement. Hypothetical participant accounts shall be adjusted annually for hypothetical earnings and hypothetical losses based upon the option selected by the company in Section 7 of the Adoption Agreement.

(Optional) If the company allows Plan contributions to be indexed to specific outside investments, the list of outside investments shall be selected at the sole discretion of the company. The participant may select the outside investments from the list of specific outside investments selected at the sole discretion of the company. The participant's selection of the outside investments will be used to determine the annual crediting rate for the participant's hypothetical participant account. The participant must file a Participant Investment Preference form in writing and within the time period specified by the company. The submission of the Participant Investment Preference form does not provide the participant with any interest or right to any assets or investments owned by the company. The choices designated on the Participant Investment Preference form are merely used as an indexing device (crediting rate) used to determine hypothetical growth and hypothetical losses in the participant's hypothetical participant account.

## **6.04 Vesting**

A participant shall always be immediately and 100 percent vested in the participant's deferral contributions and hypothetical earnings or losses credited to the participant's account.

A participant's vested balance in the company's discretionary contributions, hypothetical earnings and hypothetical losses there on shall be determined pursuant to the vesting schedule specified by the company in Section 6 of the Adoption Agreement.

# Article VII

## **Unfunded program**

### **7.01 Unfunded plan**

In no event will the assets accumulated by the company be construed as creating a funded Plan under ERISA or the Code or other any IRS pronouncements or promulgations.

### **7.01 Assets – generally**

The company shall be under no obligation to purchase or maintain any contract, policy or other asset to provide the benefits under this Plan. Any reference to a contract, policy or other asset is made solely for the purpose of computing the value of the benefits payable. Any contract, policy or other asset which the company may utilize to assure itself of the funds to provide the benefits hereunder shall not serve in any way as security to the participant for the company's performance under this Plan.

The rights accruing to the participant or any beneficiary hereunder shall be solely those of an unsecured creditor of the company. The company may establish appropriate reserves for the plan in accordance with generally accepted accounting principles. Any reserves set aside by the company shall be considered part of the general funds of company. No participant or beneficiary shall have any interest or right to any reserves.



# Preamble section continued

## Article VIII

### Amendment and termination

#### 8.01 Amendment

The company may at any time amend this Plan without the consent of any participant or beneficiary hereunder provided that any amendment is communicated to participants within 15 days prior to the amendment effective date. No amendment shall deprive a participant or beneficiary of any benefit already accrued under the Plan. This Plan will be amended from time to time to comply with provisions of the Code, related regulations and other published guidance.

#### 8.02 Termination

Although the company has established this Plan with a bona fide intention of maintaining the Plan indefinitely, the company may terminate the Plan on the earlier of the date on which there is a change in the ownership of the company or thirty days after notice has been given to all participants in writing. Upon termination, no further contributions will be allowed, and benefits will be paid out in accordance to Section 8, Section 9, Section 10 and Section 11 of the Adoption Agreement

## Article IX

### Miscellaneous

#### 9.01 Entire agreement

The plan document, beneficiary designation, and administrative forms shall constitute the total agreement between the company and the participant. No oral statement, informational reports or estimates of potential benefits regarding the Plan may be relied upon by the participant. In the event that there is a discrepancy between the plan document, administrative forms, and summary descriptions, the plan document will control.

#### 9.02 Employment rights

No provision of this Plan shall restrict the right of the company to terminate the participant's employment. Neither the establishment of this Plan nor any modification thereof, nor the creation of a trust or participant account or the payment of benefits shall be construed as giving the participant or any other person a right to employment with the company or any other right against the company unless otherwise provided herein. In no event shall the terms of employment of any participant be modified or in any way be affected by the plan.

#### 9.03 Claims procedure

##### a. Filing of claim

A participant who believes that a benefit has been denied under the Plan is entitled to file a written request for such benefit with the employer. The claimant shall address the written request to the President of the company at its principal place of business.

# Preamble section continued

## **b. Decision**

Upon receipt of the benefit claim, the employer shall inform the claimant that a reply to the claim shall be provided within ninety (90) days. The employer shall deliver the reply within the stated ninety (90) day period.

## **c. Denial of claim**

If the claim has been denied by the employer, the employer shall provide a written opinion to the claimant. The written opinion shall include the following:

- Specific reason(s) for the denial of benefits,
- Relevant provisions of the NQDC document that support the denial,
- Procedure and any time limits that claimant must follow to obtain a review of the claim, and
- Additional information and supporting material needed for the claimant to perfect his or her claim, the reason(s) why such information and material is necessary and the time limits under which such information and material must be submitted.

## **d. Request for review**

The claimant may request in writing a review of the written opinion. The claimant must submit a Request for Review within sixty (60) days from receipt of the written opinion. The claimant must submit a Request for Review to the President of the company at its principal place of business. If the claimant does not submit a Request for Review within sixty (60) days from receipt of the written opinion, the claimant will have waived his or her right to any review of the written opinion.

## **e. Review of opinion**

The employer shall review the denial of the claim, the opinion and other material provided by the claimant within sixty (60) days from receipt of the written Request for Review. The employer shall provide the claimant with a written opinion that is written in a manner which is understandable by the claimant and includes references to relevant provisions of the NQDC document that support the decision.

## **9.04 Governing law**

This agreement shall be construed according to the laws of the state of the company's state of incorporation and in accordance with federal law.

## **9.05 Other benefits**

The benefits provided under the terms of this Plan are intended as fringe benefits designed to retain the participants of the company. Any benefit payments under this agreement shall be independent of, and in addition to, those under any other plan, program or agreement which may be in effect between the parties hereto, or any other compensation payable to the participant or the participant's designated beneficiary by the company. This agreement shall not be construed as a contract of employment, nor does it restrict the right of the company to discharge the participant for proper cause or the right of the participant to terminate employment.

## **9.06 Unclaimed benefits**

Each participant and/or designated beneficiary shall keep the company informed of his or her current address. The company shall not be obligated to search for the whereabouts of any person.

## Preamble section continued

If the location of the participant or designated beneficiary is not made known to the company within one year after payment is made to the hypothetical participant account, then the company shall have no further obligation to pay any person any benefit and any such balance in the hypothetical participant account shall be forfeited.

### **9.07 Beneficiary designation**

The participant shall designate a beneficiary to receive any benefits due under the Plan. The participant may, at any time, submit a properly executed beneficiary designation form, in a manner acceptable to the company. All designations shall become effective upon receipt by the company. In the event a participant does not designate a beneficiary, any distribution of benefits due under this Plan after the participant's death shall be paid to the participant's surviving spouse, if any, or otherwise to the participant's estate.

### **9.08 Participants**

The Plan shall be binding on the adopting company and its successors, participating participants and their successor beneficiaries.

### **9.09 Severability**

Whenever possible, each provision of this Plan shall be interpreted in such a manner as to be effective and valid under applicable law. If any provision is now or later becomes invalid, the remainder of the Plan provisions and their application shall not be affected.

### **9.10 Claim of benefits upon death**

The participant's beneficiary shall present to the company, as soon as reasonably feasible, a death certificate of the participant. The company may, at its discretion, withhold benefit payments due until all necessary paperwork is received.

### **9.11 Assignment and alienation**

Unless otherwise provided by law or as otherwise provided in this Plan, no benefit which shall be payable to any person, including an participant or an participant's beneficiary, shall be subject in any manner to anticipate, assign, transfer, sell, mortgage, pledge hypothecate, or encumber any benefit under this Plan. No benefit shall in any manner be liable for, or subject to, the debts, contracts, liabilities, engagements, or torts of any such person, nor shall it be subject to legal process for or against such person. The administrator shall not recognize any attempt by a third party to attach, garnish or levy upon any benefit under the Plan except as provided by law.

The right of the participant or designated beneficiary to receive a distribution hereunder shall be an unsecured claim against the general assets of the company. Neither the participant nor his or her designated beneficiary shall have any rights in or against any amount credited to the hypothetical participant account or any other specific assets of the company.

### **9.12 Investment provider protective clause**

The Investment Provider providing the informal funding vehicle to the Company is not a party to this Plan. It is understood by all parties hereto that in issuing any investment to the Company, the Investment Provider shall have no liability except as set forth in the investment vehicle filed at its Home Office. The Investment Provider shall not be bound to inquire into or take notice of any of the covenants herein contained as to the application of the investment proceeds.

# Preamble section continued

The Investment Provider shall be protected and held harmless in acting in accordance with any written direction of the Administrator or Company or any person having capacity to make decisions under this Plan. Regardless of any provision of this Plan, the Investment Provider shall not be required to take or permit any action or allow any benefit or privilege contrary to the terms of any Contract which it issues hereunder, or the rules of the Investment Provider. Although the Investment Provider may provide values to the Administrator necessary to administer the Plan, the Investment Provider has no responsibility to administer the Plan.

## **9.13 Headings**

The headings and subheadings of this Plan have been inserted for the convenience of reference and are to be ignored in any construction of the provisions herein.

# Article X

## **Supplemental employment provisions**

### **10.01 Covenant not to compete**

The participant hereby agrees that, so long as he or she remains employed by the company, he or she will devote substantially all of his or her time, skill, diligence and attention to the business of the company. The participant further agrees that he or she shall not engage in or become interested in, directly or indirectly, any enterprise conducted in the trading area of the business of the company which enterprise is, or may be deemed to be, competitive with any business carried on by the company, without the prior written consent of the company for such period as designated in the Adoption Agreement. Determination of whether you are in competition shall be made by the Compensation Committee and communicated to the participant in writing.

This provision will terminate after all payments under this plan have been made to you or your designated recipient. The Compensation Committee may waive this provision.

### **10.02 Covenant to provide consulting services**

The participant hereby agrees to provide consulting services as an independent contractor to the company as the company may periodically require. The participant agrees that as further consideration for the agreements of the company contained herein, and as a condition to the performance by the company of its obligations hereunder, if the participant incurs a termination of employment, throughout the period through which the company is required to make payments under the Plan, the participant agrees to make himself or herself available to the company for such advisory and consultative services on a part-time basis as may, from time to time, be requested by the company.

This provision will terminate when the participant is no longer receiving benefit payments under the Plan. The Compensation Committee may waive this provision.

# Nonqualified executive deferral plan adoption agreement

## Section 1: General information

A. Name of plan: \_\_\_\_\_

### B. Participant:

Name of participant: \_\_\_\_\_ Entry date: \_\_\_\_\_

### C. Company:

Name of company: \_\_\_\_\_

Address: \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_

Telephone: \_\_\_\_\_ Employer tax ID: \_\_\_\_\_

Employer fiscal year-end: \_\_\_\_\_ Plan year-end: \_\_\_\_\_

## Section 2: Effective dates (check and complete option 1 or 2)

Option 1:  **Initial adoption:** This is the initial adoption of a nonqualified executive deferral plan by the company for the eligible executives described in Section 1 of the Adoption Agreement.

The effective date of this plan is \_\_\_\_\_, \_\_\_\_\_.

Option 2:  **Amendment:** This is an amendment and restatement of an existing executive deferred compensation plan for the eligible executives (a prior plan).

The prior plan was initially effective on \_\_\_\_\_, \_\_\_\_\_.

The effective date of this amendment and restatement is \_\_\_\_\_, \_\_\_\_\_.

## Section 3: Participation requirements

The select group of management or highly compensated executives who are eligible to participate in the plan are: **(Select and complete one or more of the following items.)**

The following executives: (may attach list)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Executives designated from time to time by the company or the Compensation Committee.

Executives with a position ranking of or above \_\_\_\_\_, earning a minimum of \$\_\_\_\_\_ per plan year.

Executives who are members of the company's select group of management or who are highly compensated executives as defined under relevant provisions of the Code and/or ERISA.

# Nonqualified executive deferral plan adoption agreement section continued

## Section 4: Participant contributions

### A: Maximum limits on deferral

An eligible participant shall be entitled to elect to defer up to the following amount of compensation per plan year: **(Choose one)**

Option 1:  \_\_\_\_\_ % of compensation

Option 2:  \$\_\_\_\_\_ flat amount

### B: Minimum deferral

An eligible participant deferrals shall be subject to a minimum deferral of \$\_\_\_\_\_.

### C: Election to defer

Executive deferral form: If the amount of the actual contribution shall be determined by the participant on an annual basis, the amount of the total deferral must be specified in writing on the Executive Deferral form and submitted to the company in the year prior to the year that the contribution is earned.

## Section 5: Discretionary company contributions

### A. Amount

The company may reserve the right to make additional discretionary contributions to the hypothetical participant accounts of participants. For each plan year, the company will determine, in its complete and sole discretion, such amount, if any, to award.

If such contributions are declared, they shall be automatically and completely allocated in their entirety to each participant's hypothetical participant account.

### B. Requirements for eligibility for company contributions

A participant will be entitled to have 100 percent of the participant's portion of the company contributions allocated to the participant's hypothetical participant account for any plan year only if the participant satisfies the following additional conditions **(Check one or more Options)**:

Option 1:  No additional conditions.

Option 2:  Hours of service requirement. The eligible participant works at least \_\_\_\_\_ months for the company during the plan year.

Option 3:  Last day requirement. The eligible participant of the company on the last day of the plan year. However, this condition will be waived for the following reasons: **(Check at least one)**

The eligible participant's death.

The eligible participant's termination of employment after having incurred a disability.

The eligible participant's termination of employment after having reached normal retirement age.

This condition will not be waived.

Option 4:  Other: (specify) \_\_\_\_\_.

# Nonqualified executive deferral plan adoption agreement section continued

## Section 6: Vesting of company contributions

The portion of an eligible participant's hypothetical participant account attributable to company contributions shall be vested as follows: **(Choose one)**

- Option 1:  5-year cliff vesting (0-5 years 0%, 100% beginning of year 6)
- Option 2:  5-year graded vesting  
(0% beginning of year 1, 20% beginning of year 2,  
40% beginning of year 3, 60% beginning of year 4,  
80% beginning of year 5, 100% beginning of year 6)
- Option 3:  100% upon entering Plan
- Option 4:  Other: \_\_\_\_\_

## Section 7: Crediting rate on plan contributions

Pursuant to Section 6 of the Nonqualified Executive Deferral plan-agreement, the company shall annually credit each eligible participant's hypothetical participant account with hypothetical earnings based upon the following: **(Choose one)**

- Option 1:  Crediting rate of \_\_\_\_\_ percent for first year of the Plan. Crediting rate applicable for years following the first year will be determined by the company annually for the life of the plan. The crediting rate is to be determined in the first quarter of each year. If a crediting rate is not determined, the previous year's crediting rate will be applied. Distribution discount rate for distributions will be specified under Section 9 of the Adoption Agreement. **(Please complete Section 9.)**
- Option 2:  Crediting rate of \_\_\_\_\_ percent per year annually for the life of the plan. Distribution discount rate for distributions will be specified under Section 9 of the Adoption Agreement. **(Please complete Section 9.)**
- Option 3:  Variable crediting rate as determined by the form specifying the participant's hypothetical investment options. Distribution discount rate for distributions will be specified under Section 9 of the Adoption Agreement. **(Please complete Section 9.)**

## Section 8: Benefit distribution events

The amounts in a participant's hypothetical participant account shall be payable upon the occurrence on any one of the following events (Check all that apply and coordinate the selection with Section 9 below and other provisions in the plan document.):

- A.  Normal retirement age of the participant
- B.  Death of the participant (optional)
- C.  Separation from service of the participant (optional)
- D.  The participant's attainment of the benefit distribution date of \_\_\_\_\_,  
\_\_\_\_\_ (optional)
- E.  Disability of the participant (optional)
- F.  Unforeseeable emergency of the participant (optional)
- G.  Change in the ownership of the company (optional)

# Nonqualified executive deferral plan adoption agreement section continued

## Section 9: Benefit payments – form of payment

Complete the Form of Payment for each of the distribution events selected in Section 8 of the Adoption Agreement if the Form of Payment is not required to have been completed with a valid and current Election to Defer form that specifies the time and form of payment in compliance with IRC Section 409A.

### A. Normal retirement age of the participant: (Complete only if selected in Section 8.)

#### 1. Duration of payments: Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_
- Option 6:  As elected on a valid and timely filed Election to Defer form

#### 2. Frequency of payments: Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

#### 3. Distribution discount rate: The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

- Option 1: \_\_\_ Average rate of return of the hypothetical participant account
- Option 2: \_\_\_ Discount rate (listed as a percentage between 1-15%)

#### 4. Time of payment: As specified in Section 10.

### B. Death of the participant/survivor benefit: (Complete only if selected in Section 8.)

#### 1. Duration of payments: Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_
- Option 6:  As elected on a valid and timely filed Election to Defer form

#### 2. Frequency of payments: Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

#### 3. Distribution discount rate: The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

- Option 1: \_\_\_ Average rate of return of the hypothetical participant account
- Option 2: \_\_\_ Discount rate (listed as a percentage between 1-15%)



# Nonqualified executive deferral plan adoption agreement section continued

## **C. Separation from service of the participant:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

### **2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

### **3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 2: \_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_ Discount rate (listed as a percentage between 1-15%)

## **D. The participant's attainment of the benefit distribution date:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

### **2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

### **3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_ Discount rate (listed as a percentage between 1-15%)

### **4. Time of payment:** As specified in Section 12.

# Nonqualified executive deferral plan adoption agreement section continued

## **E. Disability of the participant:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

### **2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

### **3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_ Discount rate (listed as a percentage between 1-15%)

## **F. Unforeseeable emergency of the participant:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

Option 1:  Lump sum

Option 2:  Other: \_\_\_\_\_

Option 3:  As elected on a valid and timely filed Election to Defer form

### **2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Other: \_\_\_\_\_

### **3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_ Discount rate (listed as a percentage between 1-15%)

## **G. Change in the ownership of the company:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

# Nonqualified executive deferral plan adoption agreement section continued

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

**3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_ Discount rate (listed as a percentage between 1-15%)

## Section 10: Normal retirement age

The normal retirement age under the Plan shall be:

Option 1:  Age 65

Option 2:  Age: \_\_\_\_\_

Option 3:  As elected on a valid and timely filed Election to Defer form

## Section 11: Death of the participant/survivor benefit

If participant dies prior to normal retirement age or benefit distribution date the participant's designated beneficiaries will receive the following: (Complete only if Option B in Section 8 and Section 9 was selected.)

Option 1:  Vested balance of the hypothetical participant account

Option 2:  Greater of the vested balance of their hypothetical participant account

or \$ \_\_\_\_\_

(If Option 2 in Section 8 and Section 9 has not been selected, then this provision is not necessary.)

## Section 12: Benefit distribution date

If applicable, the benefit distribution date under the Plan shall be:

Option 1:  Date \_\_\_\_\_, \_\_\_\_\_

Option 2:  As elected on a valid and timely filed Election to Defer form

(If Option D in Section 8 and Section 9 has not been selected, then this provision is not necessary.)

## Section 13: Agreement not to compete

(Select and complete one option.)

Option 1:  The participant shall honor the agreement not to compete as set forth in Section 10.01 of the plan provisions for a period of \_\_\_\_\_ years following termination of employment for any reason.

Option 2:  The participant shall honor the agreement not to compete as set forth in Section 10.01 of the plan provisions for the entire period during which payments are due hereunder.

# Nonqualified executive deferral plan adoption agreement section continued

Option 3:  In lieu of the agreement not to compete as set forth in Section 10.01 of the plan provisions, the following agreement not to compete shall apply: (Specify and attach an additional sheet if necessary.)

\_\_\_\_\_

\_\_\_\_\_

Option 4:  There shall be no agreement not to compete hereunder.

## Section 14: Additional conditions

(Select and complete one or more option.)

Option 1:  The executive shall honor the agreement to provide advisory and consulting services as set forth in Section 10.02 of the plan provisions for a period of \_\_\_\_\_ years following termination of employment with the company for any reason.

Option 2:  The executive shall honor the agreement to provide advisory and consulting services as set forth in Section 10.02 of the plan provisions for the entire period during which payments are due hereunder.

Option 3:  Other: (Specify and attach an additional sheet if necessary.)

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Option 4:  No additional conditions will apply.

## Section 15: Third-party administrator

Option 1:  The Pangburn Company

Option 2:  Other:

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Telephone: \_\_\_\_\_

## Company signature

Authorized signature for company: \_\_\_\_\_

Printed name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

## Participant signature

Participant name (printed): \_\_\_\_\_

Participant signature: \_\_\_\_\_

Date: \_\_\_\_\_

# Nonqualified deferred bonus plan provisions

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This is a specimen booklet for general information only and is intended to be exhibited to the client’s attorney for consideration. The specimen agreements are general agreements and must not be represented as adapted to the particular situation of any client. The laws of the various states may differ considerably, and all legal instruments must be prepared by the client’s attorney.

# Preamble

The company, by executing the attached Adoption Agreement, hereby establishes an unfunded Nonqualified Executive Deferral plan (Plan) for a select group of executives intended to meet the top hat exemption for Titles I and IV of ERISA. The Plan will allow eligible executives to defer a portion of their compensation not yet earned according to their executive deferral election forms.

The Plan shall be binding on participating executives as well as any of the participant's successors who may become eligible to receive payments under the Plan such as a spouse or beneficiaries. Executives participating in the Plan will have no right, directly or indirectly, to anticipate, assign, sell or pledge any asset set aside to satisfy benefit obligations under the Plan. The assets used as a source to satisfy Plan benefits shall be available to the general creditors of the company.

## Article I

### Definitions

#### 1.01 Administrator

The party appointed by the company to administer the Plan as provided in Section 15 of the Adoption Agreement that will administer the Plan on behalf of the company. If no such appointment is made, the Compensation Committee of the Board of Directors of the company shall serve as the administrator. The party responsible for administration may engage a third-party administrator in order to provide essential Plan and accounting information.

#### 1.02 Adoption agreement

The written instrument that is attached to this Nonqualified Deferred Bonus plan specifying the applicable elective provisions that apply to this Plan.

#### 1.03 Benefit distribution event

The date specified in the Adoption Agreement on which a participant's benefit is payable under the Plan. A participant shall have no right to receive payment of his or her benefit until reaching his or her benefit distribution date.

#### 1.04 Benefit payment

An amount an eligible participant or successor may receive at the specified benefit distribution event.

#### 1.05 Beneficiary

The participant's designated recipient of the Plan proceeds upon death.

#### 1.06 Change in the ownership

Change in control: The following three situations are permitted distribution events according to the Final Regulations under 409A:

1. Change in ownership
2. Change in effective control
3. Change in ownership of a substantial portion of corporate assets

# Preamble section continued

## **1. Change in ownership**

A change in the ownership of the corporation occurs if a person or a group acquires stock, combined with previously owned stock, controls more than 50 percent of the value or voting power of the stock of the corporation.

## **2. Change in effective control**

A change in effective control occurs if a person or group acquires, during a 12-month period, stock possessing 30 percent or more of the total voting power; or a majority of the board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the corporation's board of directors who were directors before the date of the election or appointment.

## **3. Change in ownership of a substantial portion of corporate assets**

A change in ownership of a substantial portion of the assets occurs if a person or group acquires, within a 12-month period, assets of the corporation having a total gross fair market value equal to 40 percent or more of the total gross fair market value of all of the corporation's assets.

### **1.07 Company**

The business entity specified in the Adoption Agreement which adopts the Plan. The term "company" shall also include any successor who by merger, consolidation, purchase, or otherwise assumes the obligations of the Plan and any predecessor which has maintained this Plan.

### **1.08 Company bonus**

An amount as specified in Section 5 of the Adoption Agreement. Such amounts cannot yet have been earned by the participant at the time these amounts are automatically and completely allocated in their entirety to each participant's hypothetical participant account.

### **1.09 Compensation**

The total annual remuneration for employment received by an executive from the company.

### **1.10 Compensation committee**

A person or group of persons from the company that has the discretion to make decisions regarding the Plan.

### **1.11 Code**

The Internal Revenue Code of 1986, as amended.

### **1.12 Crediting rate**

The rate at which Plan contributions will be credited or debited based upon the gains/losses of the index chosen by the company in the Adoption Agreement. The consequences of the crediting rate will be documented and tracked in the hypothetical participant account.

### **1.13 Deferrals**

All or a percentage of the company bonus which is deferred under the terms of the plan. Such company bonus cannot yet have been earned by the participant at the time of the deferral.

# Preamble section continued

## **1.14 Disability**

A participant shall be considered disabled if the participant is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the participant's employer.

## **1.15 Effective date**

The date on which the company's Nonqualified Deferred Bonus plan or any amendment thereto becomes effective.

## **1.16 Election to defer form**

The written agreement between an eligible participant and the company to defer receipt by the participant of compensation not yet earned. Such an agreement shall state the deferral amount or percentage of compensation to be withheld from the participant's compensation, the date on which the agreement is effective, the distribution date for the benefit and the form and timing of the benefit payment.

## **1.17 Eligible executive**

The term eligible executive refers to a member of the general group that comprises the select group of management or highly compensated employees who has been identified as meeting the requirements to participate in the NQDC plan and has been designated by the company as eligible to participate in the Plan.

## **1.18 Entry date**

The date on which an executive commences participation in the Plan as determined by the company or compensation committee specified in Section 1 of the Adoption Agreement.

## **1.19 ERISA**

The Employee Retirement Income Security Act of 1974, as amended.

## **1.20 Executive**

The term executive refers to a member of the general group that comprises the select group of management or highly compensated employees before any participation in the NQDC plan has been determined.

## **1.21 Hypothetical participant account**

The hypothetical book account to which participant and company contributions may be credited.

## **1.22 Nonqualified deferred bonus plan ("Plan")**

A Plan within the meaning of ERISA Section 201(2), the purpose of which is to permit a select group of management or highly compensated employees to defer receipt of a portion of compensation to a future date. The Plan, as set forth herein, shall include the Adoption Agreement and any administrative forms included by reference.



# Preamble section continued

## **1.23 Participant**

An eligible executive who is an actually participating in the Plan.

## **1.24 Plan document**

The unfunded Nonqualified Deferred Bonus plan as specified in the Nonqualified Deferred Bonus plan-Plan Provisions and the Nonqualified Deferred Bonus plan- Adoption Agreement.

## **1.25 Plan year**

The twelve consecutive month period commencing January 1 and ending on December 31. The first Plan year shall commence on January 1 of the calendar year in which the Plan became effective.

## **1.26 Retirement benefit**

An amount an eligible participant or successor may receive at the specified retirement date or age.

## **1.27 Separation from service**

The severance of a participant's employment with the company for whatever reason.

## **1.28 Third-party administrator**

The party responsible for administration may engage a third-party administrator in order to provide essential Plan, accounting information, company reports and participant reports.

## **1.29 Unforeseeable emergency**

The term "unforeseeable emergency" means a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

## **1.30 Vesting**

The non-forfeitable portion of a participant's hypothetical participant account. The vested amount will always be subject to the creditors of the company.

# Article II

## **Eligibility**

### **2.01 Participation**

Executives who meet the eligibility requirements set forth in Section 3 of the Adoption Agreement on the date the Plan is adopted by the company and have been designated by the company as participants in the Plan. The company may, at its sole discretion, designate the eligible executives to participate in the Plan. The company may, at its sole discretion, determine or make ineligible otherwise eligible executives at any time.

### **2.02 Election not to participate**

An otherwise eligible executive who has been designated by the company as a participant in the plan may elect voluntarily not to participate in the plan, subject to the approval by the Compensation Committee. The election not to participate in the Plan must be communicated to the company in writing.

# Preamble section continued

## 2.04 Entry date

The eligible executive will be allowed to start participating in the Plan as of the entry date designated by the company or the Compensation Committee.

## Article III

### Company bonus

#### 3.01 Company bonus

The company may make discretionary dollar amount contributions under the terms of the Plan. The amount of the bonus and the requirements for eligibility for discretionary company bonus shall be determined by the company according to Section 5 of the Adoption Agreement. All company bonuses shall be subject to the company's creditors.

#### 3.02 Vesting

Company bonus may be subject to a vesting schedule as determined in Section 6 of the Adoption Agreement.

#### **3.03 Election to defer form – Amount (This section applies if the election to defer the amount of the company bonus to be deferred is not already specified in the plan document.)**

The participant shall complete a properly executed and timely submitted Election to Defer form with the company authorizing the deferral of all or part of the company bonus under the Plan earned during the period in which the participant participates in the Plan.

Upon receipt of the Election to Defer form, the company shall withhold that portion of the participant's specified company bonus. The company shall have the right to refuse or hold any company bonus for any reasonable period of time necessary to facilitate administrative responsibility(s).

The participant may not increase or decrease his or her deferrals for the current year. Any subsequent Election to Defer form that has been properly submitted to the company will become effective as of the first day of the following year.

The participant must defer at least the minimum amount specified in Section 4 of the Adoption Agreement. In no event may any such election exceed the maximum deferral limitation in Section 4 of the Adoption Agreement.

In no circumstance may a participant or the company allow compensation already earned to be deferred. All participant contributions will be subject to the company's creditors.

#### **3.04 Election to Defer form – Time and Form of Benefit Payment (This section applies if the time and form of benefit payment elections are not already specified in the plan document.)**

If the time and form of benefit payment is not specified in this plan document, the time and form of benefit payment must be specified on a properly executed and timely submitted Election to Defer form.

Upon entering the Plan, the participant must file a properly executed Election to Defer form that specifies the time and form of benefit payment and is timely submitted it to the company.

Any subsequent changes in the time and form of benefit payment must be communicated in a properly executed Election to Defer form that is timely submitted it to the company. The changes must be submitted at least one full year before the participant has the right to begin benefit payments and the benefit payments must be postponed for a minimum of five years.

# Preamble section continued

## **3.05 Responsibility for contributions**

The company shall have sole responsibility for calculating the participant's company bonus, withholding the appropriate amount and forwarding all contributions in a timely manner.

## **Article IV**

### **Benefits payments**

#### **4.01 Retirement benefit payments**

In the event the participant retires from employment upon attaining the retirement age specified in Section 10 of the Adoption Agreement, he or she shall be entitled to receive from the company a retirement benefit equal to the vested portion of the hypothetical participant account balance.

Such benefit payments shall follow the benefits payment provisions specified in Section 8, Section 9 and Section 10 of the Adoption agreement. The participant's vested balance of the hypothetical participant account shall be the amount to be paid out over the years and method selected.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 and Section 10 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the form of benefit payment. If Section 10 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the time of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

#### **4.02 Survivor benefit** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

If the participant dies while employed by the company prior to attaining the retirement age as specified in Section 10 of the Adoption Agreement, the company shall pay to such individual or individuals as the participant shall have designated in a writing filed with the company or, in the absence of such designation, to the estate of the participant, the amount of the survivor benefit in accordance with the terms specified in Section 9 and Section 11 of the Adoption Agreement. The benefit payments will be paid out of the hypothetical participant account as elected in Section 8, Section 9 and Section 11 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the form of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

## Preamble section continued

### **4.03 Benefit – separation from service** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

In the event the participant terminates employment for reasons other than death, retirement or for cause, he or she shall be entitled to receive from the company a benefit. The amount of the benefit payment shall be the vested balance of the hypothetical participant account. The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **4.04 Benefits – the participant’s attainment of a specified date** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

In the event of the participant’s attainment of a specified date specified in Section 11 of the Adoption Agreement, he or she shall be entitled to receive from the company a benefit payment equal to the vested hypothetical participant account balance.

Such benefit payments shall follow the benefits payment provisions specified in Section 8, Section 9 and Section 11 of the Adoption Agreement. The participant’s vested balance of the hypothetical participant account shall be the amount to be paid out over the years and method selected.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 and Section 12 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the form of benefit payment. If Section 12 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form must have been filed that specifies the time of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **4.05 Disability benefits** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

In the event of the participant becomes disabled within the meaning as specified above, participant shall be entitled to receive from the company a benefit payment equal to the vested hypothetical participant account balance.

Such benefit payments shall follow the benefits payment provisions specified in Section 8 and Section 9 of the Adoption Agreement. The participant’s vested balance of the hypothetical participant account shall be the amount to be paid out over the years and method selected.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

## Preamble section continued

Any benefit payment to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

**4.06 Change in the ownership** (optional, please see Section 8 and Section 9 of the Adoption Agreement and the section on Change in the Ownership in the Appendix.)

If there is a change in the ownership of the company, the company shall pay to each participant an amount equal to the vested balance of the participant's hypothetical participant account, as determined on the date on which such change of control occurs.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

**4.07 Unforeseeable emergency** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

If the participant experiences an unforeseeable emergency, the company shall pay to the participant an amount not to exceed the cost of the unforeseeable emergency taking into consideration tax consequences. The payment for the unforeseeable emergency shall be limited to the vested balance of the participant's hypothetical participant account, as determined on the date on which such of the unforeseeable emergency occurs. Such payment shall be made as soon as practicable after the date of the unforeseeable emergency occurs. Determination of the classification of an event as meeting the standard of an unforeseeable emergency shall be made at the sole discretion of the company or Compensation Committee and in complete accordance with IRS standards and definitions.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement. If Section 9 of the Adoption Agreement requires an Election to Defer form, a valid and timely filed Election to Defer form will specify the time and form of benefit payment.

Any benefit payment to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

## Article V

### Hypothetical participant accounts

#### 5.01 Establishment of hypothetical participant accounts

The Administrator shall establish and maintain individual bookkeeping accounts on behalf of each participant participating in the Plan for purposes of determining each participant's accrued benefits under the terms of the Plan. Separate hypothetical participant accounts shall be established for each participant.

# Preamble section continued

The company may exercise its discretion to make binding decisions with regard to Plan administration. Plan administration may be delegated to a competent third-party administrator. However, any such third party administrator shall have no authority to make binding discretionary decisions without the written consent of the company that is beyond the scope of any contract entered into between the company and the administrator.

## **5.02 Allocation methods**

The participant's contributions shall be allocated to each participant's hypothetical participant accounts as deferred.

The company's matching or discretionary contributions, if any, shall be allocated to each participant's hypothetical participant accounts in accordance to Section 5 of the Adoption Agreement.

## **5.03 Crediting rate**

All contributions to the Plan shall be credited in accordance with the crediting rate specified in Section 7 of the Adoption Agreement. Hypothetical participant accounts shall be adjusted annually for hypothetical earnings and hypothetical losses based upon the option selected by the company in Section 7 of the Adoption Agreement.

(Optional) If the company allows Plan contributions to be indexed to specific outside investments, the list of outside investments shall be selected at the sole discretion of the company. The participant may select the outside investments from the list of specific outside investments selected at the sole discretion of the Company. The participant's selection of the outside investments will be used to determine the annual crediting rate for the participant's hypothetical participant account. The participant must file a Participant Investment Preference form in writing and within the time period specified by the company. The submission of the Participant Investment Preference form does not provide the participant with any interest or right to any assets or investments owned by the company. The choices designated on the Participant Investment Preference form are merely used as an indexing device (crediting rate) used to determine hypothetical growth and hypothetical losses in the participant's hypothetical participant account.

## **5.04 Vesting**

A participant shall always be immediately and 100 percent vested in the participant's deferral contributions and hypothetical earnings or losses credited to the participant's account.

A participant's vested balance in the company's discretionary contributions, hypothetical earnings and hypothetical losses there on shall be determined pursuant to the vesting schedule specified by the company in Section 6 of the Adoption Agreement.

# Article VI

## **Unfunded program**

### **6.01 Unfunded plan**

In no event will the assets accumulated by the company be construed as creating a funded Plan under ERISA or the Code or other any IRS pronouncements or promulgations.

# Preamble section continued

## **6.01 Assets – generally**

The company shall be under no obligation to purchase or maintain any contract, policy or other asset to provide the benefits under this Plan. Any reference to a contract, policy or their asset is made solely for the purpose of computing the value of the benefits payable. Any contract, policy or other asset which the company may utilize to assure itself of the funds to provide the benefits hereunder shall not serve in any way as security to the participant for the company's performance under this Plan. The rights accruing to the participant or any beneficiary hereunder shall be solely those of an unsecured creditor of the company. The company may establish appropriate reserves for the Plan in accordance with generally accepted accounting principles. Any reserves set aside by the company shall be considered part of the general funds of company. No participant or beneficiary shall have any interest or right to any reserves.

## **Article VII**

### **Amendment and termination**

#### **7.01 Amendment**

The company may at any time amend this Plan without the consent of any participant or beneficiary hereunder provided that any amendment is communicated to participants within 15 days prior to the amendment effective date. No amendment shall deprive a participant or beneficiary of any benefit already accrued under the Plan. This Plan will be amended from time to time to comply with provisions of the code, related regulations and other published guidance.

#### **7.02 Termination**

Although the company has established this Plan with a bona fide intention of maintaining the Plan indefinitely, the company may terminate the Plan on the earlier of the date on which there is a change in the ownership of the company or thirty days after notice has been given to all participants in writing. Upon termination, no further contributions will be allowed, and benefits will be paid out in accordance to Section 8, Section 9, Section 10 and Section 11 of the Adoption Agreement.

## **Article VIII**

### **Miscellaneous**

#### **8.01 Entire agreement**

The plan document, beneficiary designation, and administrative forms shall constitute the total agreement between the company and the participant. No oral statement, informational reports or estimates of potential benefits regarding the Plan may be relied upon by the participant. In the event that there is a discrepancy between the plan document, administrative forms, and summary descriptions, the plan document will control.

#### **8.02 Employment rights**

No provision of this Plan shall restrict the right of the company to terminate the participant's employment. Neither the establishment of this Plan nor any modification thereof, nor the creation of a trust or participant account or the payment of benefits shall be construed as giving the participant or any other person a right to employment with the company or any other right against the company unless otherwise provided herein. In no event shall the terms of employment of any participant be modified or in any way be affected by the Plan.

# Preamble section continued

## 8.03 Claims procedure

### a. Filing of claim

A participant who believes that a benefit has been denied under the Plan is entitled to file a written request for such benefit with the employer. The claimant shall address the written request to the President of the company at its principal place of business.

### b. Decision

Upon receipt of the benefit claim, the employer shall inform the claimant that a reply to the claim shall be provided within ninety (90) days. The employer shall deliver the reply within the stated ninety (90) day period.

### c. Denial of claim

If the claim has been denied by the employer, the employer shall provide a written opinion to the claimant. The written opinion shall include the following:

- Specific reason(s) for the denial of benefits;
- Relevant provisions of the NQDC document that support the denial;
- Procedure and any time limits that claimant must follow to obtain a review of the claim; and
- Additional information and supporting material needed for the claimant to perfect his or her claim, the reason(s) why such information and material is necessary and the time limits under which such information and material must be submitted.

### d. Request for review

The claimant may request in writing a review of the written opinion. The claimant must submit a Request for Review within sixty (60) days from receipt of the written opinion. The claimant must submit a Request for Review to the President of the company at its principal place of business. If the claimant does not submit a Request for Review within sixty (60) days from receipt of the written opinion, the claimant will have waived his or her right to any review of the written opinion.

### e Review of opinion

The employer shall review the denial of the claim, the opinion and other material provided by the claimant within sixty (60) days from receipt of the written Request for Review. The employer shall provide the claimant with a written opinion that is written in a manner which is understandable by the claimant and includes references to relevant provisions of the NQDC document that support the decision.

## 8.04 Governing law

This agreement shall be construed according to the laws of the state of the company's state of incorporation and in accordance with federal law.

## 8.05 Other benefits

The benefits provided under the terms of this Plan are intended as fringe benefits designed to retain the participants of the company. Any benefit payments under this agreement shall be independent of, and in addition to, those under any other plan, program or agreement which may be in effect between the parties hereto, or any other compensation payable to the participant or the participant's designated beneficiary by the company. This agreement shall not be construed as a contract of employment nor does it restrict the right of the company to discharge the participant for proper cause or the right of the participant to terminate employment.



# Preamble section continued

## **8.06 Unclaimed benefits**

Each participant and/or designated beneficiary shall keep the company informed of his or her current address. The company shall not be obligated to search for the whereabouts of any person. If the location of the participant or designated beneficiary is not made known to the company within one year after payment is made to the hypothetical participant account, then the company shall have no further obligation to pay any person any benefit and any such balance in the hypothetical participant account shall be forfeited.

## **8.07 Beneficiary designation**

The participant shall designate a beneficiary to receive any benefits due under the Plan. The participant may, at any time, submit a properly executed beneficiary designation form, in a manner acceptable to the company. All designations shall become effective upon receipt by the company. In the event a participant does not designate a beneficiary, any distribution of benefits due under this Plan after the participant's death shall be paid to the participant's surviving spouse, if any, or otherwise to the participant's estate.

## **8.08 Participants**

The Plan shall be binding on the adopting company and its successors, participating participants and their successor beneficiaries.

## **8.09 Severability**

Whenever possible, each provision of this Plan shall be interpreted in such a manner as to be effective and valid under applicable law. If any provision is now or later becomes invalid, the remainder of the Plan provisions and their application shall not be affected.

## **8.10 Claim of benefits upon death**

The participant's beneficiary shall present to the company, as soon as reasonably feasible, a death certificate of the participant. The company may, at its discretion, withhold benefit payments due until all necessary paperwork is received.

## **8.11 Assignment and alienation**

Unless otherwise provided by law or as otherwise provided in this Plan, no benefit which shall be payable to any person, including an participant or an participant's beneficiary, shall be subject in any manner to anticipate, assign, transfer, sell, mortgage, pledge hypothecate, or encumber any benefit under this Plan. No benefit shall in any manner be liable for, or subject to, the debts, contracts, liabilities, engagements, or torts of any such person, nor shall it be subject to legal process for or against such person. The administrator shall not recognize any attempt by a third party to attach, garnish or levy upon any benefit under the Plan except as provided by law.

The right of the participant or designated beneficiary to receive a distribution hereunder shall be an unsecured claim against the general assets of the company. Neither the participant nor his or her designated beneficiary shall have any rights in or against any amount credited to the hypothetical participant account or any other specific assets of the company.

# Preamble section continued

## **8.12 Investment provider protective clause**

The investment provider providing the informal funding vehicle to the company is not a party to this Plan. It is understood by all parties hereto that in issuing any investment to the company, the investment provider shall have no liability except as set forth in the investment vehicle filed at its home office. The investment provider shall not be bound to inquire into or take notice of any of the covenants herein contained as to the application of the investment proceeds.

The investment provider shall be protected and held harmless in acting in accordance with any written direction of the administrator or company or any person having capacity to make decisions under this Plan. Regardless of any provision of this Plan, the investment provider shall not be required to take or permit any action or allow any benefit or privilege contrary to the terms of any contract which it issues hereunder, or the rules of the investment provider. Although the investment provider may provide values to the administrator necessary to administer the Plan, the investment provider has no responsibility to administer the Plan.

## **8.13 Headings**

The headings and subheadings of this Plan have been inserted for the convenience of reference and are to be ignored in any construction of the provisions herein.

# Article IX

## **Supplemental employment provisions**

### **9.01 Covenant not to compete**

The participant hereby agrees that, so long as he or she remains in the employ of the company, he or she will devote substantially all of his or her time, skill, diligence and attention to the business of the company. The participant further agrees that he or she shall not engage in or become interested in, directly or indirectly, any enterprise conducted in the trading area of the business of the company which enterprise is, or may be deemed to be, competitive with any business carried on by the company, without the prior written consent of the company for such period of time as designated in the Adoption Agreement. Determination of whether you are in competition shall be made by the Compensation Committee and communicated to the participant in writing.

This provision will terminate after all payments under this plan have been made to you or your designated recipient. The Compensation Committee may waive this provision.

### **9.02 Covenant to provide consulting services**

The participant hereby agrees to provide consulting services as an independent contractor to the company as the company may periodically require. The participant agrees that as further consideration for the agreements of the company contained herein, and as a condition to the performance by the company of its obligations hereunder, if the participant incurs a termination of employment, throughout the period through which the company is required to make payments under the Plan, the participant agrees to make himself or herself available to the company for such advisory and consultative services on a part-time basis as may, from time to time, be requested by the company.

This provision will terminate when the participant is no longer receiving benefit payments under the Plan. The Compensation Committee may waive this provision.

# Nonqualified deferred bonus plan adoption agreement

## Section 1: General information

A. Name of plan: \_\_\_\_\_

### B. Participant:

Name of participant: \_\_\_\_\_ Entry date: \_\_\_\_\_

### C. Company:

Name of company: \_\_\_\_\_

Address: \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_

Telephone: \_\_\_\_\_ Employer tax ID: \_\_\_\_\_

Employer fiscal year-end: \_\_\_\_\_ Plan year-end: \_\_\_\_\_

## Section 2: Effective dates (Check and complete option 1 or 2)

Option 1:  **Initial adoption:** This is the initial adoption of a Nonqualified Executive Deferral plan by the company for the eligible executives described in Section 1 of the Adoption Agreement.

The effective date of this Plan is \_\_\_\_\_, \_\_\_\_\_.

Option 2:  **Amendment:** This is an amendment and restatement of an existing Executive Deferred Compensation plan for the eligible executives (a prior plan).

The prior plan was initially effective on \_\_\_\_\_, \_\_\_\_\_.

The effective date of this amendment and restatement is \_\_\_\_\_, \_\_\_\_\_.

## Section 3: Participation requirements

The select group of management or highly compensated executives who are eligible to participate in the Plan are: **(Select and complete one or more of the following items.)**

The following executives: (may attach list)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Executives designated from time to time by the company or the Compensation Committee.

Executives with a position ranking of or above \_\_\_\_\_, earning a minimum of \$\_\_\_\_\_ per plan year.

Executives who are members of the company's select group of management or who are highly compensated executives as defined under relevant provisions of the Code and/or ERISA.

# Nonqualified deferred bonus plan adoption agreement section continued

## Section 4: Discretionary company bonus contributions

### A. Amount:

The company reserves the right to make discretionary company bonus contributions to the hypothetical participant accounts of participants. For each plan year, the company will determine, in its complete and sole discretion, such amount, if any, to award.

If such company bonus contributions are declared, they shall be automatically and completely allocated in their entirety to each participant's hypothetical participant account.

### B. Requirements for eligibility for company bonus:

A participant will be entitled to have 100 percent of the specified portion of the company bonus allocated to the participant's hypothetical participant account for any plan year only if the participant satisfies the following additional conditions: **(Check one or more options.)**

- Option 1:  No additional conditions.
- Option 2:  Hours of service requirement. The eligible participant works at least \_\_\_\_\_ months for the company during the plan year.
- Option 3:  Last day requirement. The eligible participant of the company on the last day of the plan year. However, this condition will be waived for the following reasons: (Check at least one.)
- The eligible participant's death.
  - The eligible participant's termination of employment after having incurred a disability.
  - The eligible participant's termination of employment after having reached normal retirement age.
  - This condition will not be waived.
- Option 4:  Other: (specify) \_\_\_\_\_.

## Section 5: Amount of company bonus to be deferred

- Option 1:  Mandatory deferral of 100 percent of the company bonus.
- Option 2:  Specified deferral of a percentage of the company bonus.

### A. Maximum Limits on Deferral

An eligible participant shall be entitled to elect to defer up to the following amount of company bonus per plan year (Choose one):

- Option 1:  100% of company bonus
- Option 2:  \_\_\_\_\_ % of company bonus
- Option 3:  \$\_\_\_\_\_ flat amount

### B: Minimum Deferral:

An eligible participant deferrals shall be subject to a minimum deferral of \$\_\_\_\_\_.

# Nonqualified deferred bonus plan adoption agreement section continued

## C: Election to defer – executive deferral form:

If the amount of the actual contribution shall be determined by the participant on an annual basis, the amount of the total deferral **must be specified in writing on the Executive Deferral form** and submitted to the company in the year prior to the year that the contribution is earned.

### Section 6: Vesting of company bonus

The portion of an eligible participant's hypothetical participant account attributable to company bonus shall be vested as follows: (Choose one)

- Option 1:  5-year cliff vesting (0-5 years 0%, 100% beginning of year 6)
- Option 2:  5-year graded vesting (0% beginning of year 1, 20% beginning of year 2, 40% beginning of year 3, 60% beginning of year 4, 80% beginning of year 5, 100% beginning of year 6)
- Option 3:  100% upon entering Plan
- Option 4:  Other: \_\_\_\_\_

### Section 7: Crediting rate on plan contributions

Pursuant to Section 6 of the Nonqualified Deferred Bonus plan-Agreement, the company shall annually credit each participant's hypothetical participant account with hypothetical earnings based upon the following: (Choose one)

- Option 1:  Crediting rate of \_\_\_\_\_ percent for first year of the Plan. Crediting rate applicable for years following the first year will be determined by the company annually for the life of the plan. The crediting rate is to be determined in the first quarter of each year. If a crediting rate is not determined, the previous year's crediting rate will be applied. Distribution discount rate for distributions will be specified under Section 9 of the Adoption Agreement. (Please complete Section 9.)
- Option 2:  Crediting rate of \_\_\_\_\_ percent per year annually for the life of the plan. Distribution discount rate for distributions will be specified under Section 9 of the Adoption Agreement. (Please complete Section 9.)
- Option 3:  Variable crediting rate as determined by the form specifying the participant's hypothetical investment options. Distribution discount rate for distributions will be specified under Section 9 of the Adoption Agreement. (Please complete Section 9.)

### Section 8: Benefit distribution events

The amounts in a participant's hypothetical participant account shall be payable upon the occurrence on any one of the following events: (Check all that apply and coordinate the selection with Section 9 below and other provisions in the Plan Document.)

- A.  Normal retirement age of the participant
- B.  Death of the participant (optional)
- C.  Separation from service of the participant (optional)
- D.  The participant's attainment of the benefit distribution date of \_\_\_\_\_, \_\_\_\_\_ (optional)
- E.  Disability of the participant (optional)
- F.  Unforeseeable emergency of the participant (optional)
- G.  Change in the ownership of the company (optional)

# Nonqualified deferred bonus plan adoption agreement section continued

## Section 9: Benefit payments – form of payment

Complete the Form of Payment for each of the distribution events selected in Section 8 of the Adoption Agreement if the Form of Payment is not required to have been completed with a valid and current Election to Defer form that specifies the time and form of payment in compliance with IRC Section 409A.

### A. Normal retirement age of the participant: (Complete only if selected in Section 8.)

#### 1. Duration of payments: Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

#### 2. Frequency of payments: Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

#### 3. Distribution discount rate: The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_ Discount rate (listed as a percentage between 1-15 percent)

#### 4. Time of payment: As specified in Section 10.

### B. Death of the Participant/Survivor Benefit: (Complete only if selected in Section 8.)

#### 1. Duration of payments: Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

#### 2. Frequency of payments: Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

# Nonqualified deferred bonus plan adoption agreement section continued

**3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_\_\_ Discount rate (listed as a percentage between 1-15 percent)

**C. Separation from service of the participant:** (Complete only if selected in Section 8.)

**1. Duration of payments:** Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

**3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_\_\_ Discount rate (listed as a percentage between 1-15 percent)

**D. The Participant's attainment of the benefit distribution date:** (Complete only if selected in Section 8.)

**1. Duration of payments:** Benefit payments shall be made over the following period of time:

Option 1:  10 years

Option 2:  Lump sum

Option 3:  5 years

Option 4:  15 years

Option 5:  Specify years: \_\_\_\_\_

Option 6:  As elected on a valid and timely filed Election to Defer form

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

**3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_\_\_ Discount rate (listed as a percentage between 1-15 percent)

**4. Time of payment:** As specified in Section 12.

# Nonqualified deferred bonus plan adoption agreement section continued

## **E. Disability of the participant:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_
- Option 6:  As elected on a valid and timely filed Election to Defer form

### **2. Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

### **3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

- Option 1: \_\_ Average rate of return of the hypothetical participant account
- Option 2: \_\_ Discount rate (listed as a percentage between 1-15 percent)

## **F. Unforeseeable emergency of the participant:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  Lump sum
- Option 2:  Other: \_\_\_\_\_
- Option 3:  As elected on a valid and timely filed Election to Defer form

### **2. Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Other: \_\_\_\_\_

### **3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

- Option 1: \_\_ Average rate of return of the hypothetical participant account
- Option 2: \_\_ Discount rate (listed as a percentage between 1-15 percent)

## **G. Change in the ownership of the company:** (Complete only if selected in Section 8.)

### **1. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_
- Option 6:  As elected on a valid and timely filed Election to Defer form



# Nonqualified deferred bonus plan adoption agreement section continued

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

Option 1:  Annually

Option 2:  Quarterly

Option 3:  Monthly

**3. Distribution discount rate:** The hypothetical participant account will be paid over the period elected above at a rate specified directly below.

Option 1: \_\_\_\_\_ Average rate of return of the hypothetical participant account

Option 2: \_\_\_\_\_ Discount rate (listed as a percentage between 1-15 percent)

## Section 10: Normal retirement age

The normal retirement age under the Plan shall be:

Option 1:  Age 65

Option 2:  Age: \_\_\_\_\_

Option 3:  As elected on a valid and timely filed Election to Defer form

## Section 11: Death of the participant/survivor benefit

If participant dies prior to normal retirement age or benefit distribution date the participant's designated beneficiaries will receive the following: (Complete only if Option B in Section 8 and Section 9 was selected.)

Option 1:  Vested balance of the hypothetical participant account

Option 2:  Greater of the vested balance of their hypothetical participant account or \$ \_\_\_\_\_

(If Option 2 in Section 8 and Section 9 has not been selected, then this provision is not necessary.)

## Section 12: Benefit distribution date

If applicable, the benefit distribution date under the Plan shall be:

Option 1:  Date \_\_\_\_\_ , \_\_\_\_\_

Option 2:  As elected on a valid and timely filed Election to Defer form

(If Option D in Section 8 and Section 9 has not been selected, then this provision is not necessary.)

## Section 13: Agreement not to compete

(Select and complete one option.)

Option 1:  The participant shall honor the agreement not to compete as set forth in Section 9.01 of the plan provisions for a period of \_\_\_\_\_ years following termination of employment for any reason.

Option 2:  The participant shall honor the agreement not to compete as set forth in Section 9.01 of the plan provisions for the entire period during which payments are due hereunder.

# Nonqualified deferred bonus plan adoption agreement section continued

Option 3:  In lieu of the agreement not to compete as set forth in Section 9.01 of the plan provisions, the following agreement not to compete shall apply: (Specify and attach an additional sheet if necessary.)

\_\_\_\_\_

\_\_\_\_\_

Option 4:  There shall be no agreement not to compete hereunder.

## Section 14: Additional conditions

(Select and complete one or more option.)

Option 1:  The executive shall honor the agreement to provide advisory and consulting services as set forth in Section 9.02 of the plan provisions for a period of \_\_\_\_\_ years following termination of employment with the company for any reason.

Option 2:  The executive shall honor the agreement to provide advisory and consulting services as set forth in Section 9.02 of the plan provisions for the entire period during which payments are due hereunder.

Option 3:  Other: (Specify and attach an additional sheet if necessary.)

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Option 4:  No additional conditions will apply.

## Section 15: Third-party administrator

Option 1:  The Pangburn Company

Option 2:  Other: \_\_\_\_\_  
Name: \_\_\_\_\_  
Address: \_\_\_\_\_  
Telephone: \_\_\_\_\_

## Company signature

Authorized signature for company: \_\_\_\_\_

Printed name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

## Participant signature

Participant name (printed): \_\_\_\_\_

Participant signature: \_\_\_\_\_

Date: \_\_\_\_\_

# Nonqualified salary continuation plan provisions

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This is a specimen booklet for general information only and is intended to be exhibited to the client’s attorney for consideration. The specimen agreements are general agreements and must not be represented as adapted to the particular situation of any client. The laws of the various states may differ considerably, and all legal instruments must be prepared by the client’s attorney.

# Preamble

The company, by executing the attached Adoption Agreement, hereby establishes an unfunded Nonqualified Salary Continuation plan (Plan) for a select group of executives intended to meet the top hat exemption for Titles I and IV of ERISA. The Plan will allow the company to provide additional terms and conditions upon the executive and to pay such additional compensation upon the executive's retirement or benefit distribution date.

The Plan shall be binding on participating executives as well as any of the executive's successors who may become eligible to receive payments under the Plan such as a spouse or beneficiaries. Executives participating in the Plan will have no right, directly or indirectly, to anticipate, assign, sell or pledge any asset set aside to satisfy benefit obligations under the Plan. The assets used as a source to satisfy Plan benefits shall be available to the general creditors of the company.

## Article I

### Definitions

#### 1.01 Administrator

The party appointed by the company to administer the Plan as provided in Section 15 of the Adoption Agreement that will administer the Plan on behalf of the company. If no such appointment is made, the Compensation Committee of the Board of Directors of the company shall serve as the administrator. The party responsible for administration may engage a third-party administrator in order to provide essential Plan and accounting information.

#### 1.02 Adoption agreement

The written instrument that is attached to this Nonqualified Deferred Bonus plan- Agreement specifying the applicable elective provisions that apply to this Plan.

#### 1.03 Benefit distribution event

The date specified in the Adoption Agreement on which a participant's benefit is payable under the Plan. A participant shall have no right to receive payment of his or her benefit until reaching his or her benefit distribution date.

#### 1.04 Benefit payment

An amount an eligible participant or successor may receive at the specified benefit distribution event.

#### 1.05 Beneficiary

The participant's designated recipient of the Plan proceeds upon death.

#### 1.06 Change in the ownership

Change in control: The following three situations are permitted distribution events according to the Final Regulations under 409A:

1. Change in ownership
2. Change in effective control
3. Change in ownership of a substantial portion of corporate assets

# Preamble section continued

## **1. Change in ownership**

A change in the ownership of the corporation occurs if a person or a group acquires stock, combined with previously owned stock, controls more than 50 percent of the value or voting power of the stock of the corporation.

## **2. Change in effective control**

A change in effective control occurs if a person or group acquires, during a 12-month period, stock possessing 30 percent or more of the total voting power; or a majority of the board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the corporation's board of directors who were directors before the date of the election or appointment.

## **3. Change in ownership of a substantial portion of corporate assets**

A change in ownership of a substantial portion of the assets occurs if a person or group acquires, within a 12-month period, assets of the corporation having a total gross fair market value equal to 40 percent or more of the total gross fair market value of all of the corporation's assets.

### **1.07 Company**

The business entity specified in the Adoption Agreement which adopts the Plan. The term company shall also include any successor who by merger, consolidation, purchase, or otherwise assumes the obligations of the Plan and any predecessor which has maintained this Plan.

### **1.08 Compensation**

The total annual remuneration for employment received by an executive from the company.

### **1.09 Compensation committee**

A person or group of persons from the company that has the discretion to make decisions with regard to the Plan.

### **1.10 Code**

The Internal Revenue Code of 1986, as amended.

### **1.11 Disability**

A participant shall be considered disabled if the participant is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the participant's employer.

### **1.12 Effective date**

The date on which the company's Nonqualified Deferred Bonus plan or any amendment thereto becomes effective.

# Preamble section continued

## **1.13 Eligible executive**

The term eligible executive refers to a member of the general group that comprises the select group of management or highly compensated employees who has been identified as meeting the requirements to participate in the NQDC plan and has been designated by the company as eligible to participate in the Plan.

## **1.14 Entry date**

The date on which an executive commences participation in the Plan as determined by the company or compensation committee specified in Section 1 of the Adoption Agreement.

## **1.15 ERISA**

The Employee Retirement Income Security Act of 1974, as amended.

## **1.16 Executive**

The term executive refers to a member of the general group that comprises the select group of management or highly compensated employees before any participation in the NQDC plan has been determined.

## **1.17 Nonqualified salary continuation plan ("Plan")**

A Plan within the meaning of ERISA Section 201(2), the purpose of which is to permit a select group of management or highly compensated employees to defer receipt of a portion of their compensation to a future date. The Plan, as set forth herein, shall include the Adoption Agreement and any administrative forms included by reference.

## **1.18 Participant**

An eligible executive who is actually participating in the Plan.

## **1.19 Plan document**

The unfunded Nonqualified Salary Continuation plan as specified in the Nonqualified Salary Continuation plan. Plan Provisions- and the Nonqualified Salary Continuation plan-Adoption Agreement.

## **1.20 Plan year**

The twelve consecutive month period commencing January 1 and ending on December 31. The first Plan year shall commence on January 1 of the calendar year in which the Plan became effective.

## **1.21 Retirement benefit**

The amount an eligible participant or successor may receive at the specified retirement date or age.

## **1.26 Separation from service**

The severance of a participant's employment with the company for whatever reason.

## **1.27 Third-party administrator**

The party responsible for administration may engage a third-party administrator in order to provide essential Plan, accounting information, company reports and participant reports.

# Preamble section continued

## **1.28 Unforeseeable emergency**

The term unforeseeable emergency means a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

## **1.29 Vesting**

The non-forfeitable portion of a participant's benefit payment. The vested amount will always be subject to the creditors of the company.

## **Article II**

### **Eligibility**

#### **2.01 Participation**

Executives who meet the eligibility requirements set forth in Section 3 of the Adoption Agreement on the date the Plan is adopted by the company and have been designated by the company as participants in the Plan. The company may, at its sole discretion, designate the eligible executives to participate in the Plan. The company may, at its sole discretion, determine or make ineligible otherwise eligible executives at any time.

#### **2.02 Election not to participate**

An otherwise eligible executive who has been designated by the company as a participant in the Plan may elect voluntarily not to participate in the Plan, subject to the approval by the Compensation Committee. The election not to participate in the Plan must be communicated to the company in writing.

#### **2.04 Entry date**

The eligible executive will be allowed to start participating in the Plan as of the entry date designated by the company or the Compensation Committee.

## **Article III**

### **Benefit payments**

#### **3.01 Retirement benefit payments**

In the event the executive retires from employment upon reaching the retirement date or benefit distribution date as set forth in Section 5, Part B, he or she shall be entitled to receive from the company a retirement benefit equal to a series of payments as set forth in Section 5, Part A of the Adoption Agreement.

Such benefit payments shall follow the benefits payment provisions specified in Section 8, Section 9 and Section 10 of the Adoption Agreement. The participant's vested benefit payments shall be the amount to be paid out over the years and method selected.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

## Preamble section continued

### **3.02 Survivor benefit** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

If the participant dies while employed by the company prior to attaining the retirement age as specified in Section 10 of the Adoption Agreement, the company shall pay to such individual or individuals as the participant shall have designated in a writing filed with the company or, in the absence of such designation, to the estate of the participant, the amount of the survivor benefit in accordance with the terms specified in Section 9 and Section 11 of the Adoption Agreement.

The vested portion of the benefit payments will be paid out as elected in Section 8, Section 9 and Section 11 of the Adoption Agreement.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **3.03 Benefit – separation from service** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

In the event the participant terminates employment for reasons other than death, retirement or for cause, he or she shall be entitled to receive from the company a benefit. The amount of the benefit payment shall be the vested benefit payment.

The benefit payments will be paid out as elected in Section 9 of the Adoption Agreement.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **3.04 Benefits – the participant's attainment of a specified date** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

In the event of the participant's attainment of a specified date specified in Section 11 of the Adoption Agreement, he or she shall be entitled to receive from the company a benefit payment equal to the vested portion of the benefit payment.

Such benefit payments shall follow the benefits payment provisions specified in Section 8, Section 9 and Section 11 of the Adoption Agreement.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

### **3.05 Disability benefits** (optional, please see Section 8 and Section 9 of the Adoption Agreement.)

In the event of the participant becomes disabled within the meaning as specified above, participant shall be entitled to receive from the company a benefit payment equal to the vested portion of the benefit payment.

Such benefit payments shall follow the benefits payment provisions specified in Section 8 and Section 9 of the Adoption agreement.

Any benefit payment to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments



# Preamble section continued

**3.06 Change in the ownership** (optional, please see Section 8 and Section 9 of the Adoption Agreement and the section on Change in the Ownership in the Appendix.)

If there is a change in the ownership of the company, the company shall pay to each participant an amount equal to the vested portion of the benefit payment, as determined on the date on which such change of control occurs.

The benefit payments will be paid out of the hypothetical participant account as elected in Section 9 of the Adoption Agreement.

Any benefit payments to any participant or beneficiary or other party having a right to payment in accordance with the provisions of this Plan, shall be in full satisfaction of all claims hereunder against the company and will satisfy all benefits under the terms of the Plan. In no event will a participant or other party be allowed to accelerate benefit payments.

## Article IV

### Unfunded program

#### 4.01 Unfunded plan

In no event will the assets accumulated by the company be construed as creating a funded Plan under ERISA or the Code or other any IRS pronouncements or promulgations.

#### 4.02 Assets – generally

The company shall be under no obligation to purchase or maintain any contract, policy or other asset to provide the benefits under this Plan. Any reference to a contract, policy or their asset is made solely for the purpose of computing the value of the benefits payable. Any contract, policy or other asset which the company may utilize to assure itself of the funds to provide the benefits hereunder shall not serve in any way as security to the participant for the company's performance under this Plan.

The rights accruing to the participant or any beneficiary hereunder shall be solely those of an unsecured creditor of the company. The company may establish appropriate reserves for the Plan in accordance with generally accepted accounting principles. Any reserves set aside by the company shall be considered part of the general funds of company. No participant or beneficiary shall have any interest or right to any reserves.

## Article V

### Amendment and termination

#### 5.01 Amendment

The company may at any time amend this Plan without the consent of any participant or beneficiary hereunder provided that any amendment is communicated to executives within 15 days prior to the amendment effective date. No amendment shall deprive an executive or beneficiary with any benefit already accrued under the Plan. This Plan will be amended from time to time to comply with provisions of the Code, related regulations and other published guidance.

# Preamble section continued

## 5.02 Termination

Although the company has established this Plan with a bona fide intention of maintaining the Plan indefinitely, the company may terminate the Plan on the earlier of the date on which there is a change of control or thirty days after notice has been given to all participating executives in writing. Upon termination, no further contributions will be allowed, and benefits will be paid out in a lump sum unless otherwise provided in Section 6 of the Adoption Agreement.

## Article VI

### Miscellaneous

#### 6.01 Entire agreement

The Plan and the executed Adoption Agreement, beneficiary designation, and other administrative forms shall constitute the total agreement between the company and the executive. No oral statement regarding the Plan may be relied upon by the participant. In the event that there is a discrepancy between Adoption Agreement and plan document and the administrative forms, summary descriptions, the Adoption Agreement and plan document will control.

#### 6.02 Employment rights

No provision of this Plan shall restrict the right of the company to terminate the executive's employment. Neither the establishment of this Plan nor any modification thereof, nor the creation of a trust or executive account or the payment of benefits shall be construed as giving the executive or any other person a right to employment with the company or any other right against the company unless otherwise provided herein. In no event shall the terms of employment of any executive be modified or in any way be affected by the Plan.

#### 6.03 Governing law

This agreement shall be construed according to the laws of the state of the company's state of incorporation and in accordance with federal law.

#### 6.04 Claims procedure

##### a. Filing of claim

A participant who believes that a benefit has been denied under the Plan is entitled to file a written request for such benefit with the employer. The claimant shall address the written request to the President of the company at its principal place of business.

##### b. Decision

Upon receipt of the benefit claim, the employer shall inform the claimant that a reply to the claim shall be provided within ninety (90) days. The employer shall deliver the reply within the stated ninety (90) day period.

# Preamble section continued

## **c. Denial of claim**

If the claim has been denied by the employer, the employer shall provide a written opinion to the claimant. The written opinion shall include the following:

- Specific reason(s) for the denial of benefits;
- Relevant provisions of the NQDC document that support the denial;
- Procedure and any time limits that claimant must follow to obtain a review of the claim; and
- Additional information and supporting material needed for the claimant to perfect his or her claim, the reason(s) why such information and material is necessary and the time limits under which such information and material must be submitted.

## **d. Request for review**

The claimant may request in writing a review of the written opinion. The claimant must submit a Request for Review within 60 days from receipt of the written opinion.

The claimant must submit a Request for Review to the President of the company at its principal place of business. If the claimant does not submit a Request for Review within sixty (60) days from receipt of the written opinion, the claimant will have waived his or her right to any review of the written opinion.

## **e. Review of opinion**

The employer shall review the denial of the claim, the opinion and other material provided by the claimant within sixty 60 days from receipt of the written Request for Review. The employer shall provide the claimant with a written opinion that is written in a manner which is understandable by the claimant and includes references to relevant provisions of the NQDC document that support the decision.

## **6.05 Other benefits**

The benefits provided under the terms of this Plan are intended as fringe benefits designed to retain the executives of the company. Any payments under this agreement shall be independent of, and in addition to, those under any other plan, program or agreement which may be in effect between the parties hereto, or any other compensation payable to the executive or the executive's designated beneficiary by the company. This agreement shall not be construed as a contract of employment nor does it restrict the right of the company to discharge the executive for proper cause or the right of the executive to terminate employment.

## **6.06 Unclaimed benefits**

Each executive and/or designated beneficiary shall keep the company informed of his or her current address. The company shall not be obligated to search for the whereabouts of any person. If the location of the executive or designated beneficiary is not made known to the company within one year after payment is made due, then the company shall have no further obligation to pay any person any benefit and any such balance shall be forfeited.

## **6.07 Beneficiary designation**

The executive shall designate a beneficiary to receive any benefits due under the Plan. The executive may, at any time, submit a properly executed beneficiary designation form, in a manner acceptable to the company. All designations shall become effective upon receipt by the company. In the event a participant does not designate a beneficiary, any distribution of benefits due under this Plan after the participant's death shall be paid to the participant's surviving spouse, if any, or otherwise to the participant's estate.

# Preamble section continued

## **6.08 Offsets**

In the event the executive participating in the Plan has outstanding debts or other amounts owed to the company, the company may, at its sole discretion, offset any amounts owed by an equivalent amount from the benefits due under the Plan.

## **6.09 Participants**

The Plan shall be binding on the adopting company and its successors, participating executives and their successor beneficiaries.

## **6.10 Severability**

Whenever possible, each provision of this Plan shall be interpreted in such a manner as to be effective and valid under applicable law. If any provision is now or later becomes invalid, the remainder of the Plan provisions and their application shall not be affected.

## **6.11 Claim of benefits upon death**

The executive's beneficiary shall present to the company, as soon as reasonably feasible, a death certificate of the executive. The company may, at its discretion, withhold benefit payments due until all necessary paperwork is received.

## **6.12 Assignment and alienation**

Unless otherwise provided by law or by this Plan, no benefit which shall be payable to any person, including an executive or an executive's beneficiary, shall be subject in any manner to anticipate, assign, transfer, sell, mortgage, pledge, hypothecate, or encumber any benefit under this Plan. No benefit shall in any manner be liable for, or subject to, the debts, contracts, liabilities, engagements, or torts of any such person, nor shall it be subject to legal process for or against such person. The administrator shall not recognize any attempt by a third party to attach, garnish or levy upon any benefit under the Plan except as provided by law.

The right of the executive or designated beneficiary to receive a distribution hereunder shall be an unsecured claim against the general assets of the company. Neither the executive nor his or her designated beneficiary shall have any rights in or against any amount credited to the executive account or any other specific assets of the company.

## **6.13 Investment provider protective clause**

The investment provider is not a party to this Plan. It is understood by all parties hereto that in issuing an investment vehicle, including any policy of insurance, to the company, the investment provider shall have no liability except as set forth in the investment vehicle terms at its Home Office. The investment provider shall not be bound to inquire into or take notice of any of the covenants herein contained as to the application of the policy proceeds.

The investment provider shall be protected and held harmless in acting in accordance with any written direction of the administrator or company or any person having capacity to make decisions under this Plan. Regardless of any provision of this Plan, the investment provider shall not be required to take or permit any action or allow any benefit or privilege contrary to the terms of any contract which it issues hereunder, or the rules of the investment provider. Although the investment provider may provide values to the administrator necessary to administer the plan, the investment provider has no responsibility to administer the Plan.

# Preamble section continued

## 6.14 Headings

The headings and subheadings of this Plan have been inserted for the convenience of reference and are to be ignored in any construction of the provisions herein.

## Optional provisions Article VII

### Supplemental employment provisions

#### 7.01 Covenant not to compete

The executive hereby agrees to not directly or indirectly enter into or take part in any endeavor on any basis within the City of \_\_\_\_\_ or a \_\_\_\_\_ mile radius there from which shall be in competition with the company. Determination of whether you are in competition shall be made by the Compensation Committee and communicated to the executive in writing.

This provision will terminate after all payments under this plan have been made to you or your designated recipient.

The Compensation Committee may waive this provision.

#### 7.02 Covenant to provide consulting services

The executive hereby agrees to provide consulting services as an independent contractor to the company as the company may periodically require. This provision applies to a maximum of \_\_\_\_\_ hours monthly for which you will receive compensation at the rate of \_\_\_\_\_ per hour. This provision will terminate when you are no longer receiving benefit payments under the Plan.

The Compensation Committee may waive this provision.

# Nonqualified salary continuation plan adoption agreement

## Section 1: General information

A. Name of plan: \_\_\_\_\_

### B. Participant:

Name of participant: \_\_\_\_\_

Entry date: \_\_\_\_\_

### C. Company:

Name of company: \_\_\_\_\_

Address: \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_

Telephone: \_\_\_\_\_ Employer tax ID: \_\_\_\_\_

Employer fiscal year-end: \_\_\_\_\_ Plan year-end: \_\_\_\_\_

## Section 2: Effective dates (check and complete option 1 or 2)

Option 1:  **Initial adoption:** This is the initial adoption of a nonqualified executive deferral plan by the company for the eligible executives described in Section 1 of the Adoption Agreement.

The effective date of this plan is \_\_\_\_\_, \_\_\_\_\_.

Option 2:  **Amendment:** This is an amendment and restatement of an existing executive deferred compensation plan for the eligible executives (a prior plan).

The prior plan was initially effective on \_\_\_\_\_, \_\_\_\_\_.

The effective date of this amendment and restatement is \_\_\_\_\_, \_\_\_\_\_.

## Section 3: Participation requirements

The select group of management or highly compensated executives who are eligible to participate in the Plan are: **(Select and complete one or more of the following items.)**

The following executives: (may attach list)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Executives designated from time to time by the company or the Compensation Committee.

Executives with a position ranking of or above \_\_\_\_\_, earning a minimum of \$\_\_\_\_\_ per plan year.

Executives who are members of the company's select group of management or who are highly compensated executives as defined under relevant provisions of the Code and/or ERISA.

# Nonqualified salary continuation plan adoption agreement section continued

## Section 4: Vesting of benefit payments

The portion of a participant's benefit payments shall be vested as follows (Choose one):

- Option 1:  5-year cliff vesting (0-5 years 0%, 100% beginning of year 6)
- Option 2:  5-year graded vesting (0% beginning of year 1, 20% beginning of year 2, 40% beginning of year 3, 60% beginning of year 4, 80% beginning of year 5, 100% beginning of year 6)
- Option 3:  100% upon entering Plan
- Option 4:  Other: \_\_\_\_\_

## Section 5: Benefit distribution events

The amounts in a vested benefit payments shall be payable upon the occurrence on any one of the following events: (Check all that apply and coordinate the selection with Section 6 below and other provisions in the Plan Document.)

- A.  Normal retirement age of the participant
- B.  Death of the participant (optional)
- C.  Separation from service of the participant (optional)
- D.  The participant's attainment of the benefit distribution date of \_\_\_\_\_, \_\_\_\_\_ (optional)
- E.  Disability of the participant (optional)
- F.  Change in the ownership of the company (optional)

## Section 6: Benefit payments – form of payment

Complete the Form of Payment for each of the distribution events selected in Section 8 of the Adoption Agreement if the Form of Payment is not required to have been completed with a valid and current Election to Defer form that specifies the time and form of payment in compliance with IRC Section 409A.

### A. Normal retirement age of the participant: (Complete only if selected in Section 5.)

1. **Benefit payment:** The amount the executive will receive upon retirement for each frequency of payment period.

- Option 1:  \$\_\_\_\_\_ for each frequency of payment period.
- Option 2:  \_\_\_\_\_ percent of final annual salary for each frequency of payment period.
- Option 3:  Other: \_\_\_\_\_ for each frequency of payment period.

2. **Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

# Nonqualified salary continuation plan adoption agreement section continued

**3. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_

**4. Time of payment:** As specified in Section 7.

**B. Death of the participant/survivor benefit:** (Complete only if selected in Section 5.)

**1. Benefit payment:** The amount the executive will receive upon retirement for each frequency of payment period.

- Option 1:  \$\_\_\_\_\_ for each frequency of payment period.
- Option 2:  \_\_\_\_\_ percent of final annual salary for each frequency of payment period.
- Option 3:  Other: \_\_\_\_\_ for each frequency of payment period.

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

**3. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_

**4. Time of payment:** As specified in Section 8.

**C. Separation from service of the participant:** (Complete only if selected in Section 5.)

**1. Benefit payment:** The amount the executive will receive upon retirement for each frequency of payment period.

- Option 1:  \$\_\_\_\_\_ for each frequency of payment period.
- Option 2:  \_\_\_\_\_ percent of final annual salary for each frequency of payment period.
- Option 3:  Other: \_\_\_\_\_ for each frequency of payment period.

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly



# Nonqualified salary continuation plan adoption agreement section continued

**3. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_

**4. Time of payment:** As specified in Section 8.

**D. The participant's attainment of the benefit distribution date:** (Complete only if selected in Section 5.)

**1. Benefit payment:** The amount the executive will receive upon retirement for each frequency of payment period.

- Option 1:  \$\_\_\_\_\_ for each frequency of payment period.
- Option 2:  \_\_\_\_\_ percent of final annual salary for each frequency of payment period.
- Option 3:  Other: \_\_\_\_\_ for each frequency of payment period.

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

**3. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_

**4. Time of payment:** As specified in Section 9.

**E. Disability of the participant:** (Complete only if selected in Section 5.)

**1. Benefit payment:** The amount the executive will receive upon retirement for each frequency of payment period.

- Option 1:  \$\_\_\_\_\_ for each frequency of payment period.
- Option 2:  \_\_\_\_\_ percent of final annual salary for each frequency of payment period.
- Option 3:  Other: \_\_\_\_\_ for each frequency of payment period.

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

# Nonqualified salary continuation plan adoption agreement section continued

**3. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_

**F. Change in the ownership of the company:** (Complete only if selected in Section 5.)

**1. Benefit payment:** The amount the executive will receive upon retirement for each frequency of payment period.

- Option 1:  \$\_\_\_\_\_ for each frequency of payment period.
- Option 2:  \_\_\_\_\_ percent of final annual salary for each frequency of payment period.
- Option 3:  Other: \_\_\_\_\_ for each frequency of payment period.

**2. Frequency of payments:** Benefit payments shall be made at the following frequency:

- Option 1:  Annually
- Option 2:  Quarterly
- Option 3:  Monthly

**3. Duration of payments:** Benefit payments shall be made over the following period of time:

- Option 1:  10 years
- Option 2:  Lump sum
- Option 3:  5 years
- Option 4:  15 years
- Option 5:  Specify years: \_\_\_\_\_

## Section 7: Normal retirement age

The normal retirement age under the Plan shall be:

- Option 1:  Age 65
- Option 2:  Age: \_\_\_\_\_

## Section 8: Death of the participant/survivor benefit

If participant dies prior to normal retirement age or benefit distribution date the participant' designated beneficiaries will receive the following: (Complete only if Option B in Section 5 and Section 6 was selected.)

- Option 1:  Vested balance of the benefit payments
- Option 2:  Other: \_\_\_\_\_

(If Option 2 in Section 8 and Section 9 has not been selected, then this provision is not necessary.)

# Nonqualified salary continuation plan adoption agreement section continued

## Section 9: Benefit distribution date

If applicable, the benefit distribution date under the Plan shall be:

Date \_\_\_\_\_, \_\_\_\_\_

(If Option D in Section 5 and Section 6 has not been selected, then this provision is not necessary.)

## Section 10: Agreement not to compete

(Select and complete one option.)

Option 1:  The executive shall honor the agreement not to compete as set forth in Section 7.01 of the Plan for a period of \_\_\_\_\_ years following termination of employment for any reason.

Option 2:  The executive shall honor the agreement not to compete as set forth in Section 7.01 of the Plan for the entire period during which payments are due hereunder.

Option 3:  In lieu of the agreement not to compete as set forth in Section 8.1 of the Plan, the following agreement not to compete shall apply: (Specify and attach an additional sheet if necessary.)

\_\_\_\_\_  
\_\_\_\_\_

Option 4:  There shall be no agreement not to compete hereunder.

## Section 11: Additional conditions

(Select and complete one or more option.)

Option 1:  The executive shall honor the agreement to provide advisory and consulting services as set forth in Section 7.02 of the plan provisions for a period of \_\_\_\_\_ years following termination of employment with the company for any reason.

Option 2:  The executive shall honor the agreement to provide advisory and consulting services as set forth in Section 7.02 of the plan provisions for the entire period during which payments are due hereunder.

Option 3:  Other: (Specify and attach an additional sheet if necessary.)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Option 4:  No additional conditions will apply.

## Section 12: Administration

Option 1:  The Pangburn Company

Option 2:  Other: \_\_\_\_\_

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Telephone: \_\_\_\_\_

# Nonqualified salary continuation plan adoption agreement section continued

## Company signature

Authorized signature for company: \_\_\_\_\_

Printed name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

## Participant signature

Participant name (printed): \_\_\_\_\_

Participant signature: \_\_\_\_\_

Date: \_\_\_\_\_

# Specimen ERISA Labor Department Statement

To be filed within 120 days of the adoption of a nonqualified plan.

DATE: \_\_\_\_\_

TO: Pension and Welfare Benefits Administration  
Room N-5644  
U.S. Department of Labor  
200 Constitution Avenue N.W.  
Washington, D.C. 20210

FROM: Employer: \_\_\_\_\_

Employer tax ID: \_\_\_\_\_

Address: \_\_\_\_\_

Phone: \_\_\_\_\_

## RE: Top hat plan exemption

This document constitutes the statement required by 29 C.F.R. 2520, 104-23(a)(1) to be filed with the Secretary of Labor in respect to Nonqualified Benefit plan(s) maintained by the above employer.

The employer currently maintains (state number of plans) Nonqualified Benefit plan(s) for managerial and highly compensated employees. Copies of the plan(s) will be provided to the Department upon the receipt of a written request.

The number of participants in each plan is as follows:

Plan 1 (Number of executives)

Plan 2 (Number of executives)

Plan 3 (Number of executives)

Signed \_\_\_\_\_

(Authorized signature of employer)

**Employer Owned Life Insurance Policy  
Insured's Acknowledgment of Disclosure and Consent**



Minnesota Life Insurance Company - a Securian Financial company  
Life New Business • 400 Robert Street North • St. Paul, Minnesota 55101-2098

<b>Employee/Proposed Insured - Information (please print)</b>			
Name			Date of birth
Address	City	State	Zip code
Telephone number			

<b>Employer Information</b>			
Legal name			
Address	City	State	Zip code
Telephone number			

**I, the employee/proposed insured, acknowledge disclosure and consent that:**

- The employer intends to insure my life.
- I authorize and allow the employer to purchase such life insurance on my life.
- The maximum face amount for which I will be insured is: \$ \_\_\_\_\_
- The employer will be the beneficiary of all or part of the life insurance policy proceeds.
- Such life insurance coverage may continue after my employment with employer has terminated.
- I have received this written Acknowledgment of Disclosure and Consent form from the employer.

Signature of employee/proposed insured <b>X</b>	Date
--	------

**Employer - please review the following:**

- This form must be executed and signed before the policy is issued.
- The execution of this form must involve an appropriate insured under IRC Section 101(j).
- Copies of this Acknowledgment of Disclosure and Consent form are retained by the Employer.
- For survivor life insurance policies, a separate form must be completed and retained for each of the proposed insureds.
- This form and information is not intended as tax, legal or accounting advice. It is provided only as a convenience. Taxpayers should consult with their own legal counsel for guidance in order to determine IRC Section 101(j) requirements and whether a specific planning strategy is suitable for any particular individual.

**Employer Owned Life Insurance Policy  
Insured's Acknowledgment of Disclosure and Consent**



**Securian Life Insurance Company**

Life New Business • 400 Robert Street North, St. Paul, MN 55101-2098

**Employee/Proposed Insured - Information (please print)**

Name	Date of birth
Street address, city, state, zip code	Telephone number

**Employer Information**

Legal name	
Street address, city, state, zip code	Telephone number

**I, the employee / proposed insured, acknowledge disclosure and consent that:**

- The employer intends to insure my life.
- I authorize and allow the employer to purchase such life insurance on my life.
- The maximum face amount for which I will be insured is: \$ \_\_\_\_\_
- The employer will be the beneficiary of all or part of the life insurance policy proceeds.
- Such life insurance coverage may continue after my employment with employer has terminated.
- I have received this written Acknowledgment of Disclosure and Consent form from the employer.

Signature of employee/proposed insured	Date
--	------

**X**

**Employer - please review the following:**

- This form must be executed and signed before the policy is issued.
- The execution of this form must involve an appropriate insured under IRC Section 101(j).
- Copies of this Acknowledgment of Disclosure and Consent form are retained by the Employer.
- For survivor life insurance policies, a separate form must be completed and retained for each of the proposed insureds.
- This form and information is not intended as tax, legal or accounting advice. It is provided only as a convenience. Taxpayers should consult with their own legal counsel for guidance in order to determine IRC Section 101(j) requirements and whether a specific planning strategy is suitable for any particular individual.

# Change in the ownership – considerations

The change in the ownership distribution provisions are a permitted distribution event according to IRC Section 409A. However, a change in the ownership distribution provision is not required.

In the past, change in the ownership may have been characterized as change of control. If a change in the ownership distribution provision is necessary, the information from the Proposed Regulations for IRC Section 409A and IRS Notice 2005-1 should be considered. For convenience, portions of the Proposed Regulations and IRS Notice 2005-1 have been included directly below. Emphasis has been added.

## Change in ownership or effective control of the corporation

(From: Proposed Regulations – IRC Section 409A)

The provisions defining a change in ownership or effective control of a corporation remain substantially unchanged from Notice 2005-1, Q&As-11 through 14.

## Change in the ownership events

(From: IRS Notice 2005-1):

### **Q-11 Under what circumstances will payments be permitted upon a change in the ownership or effective control of a corporation, or a change in the ownership of a substantial portion of the assets of a corporation?**

A-11 (a) In general. Pursuant to § 409A(a)(2)(A)(v), a plan may permit a payment upon the occurrence of a **change in the ownership** of the corporation (as defined in Q&A 12), a change in **effective control of the corporation** (as defined in Q&A 13), or a **change in the ownership of a substantial portion of the assets of the corporation** (as defined in Q&A 14) (collectively referred to as a Change in Control Event). To qualify as a Change in Control Event, the occurrence of the event must be objectively determinable and any requirement that any other person, such as a plan administrator or board of director's compensation committee, certify the occurrence of a Change in Control Event must be strictly ministerial and not involve any discretionary authority. For purposes of this paragraph (a), a payment also will be treated as occurring upon a Change in Control Event if the right to the payment arises due to the corporation's exercise of discretion under the terms of the plan to terminate the plan and distribute the compensation deferred there under within 12 months of the Change in Control Event. The plan may provide for a payment on any Change in Control Event, and need not provide for a payment on all such events, provided that each event upon which a payment is provided qualifies as a Change in Control Event.

(b) Identification of relevant corporation(s). To constitute a Change in Control Event as to the plan participant, the Change in Control Event must relate to (i) the corporation for whom the participant is performing services at the time of the Change in Control Event, (ii) the corporation that is liable for the payment of the deferred compensation (or all corporations liable for the payment if more than one corporation is liable), or (iii) a corporation that is a majority shareholder of a corporation identified in (i) or (ii), or any corporation in a chain of corporations in which each corporation is a majority shareholder of another corporation in the chain, ending in a corporation identified in (i) or (ii). For example, assume Corporation A is a majority shareholder of Corporation B, which is a majority shareholder of Corporation C. A change in ownership of Corporation B will constitute a Change in Control Event to plan participants performing services for Corporation B or Corporation C, and to plan participants for which Corporation B or Corporation C is solely liable for payments under the plan (for example, former employees), but will not constitute a Change in Control Event as to Corporation A or any other corporation of which Corporation A is a majority shareholder.



## Change in the ownership – considerations section continued

Notwithstanding the foregoing, a sale of Corporation B may constitute an independent Change in Control Event for Corporation A, Corporation B and Corporation C if the sale constitutes a change in the ownership of a substantial portion of Corporation A's assets (see Q&A 14). For purposes of this paragraph, a majority shareholder is a shareholder owning more than 50 percent of the total fair market value and total voting power of such corporation.

**(c) Attribution of stock ownership.** For purposes of this A-11, Q&A 12, Q&A 13 and Q&A 14, § 318(a) **applies to determine stock ownership.** Stock underlying a vested option is considered owned by the individual who holds the vested option (and the stock underlying an unvested option is not considered owned by the individual who holds the unvested option). For purposes of the preceding sentence, however, if a vested option is exercisable for stock that is not substantially vested (as defined by §§ 1.83-3(b) and (j)), the stock underlying the option is not treated as owned by the individual who holds the option. In addition, mutual and cooperative corporations are treated as having stock for purposes of this paragraph (c).

### **Q-12 What is a change in the ownership of a corporation?**

A-12 (a) Change in the ownership of a corporation.

For purposes of § 409A, a change in the ownership of a corporation occurs on the date that any one person, or more than one person acting as a group (as defined in paragraph (b)), acquires ownership of stock of the corporation that, together with stock held by such person or group, constitutes more than 50 percent of the total fair market value or total voting power of the stock of such corporation. However, if any one person or more than one person acting as a group, is considered to own more than 50 percent of the total fair market value or total voting power of the stock of a corporation, the acquisition of additional stock by the same person or persons is not considered to cause a change in the ownership of the corporation (or to cause a change in the effective control of the corporation (within the meaning of Q&A 13).

An increase in the percentage of stock owned by any one person, or persons acting as a group, as a result of a transaction in which the corporation acquires its stock in exchange for property will be treated as an acquisition of stock for purposes of this section. This A-12 applies only when there is a transfer of stock of a corporation (or issuance of stock of a corporation) and stock in such corporation remains outstanding after the transaction (see Q&A 14 for rules regarding the transfer of assets of a corporation).

(b) Persons acting as a group. For purposes of paragraph (a), persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation (see § 1.280G-1, Q&A 27(d), Example 4).

(c) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

# Change in the ownership – considerations section continued

## **Q-13 What is a change in the effective control of a corporation?**

A-13 (a) Change in the effective control of the corporation.

For purposes of § 409A, notwithstanding that a corporation has not undergone a change in ownership under Q&A 12, a change in the effective control of a corporation occurs on the date that either – (i) Any one person, or more than one person acting as a group (as determined under paragraph (iv)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of the corporation possessing 35 percent or more of the total voting power of the stock of such corporation; or (ii) a majority of members of the corporation’s board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the corporation’s board of directors prior to the date of the appointment or election, provided that for purposes of this paragraph (ii) the term corporation refers solely to the relevant corporation identified in Q&A 11, paragraph (b) for which no other corporation is a majority shareholder for purposes of that paragraph (for example, if Corporation A is a publicly held corporation with no majority shareholder, and Corporation A is the majority shareholder of Corporation B, which is the majority shareholder of Corporation C, the term corporation for purposes of this paragraph (ii) would refer solely to Corporation A).

In the absence of an event described in paragraph (i) or (ii), a change in the effective control of a corporation will not have occurred.

(b) Multiple change in control events. A change in effective control also may occur in any transaction in which either of the two corporations involved in the transaction has a Change in Control Event under A-12 or A-14. Thus, for example, assume Corporation P transfers more than 40 percent of the total gross fair market value of its assets to Corporation O in exchange for 35 percent of O’s stock. P has undergone a change in ownership of a substantial portion of its assets under A-14 and O has a change in effective control under this A-13.

(c) Acquisition of additional control. If any one person, or more than one person acting as a group, is considered to effectively control a corporation (within the meaning of this A-13), the acquisition of additional control of the corporation by the same person or persons is not considered to cause a change in the effective control of the corporation (or to cause a change in the ownership of the corporation within the meaning of Q&A 12).

(d) Persons acting as a group. Persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only with respect to the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation.

(e) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

# Change in the ownership – considerations section continued

## **Q-14 What is a change in the ownership of a substantial portion of a corporation's assets?**

A-14 (a) Change in the ownership of a substantial portion of a corporation's assets.

For purposes of § 409A, a change in the ownership of a substantial portion of a corporation's assets occurs on the date that any one person, or more than one person acting as a group (as determined in paragraph (c)), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the corporation that have a total gross fair market value equal to or more than 40 percent of the total gross fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

**(b) Transfers to a related person.** There is no Change in Control Event under this

A-14 when there is a transfer to an entity that is controlled by the shareholders of the transferring corporation immediately after the transfer, as provided in this paragraph (b). A transfer of assets by a corporation is not treated as a change in the ownership of such assets if the assets are transferred to:

(i) A shareholder of the corporation (immediately before the asset transfer) in exchange for or with respect to its stock;

(ii) An entity, 50 percent or more of the total value or voting power of which is owned, directly or indirectly, by the corporation;

(iii) A person, or more than one person acting as a group, that owns, directly or indirectly, 50 percent or more of the total value or voting power of all the outstanding stock of the corporation; or

(iv) An entity, at least 50 percent of the total value or voting power of which is owned, directly or indirectly, by a person described in paragraph (iii).

For purposes of this paragraph (b) and except as otherwise provided, a person's status is determined immediately after the transfer of the assets. For example, a transfer to a corporation in which the transferor corporation has no ownership interest before the transaction, but which is a majority-owned subsidiary of the transferor corporation after the transaction is not treated as a change in the ownership of the assets of the transferor corporation.

(c) Persons acting as a group. Persons will not be considered to be acting as a group solely because they purchase assets of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of assets, or similar business transaction with the corporation. If a person, including an entity shareholder, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only to the extent of the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation.

(d) Stock ownership. For purposes of determining stock ownership, see Q&A 11.

# Quick reference chart

## IRC Section 409A

### Former NQDC rules vs. new NQDC rules

#### Elections to defer

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Timing:</b> Elections to defer	<ul style="list-style-type: none"> <li>Elections must be made prior to the compensation being earned and a right to it exists. It is prudent to make the election prior to the calendar year in which the taxpayer has earned the income and has a right to the income.</li> <li>For the first year of eligibility, the election to defer must be made within 30 days of such eligibility.</li> </ul>	<ul style="list-style-type: none"> <li>New election rules apply to deferrals made “On or After January 1, 2005.”</li> </ul> <p><b>General rule:</b></p> <ul style="list-style-type: none"> <li>Election to defer must generally be made before the year in which the income deferred will be earned and services are performed.</li> </ul> <p><b>First eligible year:</b></p> <ul style="list-style-type: none"> <li>Election to defer must be made within 30 days of eligibility.</li> </ul> <p><b>Performance-based compensation:</b></p> <ul style="list-style-type: none"> <li>Performance-based awards may be deferred six months before service ends providing that the period of service is at least 12 months.</li> </ul>	<ul style="list-style-type: none"> <li>If certain requirements listed in Notice 2005-1 have been met, the IRS allowed for deferrals to be made on or before March 15, 2005, for services performed on or before December 31, 2005.</li> <li>Deferrals for year 2006 must be made on or before December 31, 2005.</li> <li>The NQDC plan document must also be followed.</li> <li>Additional guidance may be provided.</li> </ul>

IRC Section 409A created by the American Jobs Creation Act of 2004 (H.R. 4520), IRS Final Regulations 409A, IRS Notice 2006-79, Notice 2005-1 IRS Notice 2010-6. Section 409A is comprehensive. The items mentioned in this chart are only a small sampling of many provisions in Section 409A.

The summaries provided in this chart are intended only as general information. The information is not intended as tax, legal or accounting advice. Federal laws and regulations, including tax laws, may be subject to varying interpretations. Each client must consult his or her own counsel.

The summaries provided in this chart are not exhaustive but represent only certain changes.

# Quick reference chart section continued

## Elections to defer

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Election to delay or change payment terms</b>	<ul style="list-style-type: none"> <li>• Certain modifications to the deferral period or the payment terms were allowed prior to the actual NQDC payments.</li> </ul>	<ul style="list-style-type: none"> <li>• Election to delay or change payment terms must be made at least 12 months prior to date of the scheduled NQDC payments.</li> <li>• New payments must be delayed for a minimum of five years except in the case of death, disability, or an unforeseeable emergency.</li> <li>• Election is not effective until 12 months after it has been made.</li> </ul>	<ul style="list-style-type: none"> <li>• A NQDC plan that is terminated on or before December 31, 2005, would generally avoid the penalties imposed under the new NQDC law upon any distributions.</li> <li>• Additional guidance may be provided.</li> </ul>

## Reporting requirements

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Initial implementation of NQDC plan</b>	<ul style="list-style-type: none"> <li>• One-time letter to the Department of Labor.</li> </ul>	<ul style="list-style-type: none"> <li>• No change</li> </ul>	<ul style="list-style-type: none"> <li>• NA</li> </ul>
<b>Annual tax reporting</b>	<ul style="list-style-type: none"> <li>• NA to deferrals, deferred benefits or earnings.</li> <li>• Distributions must have been reported.</li> </ul>	<ul style="list-style-type: none"> <li>• For calendar years beginning after 2004, annual deferrals must be separately reported on Form W-2 (Wage and Tax Statement) or Form 1099 (Miscellaneous Income).</li> <li>• All compensation deferred under a NQDC plan for the year is required to be reported.</li> <li>• Update: Reporting requirements have been temporarily suspended. The IRS will provide future guidance.</li> </ul>	<ul style="list-style-type: none"> <li>• Report the total deferral in box 12 of Form W-2 as code Y.</li> <li>• Report all distributions in box 12 of Form W-2 as code Z.</li> <li>• A taxpayer should report to a nonemployee the total amount of deferrals for the year under a NQDC plan in box 15a of Form 1099-MISC.</li> </ul>

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The summaries provided in this chart are not exhaustive but represent only certain changes.

# Quick reference chart section continued

## Grandfathering

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>What is grandfathering?</b>	NA	<ul style="list-style-type: none"> <li>• Amounts deferred are eligible for some grandfathering relief.</li> <li>• Plans are not eligible for grandfathering.</li> </ul>	<ul style="list-style-type: none"> <li>• Additional guidance might be provided.</li> </ul>
<b>Effective date</b>	NA	<ul style="list-style-type: none"> <li>• Amounts deferred, benefits and earnings that are also “earned and vested” before January 1, 2005, and to which the service recipient has a binding legal obligation to pay an amount in a future taxable year to the plan participant are not subject to the new NQDC laws.</li> <li>• Certain restrictions apply.</li> </ul>	<ul style="list-style-type: none"> <li>• The new NQDC laws also apply to amounts deferred in taxable years beginning before January 1, 2005, if the NQDC plan under which the deferral is made is “materially modified” after October 3, 2004.</li> </ul>
<b>Requirements to qualify for any grandfathering</b>	NA	<ul style="list-style-type: none"> <li>• The deferrals, benefits and earnings must be “earned and vested” before January 1, 2005.</li> <li>• If a NQDC plan is “materially modified” on or after October 3, 2004, the amounts deferred, benefits and earnings that were grandfathered will fall under the new NQDC laws.</li> </ul>	<ul style="list-style-type: none"> <li>• A material modification will be made if the NQDC plan adds or increases a benefit or a right to a plan in existence before January 1, 2005.</li> <li>• Any acceleration of vesting made in order to qualify deferrals or benefits made before January 1, 2005, will be a material modification.</li> <li>• The material modification subjects the plan and those deferrals or benefits to the new NQDC laws.</li> </ul>
<b>Effect of any grandfathering</b>	NA	<ul style="list-style-type: none"> <li>• The old NQDC law will continue to apply to amounts deferred, benefits and earnings that were “earned and vested” before January 1, 2005, unless there is a “material modification” to the plan after October 3, 2004.</li> </ul>	<ul style="list-style-type: none"> <li>• In general, the new NQDC laws are “effective with respect to (i) amounts deferred in taxable years beginning after December 31, 2004; and</li> <li>• (ii) amounts deferred in taxable years beginning before January 1, 2005, if the plan under which the deferral is made is materially modified after October 3, 2004.”</li> </ul>

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The summaries provided in this chart are not exhaustive but represent only certain changes.

# Quick reference chart section continued

## NQDC features: Questioned but allowable

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Rabbi trusts: (Not offshore rabbi trusts)</b>	<ul style="list-style-type: none"> <li>• Non-foreign rabbi trusts and foreign rabbi trusts seemed to be allowed.</li> </ul>	<ul style="list-style-type: none"> <li>• Non-foreign rabbi trusts are generally allowed.</li> <li>• Any foreign rabbi trusts or similar arrangements will be taxable.</li> </ul>	<ul style="list-style-type: none"> <li>• Additional guidance will be provided.</li> </ul>
<b>Investment selection</b>	<ul style="list-style-type: none"> <li>• Unlimited investment selection allowed.</li> </ul>	<ul style="list-style-type: none"> <li>• Unlimited investment selection is still allowed.</li> </ul>	<ul style="list-style-type: none"> <li>• Additional guidance will be provided.</li> </ul>

## Plan amendments

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Amendments</b>	<ul style="list-style-type: none"> <li>• May have been made if the amendment complied with the old NQDC law.</li> </ul>	<ul style="list-style-type: none"> <li>• Plan amendments made to comply with IRC Section 409A are now permitted only within the guidance of IRS Notice 2010-6. Notice 2010-6 established a 409A document correction program.</li> </ul>	<ul style="list-style-type: none"> <li>• Notice 2010-6 has four major parts: 1) transition relief; 2) remedial amendment period; 3) section on ambiguous plan terms; and 4) ongoing correction program information.</li> </ul>

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The summaries provided in this chart are not exhaustive but represent only certain changes.

# Quick reference chart section continued

## Distributions

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Distributions</b>	<ul style="list-style-type: none"> <li>• Distributions were allowed for:</li> <li>• Termination of employment;</li> <li>• Services provided for a limited period of time;</li> <li>• Disability;</li> <li>• Event not relating to age;</li> <li>• Specific age, other than retirement; and</li> <li>• Unforeseeable emergency.</li> </ul>	Distributions from the NQDC plan <ol style="list-style-type: none"> <li>1) Separation from service;</li> <li>2) Time specified in the NQDC plan at the time of deferral;</li> <li>3) Change of ownership/substantial asset change;</li> <li>4) Unforeseeable emergency;</li> <li>5) Disability; or retirement</li> <li>6) Death</li> </ol>	<ul style="list-style-type: none"> <li>• When a separation from service for certain “key employees” of a publicly traded company are involved, distribution must occur at least six months after the separation date.</li> </ul>
<b>Acceleration of distributions</b>	Generally allowed if accompanied by a 10 percent reduction of the distribution; otherwise known as a “haircut” provision.	<ul style="list-style-type: none"> <li>• Accelerated distributions and “haircut” provisions are prohibited.</li> </ul>	<ul style="list-style-type: none"> <li>• Haircut provisions are prohibited for any deferrals made after December 31, 2004.</li> <li>• The acceleration of vesting is considered a material modification.</li> <li>• Vesting may be accelerated as long as the acceleration of the vesting does not trigger an accelerated distribution.</li> <li>• Accelerated distributions are allowed under the following limited situations.               <ul style="list-style-type: none"> <li>- Under a domestic relations order;</li> <li>- Distribute \$10,000 or less;</li> <li>- Pay employment (FICA) taxes; and</li> <li>- Pay income taxes due to the vesting under certain section 457(f) plans.</li> </ul> </li> </ul>

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# Quick reference chart section continued

## Penalties

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Violations of new NQDC rules are subject to new penalties</b>	<ul style="list-style-type: none"> <li>• Concepts of constructive receipt and economic benefit applied as well as general sections of the IRC.</li> <li>• Plan participant was responsible for the corresponding income tax.</li> </ul>	<ul style="list-style-type: none"> <li>• For amounts in violation, plan participants are subject to:               <ol style="list-style-type: none"> <li>1) Income taxes;</li> <li>2) 20 percent penalty tax; and</li> <li>3) An interest penalty at the underpayment rate plus 1 percent. The interest penalty applies from the earliest date the individual was vested.</li> </ol> </li> <li>• The IRC, constructive receipt and economic benefit principles must still be followed.</li> </ul>	<ul style="list-style-type: none"> <li>• Only the plan participant who is in violation of the new NQDC law is penalized.</li> <li>• All amounts associated with the NQDC plan for the current year and any preceding years are subject to income taxation and penalties.</li> <li>• IRS Notice 2010-6 offers relief for plan amendments made in compliance with the 409A document correction program.</li> </ul>

## Termination – current NQDC plan

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Termination and distribution of current NQDC Plan</b>	<ul style="list-style-type: none"> <li>• General income tax concepts and rules applied.</li> </ul>	<ul style="list-style-type: none"> <li>• A NQDC plan that is terminated on or before December 31, 2005, would generally avoid the penalties imposed under the new NQDC law.</li> <li>• Upon a termination of the NQDC plan on or before December 31, 2005, future deferrals would be terminated and distributions would be made to the NQDC plan participants.</li> </ul>	<ul style="list-style-type: none"> <li>• Amending an arrangement to stop future deferrals there under is not a material modification of the arrangement or the plan. Amending an arrangement on or before December 31, 2005, to terminate the arrangement and distribute the amounts of deferred compensation there under will not be treated as a material modification, provided that all amounts deferred under the plan are included in income in the taxable year in which the termination occurs.</li> </ul>

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# Quick reference chart section continued

## Disability Provisions

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Definition of Disability</b>	<ul style="list-style-type: none"> <li>Provisions of the NQDC agreement could be customized according to the goals of the parties involved.</li> </ul>	<ul style="list-style-type: none"> <li>“Disabled” must now be defined as a plan participant who is “by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months”:               <ol style="list-style-type: none"> <li>Unable to engage in any substantial gainful activity, or</li> <li>Is receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the participant’s employer.</li> </ol> </li> </ul>	

## NQDC Features – Disallowed

Issue	Former rules	New rules	IRS guidance – final regulations and notice 2005-1
<b>Haircut Provisions</b>	<ul style="list-style-type: none"> <li>Aggressive NQDC planning technique that was not promoted by Securian Financial.</li> </ul>	<ul style="list-style-type: none"> <li>No longer acceptable as a NQDC provision.</li> <li>“Haircut” provisions will cause current taxation and penalties.</li> </ul>	<ul style="list-style-type: none"> <li>Except under circumstances specified by the Treasury Department and the Service in guidance, a NQDC plan may not permit the acceleration of payments under the plan.</li> </ul>
<b>Offshore or Foreign Rabbi Trusts</b>	<ul style="list-style-type: none"> <li>Aggressive NQDC planning technique that was not promoted by Securian Financial.</li> </ul>	<ul style="list-style-type: none"> <li>No longer acceptable as a NQDC provision.</li> <li>Offshore trusts will cause current taxation and penalties.</li> </ul>	<ul style="list-style-type: none"> <li>The Treasury Department is requesting further comments on foreign trusts and similar arrangements.</li> </ul>
<b>Financial Triggers</b>	<ul style="list-style-type: none"> <li>Aggressive NQDC planning technique that was not promoted by Securian Financial.</li> </ul>	<ul style="list-style-type: none"> <li>No longer acceptable as a NQDC provision.</li> <li>Any change in the financial status of the employer that attempts to make the informal funding associated with the NQDC plan inaccessible to creditors will result in current taxation and penalties.</li> </ul>	

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