Balancing a Power Differential: Nonprofits vs. For-Profits in the War for Talent

Proposed Changes to IRS §457(f) Regulations May Level Imbalance

An Educational White Paper for Nonprofits
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EBS Executive Benefit Solutions

Nonqualified deferred compensation (NQDC) plans have long held a position of prominence in the constellation of executive benefits.

These agile plans deliver a host of retirement advantages for employers to attract, retain and reward their top talent. For instance, NQDC plans:

- allow executives to defer taxes due on compensation
- replace benefits lost due to government limits on qualified pension plans
- provide additional retirement benefits beyond qualified plans
- enhance benefit packages for executives hired mid-to-late career
- feature performance incentives linked to specific financial, strategic goals

However, a schism exists between two worlds vying for top talent.

Nonprofits vs. For-Profits

The for-profit corporate world has relied on the value NQDC plans for decades with prevalence in the Fortune 1000 at 92 percent, cites the ***2017 Current Practices in Non-Qualified Deferred Compensation Survey Compensation***. Compensation committees regard these plans as highly attractive, in part, because you can design them for a "select group" of employees and contractors. What's more, they may be exempt from many requirements of ERISA (Employee Retirement Income Security Act) such as funding and fiduciary responsibility.

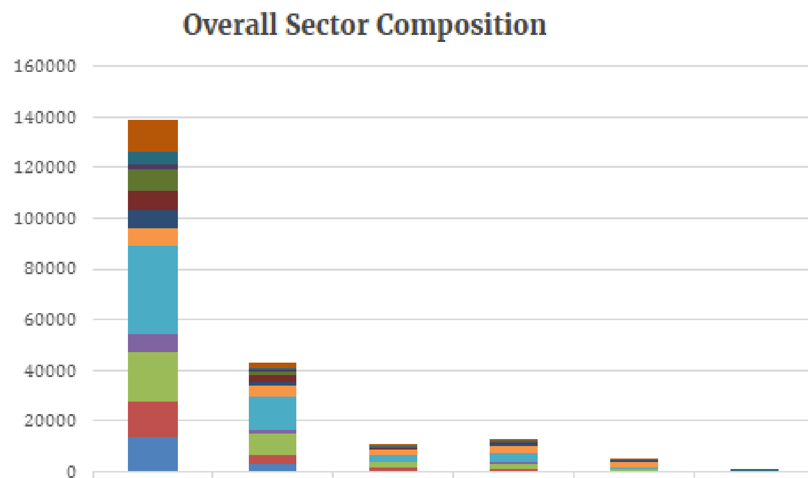
Nonprofit or tax-exempt organizations do not enjoy equal access to the planning options of full-featured NQDC plans so common in the corporate world; nonprofits are regulated under Section 457(f) of the Internal Revenue Service code. Yet the need for nonprofits to attract, retain and reward talent is at an all-time high.

With this paper, we intend to spotlight the importance of executive benefits in the nonprofit sector, discuss limitations and opportunities in its war for talent vis-à-vis proposed § 457(f) IRS regulations, and offer a range of options to level the playing field, notably, a new concept called CompPlus™.

First, let's set the table.

However, the nonprofit sector comprises 1.6 million organizations, registered as 501(c)(3)s with the IRS (2016), from public charities to private foundations. They span the fields of education, hospitals, health and human services, religion, the arts and sciences, and more. Many thousands more do not show up in the IRS master list because they are not required to apply to the IRS for exemption. For our purposes, we will zero in on tax-exempt organizations.

1. THE VAST MAJORITY OF NONPROFITS ARE SMALL, GRASSROOTS ORGANIZATIONS



	Grassroots ≤ $1M	Small $1M - $5M	Mid-size $5.1M - $10M	Large $10M - $50M	Economic Engine $50M - $5B	Powerhouse $5B
Youth Development	13091	2652	373	280	36	
Unknown	4488	681	173	199	80	1
Science, Technology & Social Sciences	2024	724	172	232	117	2
Religious Institutions	8669	1467	206	174	40	
Philanthropy	7396	2179	494	553	198	
Other	6980	1812	384	463	200	
Hospitals & Care Organizations	7523	3987	1600	2929	2234	13
Health & Human Services	34753	13266	3117	3735	598	
Environment and Animal-Related	6623	1521	230	226	50	
Educational Institutions	19535	8128	2137	2232	1044	12
Community Capacity	14179	3875	820	727	102	1
Arts, Culture & Humanities	13750	2979	556	448	115	

[1]Guidestar

Near-Trillion Dollar Industry

The nonprofit sector is vital to the health of the American economy. The facts:[2/3]

- Worth **$956.4 billion** to our economy
- Contributes more than five percent to the GNP
- Third largest employment industry in the country (10 million strong)
- Nonprofits project "significant job growth" vs. a stagnant private sector
- 57 percent planned to hire in 2016; a seven percent increase over 2015

With the size and scope of the nonprofit sector, one could conclude that finding and keeping talent should not be a major challenge. A wrong conclusion.

[2]Statistics from the biannual Nonprofit Sector in Brief report by the Urban Institute's Center on Nonprofits and Philanthropy; [3] 2016 Nonprofit Employment Practices Survey from Nonprofit HR

Hidden Fences

There are tangible and intangible obstacles constricting the nonprofit industry. For example, 54 percent of organizations surveyed by ***Nonprofit HR*** do not have a formal recruitment strategy; 71 percent do not set a formal recruitment budget. Worse yet, 84 percent reported they do not have a retention strategy, and that's in the face of a 19 percent turnover rate in the sector.

Turnover adds to an already high demand for talent due to sector growth. The nonprofit sector grew by 20 percent over the last ten years compared to the for-profit sector at two to three percent, according to a 2016 report published by ***PNP Staffing Group.***
As the top talent marketplace continues to tighten, the nonprofit sector's ability to attract top executives will become more difficult. PNP Staffing Group CEO, Gayle Brandel, said, "Nonprofits need to create an effective organizational recruitment strategy that spreads a wide net and attracts hidden talent in the marketplace."

The potential to deliver on that 'effective organizational recruitment strategy' may be buried in the way executives earn benefit packages. Common sense tells us a full-featured benefits package enables executives to reach retirement security. Organizations offering these packages are far more likely to attract those executives facing competitive offers.

Overcoming § 457 Limitations

However, benefit planning options for tax-exempt organizations are limited compared to for-profit employers, based on restrictions set out in IRS §457 on how organizations provide these benefits *before* they can qualify for **exemption from federal tax.**

Unlike a taxable employer, a tax-exempt organization may only provide deferred compensation under a § 457 plan. We will discuss some strategies used outside of 457(f) that you will find helpful.

Let's back up a moment and root ourselves in a bit of history. In 2007, the IRS promised future guidance on § 457(f) for tax-exempt organizations. Although it has taken nine years, the IRS issued the proposed new regulations in June 2016, providing needed clarity and some unexpected opportunities:

- short-term deferrals now exempt
- severance pay exemption now clarified
- non-competes carry added flexibility
- elective deferrals/vesting period extensions to be honored, if requirements met

More on these points later. For now, let's define the current playing field.

Two types of § 457 plans exist, the 457(b) and 457(f) plans, each with different tax rule applications. For working definitions of these plans, read on.

The 457(b) Plan

A 403(b) or 401(k) plan allows employees to defer compensation from their regular salary or bonuses provided by their employer, to the lesser of $18,000 (for 2017) or 100 percent of the participant's includible compensation. Employees can defer into a 457(b) an equal amount above that deferred in these plans.

While 457(b) plans do not offer over 50 catch-up provisions, you are entitled to a catch-up opportunity to contribute more during the last three (3) years of normal retirement age. Any withdrawals and related taxation would begin after severance from employment and after the age 70 ½.

As with any benefits plan, a variety of other rules related to rollover restrictions apply, alongside the unique features of 457(b) plans. For example, they are also subject to the claims of creditors of the sponsoring organization which means the participant's tax deferral amount is subject to the claims of creditors, like other nonqualified plans. In short, you cannot protect the money.

The 457(f) Plan

If your tax-exempt organization allows executives (or other highly compensated employees) to defer larger amounts than stipulated in the 457(b), do consider a 457(f) plan. While no specific limits restrict what you can contribute to a 457(f) plan, the amounts are subject to a "substantial risk of forfeiture" * and the claims of the sponsoring organization's creditors.

For example, the organization decides to structure an agreement for the CEO. It sets aside amounts on behalf of the CEO or allows him or her to defer a portion or combination of their compensation. The agreement states the CEO is eligible for the deferred 457(f) amounts provided he is still employed on December 31, 2023. The "risk" is "substantial" because if he is terminated or leaves the organization before that date, he would not be entitled to the money.

> *The Deferral of Compensation and a **Substantial Risk of Forfeiture** under Section **457**. Compensation deferred under a **457**(**f**) plan is includible in income on the later of the date on which the participant obtains a legally binding right to the compensation or the date the **substantial risk of forfeiture** lapses (vesting or receipt).

What's more, the future date cannot be "rolling" merely to defer taxation longer. Once December 31, 2023 arrives, the CEO cannot change the date to 2026 simply because he signs another three-year contract. We will offer you a planning concept shortly on how to roll forward amounts deferred.

We wish to impress on our readers, the CEO or other select executives must pay tax on the amounts deferred immediately when the lapse of a substantial risk of forfeiture occurs, regardless of when those amounts pay out. In effect, "vesting" and payment usually occur at the same time.

While both 457 plan options serve as attractive retirement planning tools, please recognize they carry significant restrictions, even pitfalls, which merit careful consideration during the plan design phase.

Form 990 Disclosure

As an aside, it is important to mention disclosures. Whether C-suite executives, physicians, or foundation directors, all tax-exempt employees must complete certain disclosure requirements on incentive compensation and nonqualified supplemental savings and retirement programs.

For example, Form 990, Schedule J, Part I, Question 4b asks if during the year any Officer, Key Employee, Director or Trustee participated in, or received payment from, a supplemental nonqualified retirement plan. If the answer to Question 4b is "yes," then a description of the plan must be included in Schedule J, Part III.

And if your organization provided supplemental retirement benefits, that amount must be reported in the Summary Compensation Table, and in Schedule J.

§ 457(f) Alternatives

Fortunately, tax-exempt organizations can take advantage of 457 alternatives to meet the retirement needs of their executives and highly compensated employees and contractors. When you subject employer-paid, tax-deferred compensation to the risk of forfeiture, or pay the required taxes, workable alternatives emerge in the design and funding of these arrangements.

We will introduce you to liability-free alternatives for the organization and tax-deferred opportunities for the participant that deliver tax-free income at retirement. And they present with favorable Form 990 reporting.

Brief Analysis of Proposed New Rules Under 457(f)

The proposed regulations, published in the Federal Register in June 2016, clarify the requirements for establishing a nonqualified deferred executive compensation plan under § 457(f) of the tax code.

In our opinion, the proposed IRS regulations hold the potential for greater mutual benefit between nonprofit organizations and their executives with minor restructuring.

While these rules should enable nonprofit organizations to create more attractive benefit packages for recruitment and retention of executive talent, they may also present accounting and reporting challenges.

"The regulations actually ended up being significantly more favorable than we as professionals were anticipating seeing originally," Mary K. Samsa, an executive compensation and tax attorney with McDermott Will & Emery LLP in Chicago told a panel discussion on the proposed regulations.

"We view that there are potentially a lot of opportunities for companies to use if they have 457(f) arrangements in place," she added.

"We were trying to make it easier, and thus we developed similar but not identical rules to the Section 409A rules," said Victoria A. Judson, the associate chief counsel of the Tax Exempt and Government Entities division of the Internal Revenue Service. Judson referenced the similar final rules governing executive compensation plans offered by for-profit corporations under § 409A of the tax code. Judson further commented that the proposed regulations seemed well received by the tax-exempt entities they are meant to cover. She did point out the public hearing on the proposed regulations attracted only a small number of attendees.

Both women spoke at the American Health Lawyers Association's Tax Issues for Health Care Organizations conference in Arlington, Va. Oct. 20, 2016.

The Executive Trade-Off

Under the proposed regulations, an executive can agree to defer a portion of his or her compensation to a later year in return for an agreement to provide two years of substantial services or an agreement not to compete with the nonprofit for two years. Additionally, the proposed regulations require the compensation paid out to equal more than 125 percent of the amount the executive agreed to defer *on a present value basis*. Obviously, such an agreement adds muscle to nonprofit organizations to better recruit and retain executive and professional talent.

"If I am on the compensation committee of a nonprofit's board of directors, I always want some non-qualified deferred compensation in the mix for executive compensation because it can act like a handcuff to retain the executive," said Alden Bianchi of Mintz Levin in Boston.

"If my rock star CEO goes elsewhere and there wasn't some kind of deferred compensation aspect that could have motivated him to stay put, the rest of the board is going to wonder why not," he added.

Bianchi, who provides tax advice to nonprofit organizations, said the proposed deferred compensation plan regulations also provide a benefit for the executives who voluntarily defer their compensation through 457(f) plans.

"Everyone wants retirement income, and these rules provide an avenue toward providing that for executives," he said.

"The proposed regulations make recruiting and retaining talent different and, generally, easier than they were before," Karen Field, a principal in Washington National Tax Compensation & Benefits at KPMG told Bloomberg BNA.

"Because of certainty on severance treatment, a nonprofit can now tell key employees who are considering a severance package that 'we can give you a better deal if you stay,' with all parties understanding what a severance arrangement is under the regs," she added.

Bianchi emphasized that those executives who defer compensation may view the tax benefits as a strong motivator. *"The compensation can be paid and taxed at the beginning of the next tax year, which would presumably be taxed at a lower marginal rate than it would have been had it been paid out when the services were performed,"* he said.

Not for Everyone

However, not all executives will embrace the deferred compensation agreements. Veteran executives who've never voluntarily deferred any of their own compensation, subject to a substantial risk of forfeiture, will likely lack interest in beginning it now, Samsa points outs.

"Those executives are already receiving benefits which do not require their own base salary be at risk and are unlikely to want to change that," she added.

"However, the elective deferral feature is a way to redesign your plan so that the new people coming in have skin in the game in exchange for receiving an employer contribution," she said.

"In addition to retention, we have seen this be construed as some sort of recruitment as well," added David Cohn, a principal in the compensation consulting firm of Sullivan Cotter and Associates Inc., in Atlanta. *"Particularly if you are hiring from the for-profit world where this sort of elective deferred compensation is very commonplace,"* he added.

Even with the more favorable proposed 457(f) rules, many organizations continue to design strategies in and around these rules.

Three Phases of Your Money

To appreciate the advantages of certain strategies, we ask you to envision the organization’s contribution and the participant’s money moving through three phases, as shown below:

Three Phases of Money

Contribution Phase	Accumulation Phase	Distribution Phase
Pre-Tax, After-Tax or both? **Qualified plans carry limits.** **Is Pre-tax better? Not always.** **Real estate investing uses after-tax dollars; accumulates tax-deferred; at sale, taxed at capital gains (+ realize $500K exemption on personal residence)** **Or think of Roth plans.** **Many new arrangements designed for participant control and creditor protection; structure as after-tax contributions or non-taxable**	**ROI (return on investment) directly impacts retirement lifestyle.** **In Modern Portfolio Theory, diversification is key** **Another common form of diversification = Mutual fund investing** **Objective? Ensure your strategy accumulates tax-deferred**	**Three money buckets available during distribution:** ▪ **Taxable as regular income** ▪ **Taxable as capital gains** ▪ **Non-taxable** **You diversify during accumulation; you should diversify during distribution** **Many available strategies designed for tax-advantaged payout like Roth plans**

During the contribution phase, a portion of income is set aside for use in future years. We’re told pre-tax deferral outperforms after-tax, but is this true?

First, by deferring pre-tax, we accept that all distributions at retirement will be taxed as ordinary income. Next, you enter the accumulation or investment phase when our money grows. Again, we have been told not to put all our eggs in one basket during this phase.

Surely, the importance of investment diversification cannot be overstated. However, non-taxable, deferred growth of your money rises to the level of critical importance.

Finally, we reach the distribution phase where money is taxed at the time of distribution, also of paramount importance.

As you look at the alternatives for 457(f) programs, factor in the three phases of your money. Time now to outline your objectives for the plan.

Plan Design Objectives

Establish your plan objectives at the outset. A nonqualified plan can simultaneously help an organization to attract, retain, reward and motivate key employees. However, which one is your top priority?

Invest time, do your homework, and select the precise design features to meet your organization’s objectives. We offer a few guidelines in the chart below:

Again, remember all nonqualified compensation plans can support your organization’s goal to attract, retain, reward, and motivate key employees. Because of the intrinsic flexibility of these plans, you can also structure them to emphasize one area of need over another by adapting some of these key features:

Flexible Goals with NQDC Plans

Attract	Retain	Reward	Motivate
Deferral of signing bonus High deferral limits Flexibility Offer employment contract with benefit	Company contribution with vesting schedule Retirement incentive Contribute amount over 403(b) and 457(b) limits	High deferral limits Flexibility Incentive payments deferred Contribute amount over 403(b) and 457(b) IRS limits	Performance-based contribution or match by the organization

Now that you have selected your primary plan objective(s), let’s begin to lay out plan design options with a more detailed comparative analysis.

Three Practical Planning Options

You will find it instructive to follow on as we examine three areas: 1) **A defined contribution supplemental executive retirement plan** (SERP) with a “performance-based” employer contribution, and with alternative approaches to vesting; 2) A **voluntary deferral plan** with employer performance-based matching contribution/retention bonus at the end of the vesting period, and 3) **Multiple life insurance-based supplemental benefit programs.**

Planning Option #1: Defined Contribution SERP

First, your organization could establish an account-balance deferred compensation plan in the name of each participant with plan sponsor contributions.

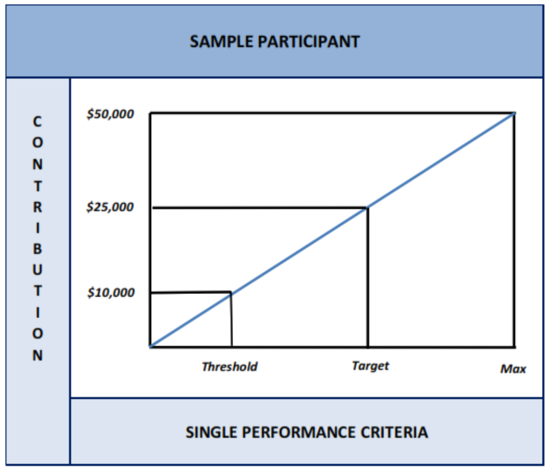
Under this arrangement, the organization contributes to each participant’s account, subject to deferred vesting. You could base contribution amounts on:

- A percentage of annual compensation;
- A target benefit at retirement and/or;
- Specific performance criteria; for example, related to patient outcomes, quality and practice improvement measures, or other.

Incentive Contribution Examples

Review the simple graphic illustration below which links the annual contribution to a single performance criterion. The second chart illustrates an approach to linking the annual contribution to two performance criteria.

Single Performance Criteria Example



Dual Performance Criteria Example

In this case, the potential contribution ties to an achievement score (from 0 – 50 points) for each of two performance criteria. The potential contribution to the participant's account ranges from 0 to 20 percent of base salary. See chart below:

As an example, if the participant's score for Performance Criteria 1 is 30, and for Performance Criteria 2 is 40, the contribution to his/her account would be 14 percent of base salary. The matrix could also be expanded to include a third Performance Criteria.

Annual Contribution as a Percentage of Base Salary

PERFORMANCE CRITERIA 1 SCORE	PERFORMANCE CRITERIA 2 SCORE					
	0	10	20	30	40	50
0	0%	2%	4%	6%	8%	10%
10	2%	4%	6%	8%	10%	12%
20	4%	6%	8%	10%	12%	14%
30	6%	8%	10%	12%	14%	16%
40	8%	10%	12%	14%	16%	18%
50	10%	12%	14%	16%	18%	20%

Vesting Options and Distribution of Benefits

Deferred compensation benefits are taxable to the participant upon vesting. Two approaches below show how you can structure the vesting of plan benefits to balance the organization's goal of retention with the participant's desire to defer taxation.

Vesting/Distribution Option 1

The participant's account becomes 100 percent vested upon retirement (at age 62 or age 65), and distributes in a lump sum at that time. Because of the requirements for "substantial risk of forfeiture," the entire benefit will be forfeited if the participant leaves before retirement. Bottom line: **Maximum risk for maximum benefit.**

Vesting/Distribution Option 2

Each year's contribution becomes 100 percent vested and taxable at the end of five years. Offset the related income tax cost with a distribution of 40 percent, as an example. The residual vested account balance continues to grow on a tax-deferred basis, and no longer subject to a "substantial risk of forfeiture." At retirement, the participant's account balance distributed in a lump sum or in annual installments, as elected. Bottom line: **Mitigate risk for reduced benefit.**

Before we close this section on the **first planning option, defined contribution SERPs,** let's offer a quick overview of pros and cons:

Defined Contribution SERP Comparison

Advantages	Disadvantages
Flexibility with employer contributions **Effective elimination of compensation limit imposed on 401(k) or 403(b) plans** **Mitigation of "substantial risk of forfeiture requirement" (with vesting option 2-rolling 5-year vesting)** **Option for installment payment of vested benefits at retirement (with vesting option 2-rolling 5-year vesting)**	**Requirement for "substantial risk of forfeiture" exposes participant to loss of some or all his/her accrued benefits** **IRS disregards voluntary/elective compensation deferrals unless opportunity exists to significantly increase compensation amount to offset voluntary assumption of required "substantial risk of forfeiture"**

Our next planning option for your review, the voluntary deferral plan:

Planning Option #2: Voluntary Deferral Plan

Tax Requirements

When a participant voluntarily defers compensation in a plan sponsored by a tax-exempt organization, current tax law only recognizes that action if the participant has an opportunity to earn a sufficient return on his or her deferred compensation to economically justify their assumption of risk of forfeiture for the vesting period.

The newly proposed §457 tax regulations indicate that to meet this test, the minimum amount of benefit payable at the end of the vesting/risk of forfeiture period is at least 125 percent of the amounts voluntarily deferred, on a present value basis.

Case Study – Hospital Retains Executives and Physicians

In our case study, a hospital allows participants to elect to defer compensation, subject to 457(f), during the first five-year period. Participants understand their deferrals are at risk of forfeiture if they leave the hospital before the end of the five-year period. You can also opt to design this requirement around a non-compete.

- At the end of the first five-year period, the hospital contributes an amount equal to 50 percent of the participant's deferred amounts to his account.
- Also at the end of year five, the hospital and the participant mutually agree to extend the risk of forfeiture five more years.
- In the second five-year period, the participant elects to defer $50,000 per year (knowing all deferred compensation is subject to the risk of forfeiture).
- At the end of year 10, the hospital contributes to the participant's account an amount equal to 50 percent of amounts deferred.
- Then, at the outset of year 11, participant's account distributes in a lump sum.
- Amounts contributed plus account balance is reported on Form 990.

Let's look at the numbers on the next page:

Voluntary Deferral Plan Example

BEGINING OF YEAR				
Yr.	Employee Elective Deferral	Employer Contribution/ Retention Bonus	Projected Account Balance	Projected Lump-sum Distribution
	(1)	(2)	(3)	(4)
1	25,000		25,000	
2	25,000		50,000	
3	25,000		75,000	
4	25,000		100,000	
5	25,000		125,000	
6		62,500	187,500	
Totals	125,000	62,500	187,500	0

BEGINING OF YEAR				
Yr.	Employee Elective Deferral	Employer Contribution/ Retention Bonus	Projected Account Balance	Projected Lump-sum Distribution
	(1)	(2)	(3)	(4)
6	237,500		237,500	
7	50,000		287,500	
8	50,000		337,500	
9	50,000		387,500	
10	50,000		437,500	
11		218,750	656,250	
Totals	437,500	218,750	656,250	656,250

Now, let's review the pros and cons of the voluntary deferral plan option:

Voluntary Deferral Plan (457(f)) Comparison

Advantages	Disadvantages
A supplemental retirement plan that allows for tax-deferred growth and bonus payment for retention	**Contributions subject to substantial risk of forfeiture: Potential for loss due to early termination**
Opportunity to defer compensation over 403(b)/457(b) compensation limits	**Account balance subject to claims of employer sponsor's general creditors**
Investment menu like 403(b)/457(b) plans with a "bonus" contribution in year 5 and year 10	**Form 990 disclosure of "bonus" amount as compensation**
	Sponsor carries deferred compensation liability on its balance sheet

You will find our third and final planning option of particular value:

Planning Option #3: Life Insurance-Based Programs

This section on life insurance-based programs offers a discussion of three optional planning concepts.

Concept A in Life Insurance-Based Programs:

Defined Contribution "Bonus" Plan

The defined contribution "bonus" plan issues a life insurance contract, owned by the participant, which provides structure for the plan. The Roth-like tax characteristics of life insurance create an opportunity for tax-deferred growth of cash value and, potentially, non-taxable withdrawals of benefits. The tax-free death benefit provides cost-effective life insurance coverage, as well.

Under this plan, the hospital sponsoring the plan pays the annual premium on behalf of the participant, which is treated as additional taxable compensation (only the annual contribution is reported on Form 990). The annual premium contributions structure as follows:

- Fixed percentage of participant's compensation (see earlier case study);
- Target benefit at retirement (or after a specified time), and/or;
- Discretionary contribution tied to achieving specific performance criteria

The participant owns all rights and interests in the policy and realizes the financial planning options available to any individual owner of a permanent, cash-value life insurance contract at the cost of 35 – 45 cents on the premium dollar (the tax cost).

Policy cash value grows tax-deferred, and withdrawals from the policy (if properly structured) are non-taxable. So, what makes these arrangements attractive?

Most organizations adopt an indexed universal life policy that tracks the S&P 500 or other indexes and features a guarantee no loss of principal (floor of zero, with some policies offing a minimum return 1%-2%). If the S&P 500 produces a negative return, the participant does not lose his or her principal contributions.

"Bonus" Plan – Taxation to the Participant

- The annual contribution is taxable as added "bonus" compensation. Thus, the amount paid into the insurance policy annually is the net after-tax amount

- The policy's cash value grows on a tax-deferred basis, and policy withdrawals (if properly structured) are non-taxable

The key characteristics of the "Bonus" Plan structure are as follows:

After-Tax "Bonus" Plan Comparison

Advantages	Disadvantages
Offers valuable and flexible supplemental benefits program without concern for "substantial risk of forfeiture" required in a Defined Contribution SERP under 457(f) Opportunity to create a non-taxable "bucket" of supplemental retirement savings Opportunity for asset-class diversification across a range of investment funds, model portfolios, or to indexed investment options with downside protection Delivers a cost-effective life insurance benefit Optional long-term care/chronic illness benefits (with some products currently available) Portability and benefit security of individually owned cash-value life insurance contract	Loads and expenses of the life insurance contract, if the death benefit is not needed. Employer views as lower-level retention characteristics vs. a defined contribution SERP with delayed vesting Form 990 disclosure of the additional "bonus" compensation (not required if voluntary plan with employee's money)

Concept B in Life Insurance-Based Programs:

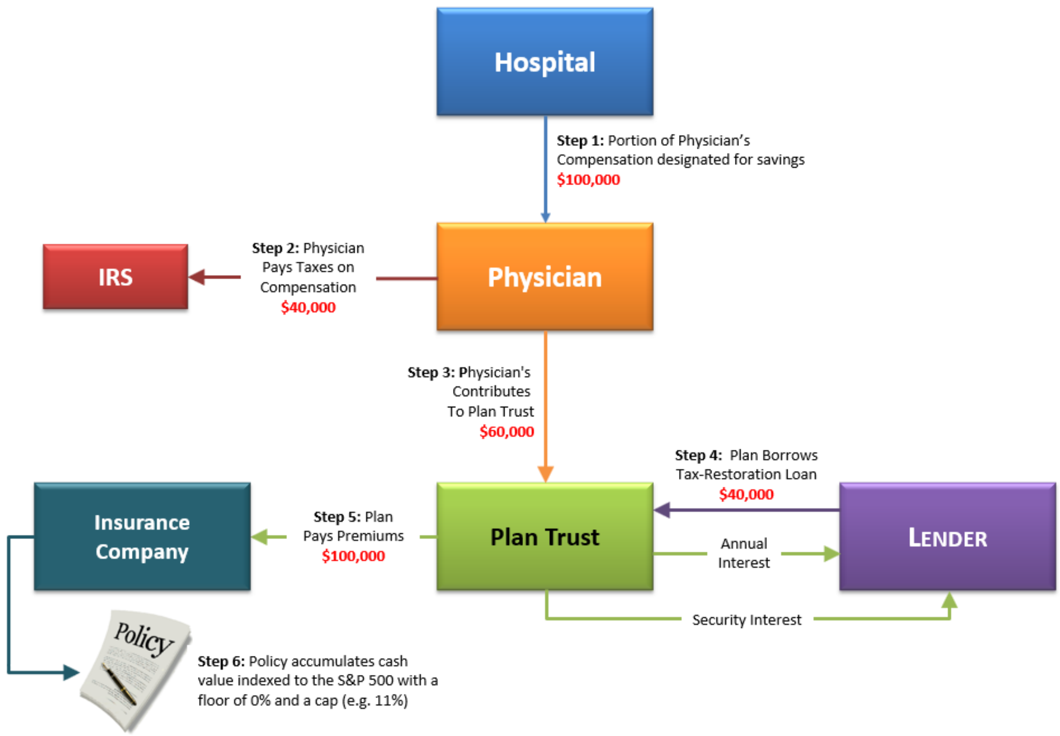
"Leveraged" Bonus Plan

In this plan, the sponsoring organization pays the annual premium, which is treated as additional taxable compensation, on behalf of the participant. However, the participant's after-tax contribution to the life insurance contract (same indexed policy described above) is supplemented by a "tax restoration loan" from an outside lending source (bank).

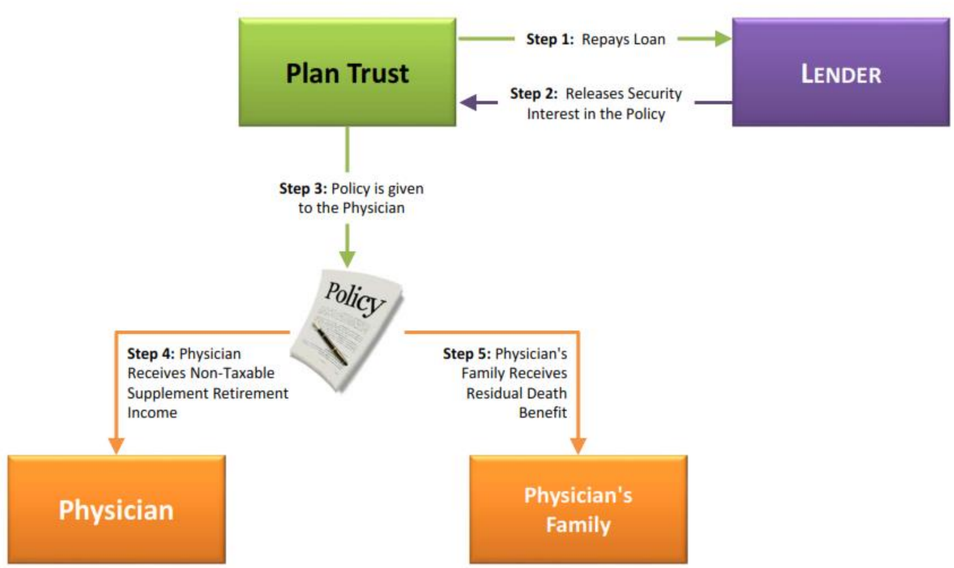
Several major healthcare institutions have adopted this concept of using an after-tax strategy; then they restore the taxes paid by letting them accumulate during the accumulation period, like a pre-tax deferral.

The following graphics illustrate the leveraged bonus plan concept, split into two phases; the Contribution/Accumulation Phase, and the Distribution Phase.

Leveraged Bonus Plan: Contribution - Accumulation Phase



Leveraged Bonus Plan – Distribution Phase



During this distribution phase, the institution repays the tax restoration loan and releases the policy to the participant. He or she can now withdraw non-taxable income for retirement and leave beneficiaries with a tax-free life insurance benefit.

Concept C in Life Insurance-Based Programs

CompPlus™ – New Concept in Nonqualified Retirement Plan Funding

Recently, EBS developed an improved concept to fund nonqualified retirement plans with the goal to further lighten the burden of taxation on participants.

What sets the CompPlus™ concept apart from traditional 457(f) plans and qualified plans is the way participants are taxed (see chart below).

CompPlus™ Concept with Potential Benefits

	CompPlus™	457(f)
Employer Contributions	**Non-taxable**	**No tax paid on contribution amount, if subject to a "substantial risk of forfeiture"**
Accumulation	**Tax-deferred earnings**	**Tax-deferred earnings until lapse of risk of forfeiture** **At that time taxation is triggered regardless of when benefits paid out**
Distribution (withdrawals)	**Non – taxable (if properly structured)**	**Taxed as ordinary income upon vesting**

The employer's contributions to CompPlus™ are reflected as an ***asset*** on its balance sheet, rather than as an expense and a ***liability*** under a traditional 457(f) plan.

Powered by Indexed Universal Life Insurance

Like the after-tax strategies mentioned above, CompPlus™ achieves its tax-advantaged status through an indexed universal life insurance policy. CompPlus distinguishes itself further due to the EBS proprietary-policy structure, which maximizes value to both the organization and the participant.

The policy(ies) are designed under a split-dollar arrangement similar to the 2016 well-published plan for Coach Jim Harbaugh at the University of Michigan. However, we have built in some unique design structure that positions CompPlus™ as even more advantageous to both the participant and the organization.

The split-dollar program allows tax-exempt or non-profit organizations to contribute substantial amounts into the program yet report only a small fraction of the contribution on the organization's annual Form 990 to the IRS.

In the case of Coach Harbaugh, stated requirements called for reporting only the "economic benefit" and not the policy's annual premium. Using this methodology, the University of Michigan had only to report approximately **$68,250** as annual compensation for the $2 million annual premium payment in 2016 for the coach.

Under CompPlus™, the participant incurs ZERO out-of-pocket cost on the premiums contributed on his/her behalf.

The major difference in CompPlus™ stems from its uncommon policy structure, which also produces more non-taxable income. Normally, most organizations adopting split-dollar programs struggle to get the policy to perform two different functions (to produce non-taxable income to the participant and to recover the sponsor's costs).

With the EBS policy structure, the sponsor can recapture all its contributions including the time value of money, and maximize the amount of non-taxable income to the participant.

Finally, we wrap up this section with an overview matrix on the next page showing the key characteristics of these life insurance-based programs. You will find it a convenient comparison tool.

Key Characteristics of Life Insurance-Based Plans

	BONUS PLAN	LEVERAGED BONUS PLAN	COMP*PLUS*
CONTRIBUTION PHASE Participant (EE) Employer (ER)	After-tax After-tax - Based on: - Percentage of salary - Target benefit - Performance criteria	After-tax After-tax - Based on: - Percentage of salary - Target benefit - Performance criteria	None Non-taxable premium loans from Employer
Financed contributions	N/A	"Tax-restoration" loans	ER premium loans
ACCUMULATION PHASE	Tax-deferred growth of cash value	Tax deferred growth of cash value	Tax-deferred growth of cash value
DISTRIBUTION PHASE	Non-taxable (if properly structured)	Non-taxable (if properly structured)	Non-taxable (if properly structured)
LIFE INSURANCE CONTRACT	Corporate Variable Universal Life *OR* Indexed Universal Life (IUL)	Indexed Universal Life (IUL)	Indexed Universal Life (IUL)
GROWTH OF CASH VALUE	*CVUL*: Based on allocation of cash value among a range of funds *IUL*: Indexed to equity markets, with downside protection	*IUL*: Indexed to equity markets, with downside protection	*IUL*: Indexed to equity markets, with downside protection
NET CASH VALUE BENEFIT TO PARTICIPANT	100% of policy cash value	100% of cash value attributable to EE and ER contributions *PLUS* The spread on the financed premiums	Cash value in excess of that needed to support the death benefit loan repayment
NET COST TO PARTICIPANT	Tax cost of the ER premiums (could be grossed-up)	Tax cost of ER premiums (could be grossed-up)	Tax cost of imputed interest at the AFR (zero, if interest accrued)
NET COST TO EMPLOYER	The after-tax cost of the premium and tax gross-up payments	The after-tax cost of the premium and tax gross-up payments	The opportunity cost of money on the premium loans
BOTTOM LINE	An opportunity for the EE to acquire a competitive cash value contract at ~40 cents on the $1	An opportunity to potentially enhance bonus plan benefits through leveraging	**For EE:** - Minimal cost (if any) - A more significant death benefit **For ER:** - Conversion of an expense into an asset - Recovery of costs - More favorable 990 disclosure

Recapping the Challenge: No Silver Bullet

In today's benefits environment, highly compensated executives and other key people working in tax-exempt organizations cannot maintain their income into retirement nor save enough for retirement without adverse tax impact and creditor risk.

This unfair situation makes the power differential between nonprofit and for-profit organizations in executive recruitment even worse. We believe the time is now to correct the imbalance between these two worlds and leverage the proposed new regulations to deliver to nonprofits the clout they need to recruit, retain and reward tomorrow's leaders.

While we have dispensed a sizeable amount of data in this paper, please understand there is no silver bullet or quick fix. Whatever you do, however, ratchet up the impact of your NQDC plans and leverage opportunities in the new regulations.

To customize the best solution for your organization will take some finessing. We certainly hope you find the data and concepts presented helpful to your process. Of course, we're here to help as needed.

The master key to designing the right strategy for your organization lies in your objectives. Begin by determining the result you seek. Do you want to achieve more effective recruitment, a stronger reward system, or higher retention rates? Or a combination of all three. Then, carefully examine the various alternatives which work best for your organization and your participant.

Let's wrap up with a comment on an evolving topic destined to impact most everyone.

Proposed 2017 Tax Legislation

The House of Representatives and the Senate recently released their initial versions of "Tax Reform." While these preliminary proposals will evolve over the next several weeks through the amendment and reconciliation processes, it is noteworthy that each of the House and the Senate versions contains provisions which could impact retirement planning for key employees and professionals of nonprofit organizations.

We are closely tracking the progress of the legislation and will post periodic updates on our website www.executivebenefitsolutions.com as the final version of "Tax Reform" moves through Congress.

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