



**Fulcrum Partners, a  
OneDigital Company**

Answering Questions About  
COVID-19 and Your  
Nonqualified Deferred  
Compensation Plans



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## **As a participant in a nonqualified deferred compensation plan, can I cancel, reduce, or suspend my deferral elections?**

Deferral elections under IRC Section 409A (“409A”) are irrevocable and cannot be reduced or suspended. However, a plan can allow for deferrals to be cancelled (not delayed) under limited circumstances, including upon an Unforeseeable Emergency (as defined in Section 409A), where the emergency can be relieved through a cessation of deferrals.

Assuming the plan allows it, a participant may petition the administrative committee of the plan to request deferral elections to be cancelled if they feel they have suffered an Unforeseeable Emergency due to COVID-19. The administrative committee will review the application and determine if the participant meets the requirement of an Unforeseeable Emergency.

Read more on Unforeseeable Emergency: See [“What is an Unforeseeable Emergency?”](#)

Payroll should update its records to reflect that the participant is no longer deferring into the nonqualified deferred compensation plan and should notify the record keeper of the plan.

Participants may re-enroll and defer into the plan prospectively, following 409A’s deferral timing rules.



## What other exceptions allow a participant to cancel a deferral election?

Some nonqualified deferred compensation plans will require a deferral to cease if a participant takes a 401(k) Hardship. (The Principal model document does not require this. If you use a non-Principal plan document, please review the plan for specifics. )

A deferral election can be cancelled upon a participant's disability (as defined by Section 409A; generally meaning total and permanent disability).

A deferral election is automatically cancelled upon a plan sponsor's decision to make a discretionary termination of the plan.

Read more on discretionary terminations: See "[As a plan sponsor, can I terminate or freeze the plan?](#)"

## Can I take a distribution from my plan due to COVID-19?

At this time, there's no specific provision for distributions due to COVID-19 itself, but if the plan design allows for distributions upon an Unforeseeable Emergency, a participant may apply to the administrative committee of the plan and request a distribution from the plan due to the Unforeseeable Emergency. In plans that do allow it, the availability of a distribution may be restricted to active employees.

## What is an Unforeseeable Emergency?

An Unforeseeable Emergency is defined as a severe financial hardship to the participant, their spouse, beneficiary or dependent, the loss of the participant's property due to casualty or other similar extraordinary and unforeseeable circumstances arising because of events beyond the participant's control.

When a participant applies for a distribution from the plan due to an Unforeseeable Emergency, regulations limit such distributions to amounts that cannot be relieved through insurance,



liquidation of assets that would not cause a severe financial hardship, or cessation of deferrals under the plan. The distribution must be limited to the amount necessary to satisfy the emergency need, plus the amount necessary to pay the tax on it. Distributions due to an Unforeseeable Emergency are subject to income tax.

### **What if my plan does not have an Unforeseeable Emergency distribution option?**

A plan sponsor may amend their plan to add Unforeseeable Emergency as a permissible distribution event effective once the proper documentation is completed.

### **As a plan sponsor, can I reduce or remove matching contributions or other employer contributions?**

The ability to stop or reduce plan contributions depends on the plan design and document. Under Section 409A, employers have considerable flexibility in choosing a plan design that can allow them to stop or reduce contributions, including match amounts. Many plans are designed so that the employer has the discretion to make or not make a contribution, so the amount, if any, is entirely determined by the employer. However, some plan designs require the employer to contribute to the plan. If the plan requires employer contributions, the plan sponsor should carefully determine whether the plan can be amended to discontinue mandatory contributions. Many plans are designed to restrict the circumstances of when an amendment may occur.

Many of you may have a similar question regarding matching in your qualified plan. Rules for employee deferrals and matching for qualified plans differ from nonqualified deferred compensation plans. Please see the qualified plan Q&A.

### **As a plan sponsor, can I terminate or freeze the plan?**

Plans may be terminated under three distinct circumstances defined in regulations: (1) at the discretion of the company; (2) if the company ceases to be a going concern, and (3) in connection with a Change in Control (as defined by regulations under Section 409A).



In the current environment, the termination of a plan at the discretion of a company is the most relevant. A termination at the discretion of the plan sponsor is subject to specific timing rules. If such a termination takes place, all similar plans of the employer (as defined using the Plan Aggregation rules under IRC 409A) must be terminated, as well. However, such a termination is not allowed if proximate to a downturn in the financial health of the company. Plan sponsors wanting to explore this option should discuss with their counsel. Deferral elections cease upon a discretionary plan termination.

Due to the irrevocability of deferral elections, as a practical matter, plans cannot be frozen until the next calendar year.

### **What happens if I need to reduce staff?**

A Separation from Service, as defined by 409A, may occur if a participant will no longer be performing services, or services will significantly be reduced. Generally, a Separation from Service will require a distribution according to the terms of the plan and the participants' pre-established time and form elections.

### **How do I handle employees on leave?**

The employment relationship is treated as continuing intact while the employee is on military leave, sick leave, or other bona fide leave of absence if the period of such leave does not exceed six months, or if longer, so long as the employee's right to reemployment is provided either by statute or contract. Consequently, if a participant is on leave, there likely is not a Separation from Service so long as there is an intent for the employee to return to work.

### **What about deferrals by employees with reduced shifts or pay?**

Participant deferral elections are irrevocable and must be honored, so they must continue to defer into the plan (unless cancelled due to an Unforeseeable Emergency, as explained above). Keep in



mind that most participants have elected a percentage of their pay to be deferred, so if their pay level is decreased, this will decrease the amount to be deferred.

A reduction in pay is not used to determine if a Separation from Service has occurred.

### **If I have to shut down operations, what do I do about contributions?**

If you intend to shut down operations for a period of time, consider these decision points:

- If there will be no payroll during this period, no deferrals will be made.
- If you continue to pay employees in some capacity, consider reducing or removing employer contributions from the plan. A plan amendment may be needed.
- Read more on employee deferrals: See [\*"As a participant in a nonqualified deferred compensation plan, can I cancel, reduce, or suspend my deferral elections?"\*](#)
- When employees come back from unpaid leave or a layoff, they will resume deferrals. Read more on Separation from Service: See [\*"How do I handle employees on leave?"\*](#)

### **Can I submit participant deferrals/ company contributions, but not corresponding asset payments?**

Nonqualified deferred compensation plans cannot be formally funded. Therefore, it's not necessary to make a corresponding asset payment when participant deferrals or company contributions are submitted. However, over the long term, most companies choose to informally finance their plan to ensure sufficient funds are in place when a distribution needs to occur.

### **What if I cannot make payments to participants who are entitled to a distribution?**

If payment of a distribution upon a distributable event would jeopardize the ability of the company to continue as a going concern, regulations under Section 409A allow an exception to the general



rule requiring that the distribution be made. The distribution may be delayed until such time as it would no longer have such an effect.

### **Will there be relief from Congress for the financial impact of COVID-19?**

So far, relief has not been provided specific to 409A, but the IRS has generally been reasonable in uncertain times. We'll continue to monitor and communicate regulatory changes or new guidance.

*The complicated nature of the regulations and the quickly changing legislative landscape in light of the impact of COVID-19, make it imperative to consult with local counsel as to each plan's unique facts and circumstances when implementing changes to the plan or its operations.*



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