

Deferred Compensation Strategy for Highly Compensated Faculty

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Status of Ongoing Reviews

Objective: Maintain the tax-favored qualified plan status of all deferred compensation plans.

Status: Internal Revenue Service initiated an audit of the 403(b) plan sponsored by the university for the tax year 2018. The audit is ongoing and there are no known issues or findings to-date.

The university initiated an internal review of its other plans for compliance in early fall 2021. The internal review is ongoing with support of university plans administrator, legal counsel, internal audit, human resources and finance as well as external counsel and tax advisors.

Finding: Operational errors in the administration of the 415(m) plan have been identified by the university.

Current Faculty Retirement/Deferred Compensation Policies

Attachment DD

- Goal:** Develop, implement and maintain effective compensation programs that afford a competitive advantage in recruitment and retention to support the university's objectives and strategic plans.
- Background:** The Faculty Handbook and Terms of Faculty Offer do not explicitly limit retirement to the annual contribution limits. The last major change to the university plans was the addition of the Qualified Governmental Excess Benefit Arrangement for Employees of Virginia Tech, a 415(m) plan established effective January 1, 2010.
- Policy:** Effective 2022, university policies include the following:
- Retirement contributions are budgeted on faculty creditable compensation.
 - In accordance with guidance from external counsel, retirement contributions (employER and mandatory employEE) up to the **compensation limit** (\$610,000/\$900,000) that exceed the annual **contribution limit** (\$61,000) are sent to the 415(m) excess plan.
 - Board approved deferred compensation actions are made up to the limits in the following order: first to the 403(b) employER contribution plan, second to the 401(a) incentive plan, and last to the 415(m) excess plan.

Deferred Compensation Plans at Virginia Tech

Deferred compensation plans usually provide a tax deferred benefit as governed by the applicable Internal Revenue Code (IRC) Section. Plans utilized by Virginia Tech include the following:

1. 401(a) employer sponsored plans for employER and mandatory employEE contributions
 - Defined Contribution (Optional Retirement Plan) or Defined Benefit/Hybrid (Virginia Retirement System)
 - Select Defined Contribution Plan for Faculty
 - EmployER Cash Match
 - Deferred compensation action in addition to retirement (Incentive Plan)
2. 415(m) Governmental Excess Plan
3. 457(b) Governmental Plan (Commonwealth of Virginia Plan) employEE elective deferred compensation
4. 403(b) Public Schools Tax Sheltered Annuity
 - EmployEE elective deferred compensation
 - EmployER deferred compensation action

Retirement Plan Limits on Contributions and Eligible Compensation

Contribution/benefit limits of IRC §415 apply to qualified plans. The 415(m) *governmental excess plans* are generally used to set aside contributions over and **above** the contribution/benefit limits. The sponsoring institution owns the 415(m) plan assets and the employees have a vested interest in the benefits.

Retirement Plan Limits	2022	2021	2020	2019
Annual Compensation Limits – 401(a)(17)/404(l)	\$ 305,000	\$ 290,000	\$ 285,000	\$ 280,000
Elective Deferrals 401(k)/403(b) – 402(g)(1)	20,500	19,500	19,500	19,000
Catch-up Contributions – 414(v)(2)(B)(i)	6,500	6,500	6,500	6,000
457 Elective Deferrals – 457(e)(15)	20,500	19,500	19,500	19,000
Defined Contribution Limits – 415(c)(1)(A)	61,000	58,000	57,000	56,000
Annual Compensation Grandfathered Governmental Plans (Pre-1996)	450,000	430,000	425,000	415,000

Tax Year 2022 Contribution Overview

In accordance with guidance from external counsel,

- Compensation over the **compensation limit** of \$305,000 but less than \$586,538/\$451,852 allows 100% of employer and mandatory employee retirement contributions first to qualified 401(a) ORP or VRS plan and second to the Select plan up to the **contribution limit** of \$61,000. Forty faculty fall into this group as of February 2022.
- Twenty-three faculty receive employer contributions on compensation up to \$610,000/\$900,000 with contributions over \$61,000 going to the 415(m) plan. As of February 2022, 9 of 23 will not receive employer contributions on salaries over \$610,000.

415(m) Plan Compliance Issues and Resolution

1. Plans for two individuals were not distributed in accordance with plan documents upon termination of the individuals from the university. Correction requires immediate disbursement of account balances and denies the former employees the opportunity to elect distribution over multiple years potentially resulting in the former employees incurring taxes that could have been avoided or delayed. **IN PROGRESS**
2. Three reconciling items were identified where contributions were not submitted to the recordkeeper. Correction requires funding the eligible contributions with an allowance for “lost earnings.” **IN PROGRESS**
3. Contributions (both employER and mandatory employEE) in excess of allowable compensation limits were made to the 415(m) plan beginning in 2016, the first year an employee exceeded the compensation limit. Correction requires refunding unallowable amounts and accrued gains/losses. **PENDING BOARD APPROVAL**

415(m) Contributions in Excess of Allowable Plan Limits Attachment DD

- The university identified that employER and mandatory employEE contributions were not capped at applicable compensation limits in late 2021.
- In accordance with guidance from external counsel, corrections were made for the 2021 tax year impacting 5 employees with compensation over \$580,000.
- Between 2016 and 2020, employER and mandatory employEE contributions were not capped at applicable compensation limits. In accordance with guidance from external counsel, the university must refund the excess contributions and accumulated earnings. Currently, seven current or former employee accounts require refunds of excess employER and if applicable, excess employEE contributions.

Self-Correction Options for 415(m) Contributions in Excess of Allowable Plan Limits

	Option 1	Option 2	Option 3
Description	Minimum Legal Requirement	Status Quo	Gross up for current year tax impact
Excess employEE contributions 2016 - 2020	Paid as compensation in 2022	Paid as compensation in 2022	Paid as compensation in 2022
Excess employER contributions 2016 - 2020	Retained by university	Include in deferred compensation action	Include in deferred compensation action
Accumulated gains/losses	Retained by university	Include in deferred compensation action	Include in deferred compensation action
EmployER contributions 2021	Retained by university	Include in deferred compensation action	Include in deferred compensation action
Employee impact (#)	7	8	8
Employee 2022 compensation (\$)	\$250 – \$40,173	\$250 – \$40,173	\$250 – \$40,173
Employee long-term impact (\$)	(\$1,250) – (\$106,627)	\$1,500 – \$164,000	\$1,500 – \$164,000
Tax impact	Employee obligation, as if the erroneous contributions had not occurred	Employee obligation, as if the erroneous contributions had not occurred	Gross up compensation for income taxes on refunded employEE 2016 – 2021 contributions
Additional cost to university	(\$243,482)	\$1,099	\$56,500 estimated

Approval of Retirement Contribution Corrections

Attachment DD

RECOMMENDATION:

That the proposed Option 3 for correcting retirement contributions in excess of allowable plan limits be approved.