



## **Severance Arrangements and Tax Exempt Organizations**

Special care must be exercised when providing severance to an executive of a tax exempt organization. Due to the requirements of IRC Section 457(f) requiring a substantial risk of forfeiture on deferred compensation arrangements associated with tax exempt organizations, severance should be provided only in the event of involuntary termination of employment. If the severance were unrestricted, IRC Section 457(f) would likely require including the amount of promised severance in the covered executive's income immediately.

*A severance plan is generally considered a nonqualified welfare benefit plan* that permits the employer to determine who may participate. To avoid characterization as nonqualified deferred compensation, a severance agreement should follow the ERISA safe harbor of limiting the total of severance payments to two times the Executive's total salary over the last twelve months of employment and be made within 24 months of the Executive's termination of employment. Although there is no statutory definition of a severance pay plan, a safe harbor appears to exist for plans that follow the ERISA definition of a severance plan which requires the following:

Payments at termination of an Executive's employment are not directly or indirectly contingent on the Executive's retirement (i.e., other conditions under which severance is paid must be present, e.g., death, disability, etc.).

Generally, all payments under the plan must be made within 24 months of the Executive's termination.

### **IRS Circular 230 Disclosure**

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