is the maximum compensation limit (called 401(a)(17), where the limit for the year 2025 is $350,000. This means that an employee can contribute a percentage of their compensation to their 401(k) up to a limit of $350,000, after which they are not allowed to contribute for that year. There are additional restrictions that cut into how much a person can put into a 401(k), like an overall contribution cap. In 2025, this limit is $23,500, which is 6.7% of the pay limit. An employee exceeding the comp limits who contributes 4% to their 401(k) and gets a full match from their employer will run into this cap, and the company will refund the excess contributions. The refunded contributions will be considered compensation and will be taxed. In addition, they will not be invested in any of the funds offered by the 401(k), so these caps can be very costly to the employee. 401(k) plans, via ERISA's regulations, also require the employer to perform "non-discrimination testing", which has rules to ensure that "highly compensated" employees aren't benefiting egregiously more than the rank-and-file. This is another reason an employee might find his contributions returned to them.

NQDC refers to a set of rules that allows a company to provide a program that looks similar to a 401(k) but removes all of the limits that are applied to qualified plans. Companies might call this a SERP (Supplemental Employee Retirement Plan) and offer other benefits to executives through such a plan. The NQDC portion of a SERP can be viewed as the continuation of the employees' 401(k) if there were no restrictions on what can be contributed. It solves the problem of what an employee is allowed to contribute, while creating a new set of problems for the company.

The main distinction for the company, and the participant, is that the tax-deferred benefit must not be "funded", lest it be considered income to the employee and taxed. This might sound like a strange detail, but it's easy to understand if you just imagine the company withholding pay and setting up nothing more than an accounting structure to track it as deferred comp in the form of NQDC. It holds the real money in its treasury, but it's not earmarked and has no special status. The program creates an accounting problem that is easily manageable by any modern company with a large enough accounting department. The biggest complication comes when we look at investment options because it is difficult to imagine investing without actual funds.

An employee will select a fund for their NQDC contribution just as they would for a 401(k). Let's assume they choose an S&P 500 Index Fund that the company makes available. But there is no actual fund for the NQDC. There is an accounting entry for the unpaid compensation directed towards that fund, and then the company tracks the performance of that fund and is accountable to provide that performance, whether it's good or bad. If the S&P 500 has negative returns, that causes a gain to the company because they now owe the employee less than what he contributed. The opposite is true when the S&P 500 has positive returns. The company must be able to deliver those positive returns