

Featured Professionals

Debra J. Linder

Related ServicesEmployment, Labor &
Benefits

409A Revisited – Important Deadline

Legal Update

11.01.2012

By Debra J. Linder

Do you have employment agreements, severance plans, change of control agreements or similar arrangements? Are the severance and other benefits payable under those arrangements conditioned on the execution of a release? If so, you need to be aware of an upcoming deadline that might require amending those arrangements.

Background. Internal Revenue Code Section 409A imposes a variety of restrictions on nonqualified deferred compensation arrangements, which, in part, requires that such arrangements specify the timing and form of payment. Unfortunately, the IRS defined the term “nonqualified deferred compensation plan” broadly, and many other types of benefit arrangements, including severance and change of control agreements, may be subject to Code Section 409A. In some cases, severance may be exempt from Code Section 409A if, for example, the severance is paid in a lump sum shortly after termination of employment or if the amount is under a certain dollar threshold. However, if an exemption does not apply, and the arrangement does not comply with the Code Section 409A requirements, the benefits payable under the arrangement may be subject to income taxes, an additional 20% tax and interest penalties.

The Problem. In most cases, the payment of severance is conditioned on the execution of a release. The IRS has indicated that, if the severance is subject to Code Section 409A, the release provisions must not allow the employee to control the timing of the severance payments. For example, if the termination occurs late in the year, the IRS is concerned that the employee could delay executing the release in order to shift the payment of the severance into the next calendar year. Unfortunately, the IRS did not raise these concerns until several years after Code Section 409A was enacted.

The Solution. To comply with Code Section 409A, the severance arrangement must either provide that (i) the severance payments will be made (or begin) on a fixed date following termination of employment (such as the 60th day following termination if the release is executed and not revoked by that day) or (ii) during a specified period following termination, but if that period crosses two tax years, the payment will be made in the second tax year, even if the release is executed earlier. If the release

provisions currently do not comply with one of these requirements, it may be possible to bring the severance arrangement into compliance, so long as the amendment is adopted **by December 31, 2012**.

What Should Employers Do Now? Employers should review their existing employment agreements, severance plans, change of control agreements and similar arrangements, and specifically any release provisions, to see if a corrective amendment is required by December 31, 2012. Going forward, employers should remember that Code Section 409A can apply to these arrangements, and should ensure that any release provisions comply with the Code Section 409A restrictions. The Compensation Planning & Employee Benefits Group is always willing to assist employers with reviewing these arrangements to ensure compliance with Code Section 409A.