

409A Deferred Compensation Plan Amendments Deadline Will Be Here Sooner Than You Think.

December 31, 2007 is the deadline for amending any deferred compensation plan or arrangement that is subject to Internal Revenue Code (I.R.C.) §409A to comply with the final 409A regulations in order to avoid triggering the draconian tax penalties for not complying with this written plan requirement.

What are the written plan requirements for a plan or arrangement that is subject to I.R.C. §409A?

The final Treasury regulations provide that the material terms of a plan or arrangement that is subject to 409A must be set forth in writing. Such written plan or arrangement may be in one or more documents and the material terms must include the amount (or the method or formula for determining the amount) of deferred compensation to be provided under the plan or arrangement and the time and form of payment.¹

What is deferred compensation for 409A purposes?

“Deferred compensation” for 409A purposes is defined as “compensation that pursuant to a plan (or arrangement) an executive or employee earns and acquires a legally binding right to in one taxable year that is not payable until a later taxable year of the executive, unless exempt from 409A.” Deferred compensation for this purpose, includes compensation that “may” be payable to (or on behalf of) the employee in a later taxable year of the employee, that is subject to conditions, including a substantial risk of forfeiture.²

I.R.C. §409A applies not only to the employee/employer relationship, but also to members of a corporate board of directors and certain independent contractors. The Treasury regulations refer to an employee, board member or independent contractor as a “service provider” and an employer as a “service recipient.” In an attempt to “keep it simple”, this brief E-Alert will refer to employees and employers.

What are the exemptions?

There are a number of statutory and regulatory exemptions. Examples of statutory exemptions are qualified employer plans, vacation leave plans, sick leave plans, compensatory time, disability pay, death benefit plans and deferred compensation the executive or employee earned and became vested in prior to January 1, 2005, provided the plan or arrangement is not “materially modified” after October 3, 2004.³

An example of a regulatory exemption is deferred compensation that is actually or constructively received by an executive or employee within the two and one-half month period after the end of the tax year of the employee or the fiscal year of the employer, whichever is later, such as an annual cash bonus that is paid on or before March 15 of each year (where both the employee and the employer are calendar year taxpayers).⁴

What requirements must a deferred compensation plan subject to I.R.C. §409A satisfy?

The plan or arrangement must satisfy certain rules relating to the following:

- (a) Elections to defer compensation;
- (b) Elections of the time and form of the distribution of deferred compensation;
- (c) Changes in elections of the time and form of distributions; and
- (d) Distributions of 409A deferred compensation. Such distributions can only be made upon one of the following distribution events:
 - i. Separation from service;
 - ii. Disability;
 - iii. Death;
 - iv. Pursuant to a fixed schedule specified in the plan or arrangement;
 - v. Upon a change of control; or
 - vi. The occurrence of an “unforeseeable emergency”;
- (e) Certain funding restrictions; and
- (f) Reporting requirements.

What are the potential draconian penalties under I.R.C. §409A?

Inclusion of all the deferred compensation in the taxable income of the covered executives or other employees, plus a penalty tax in an amount equal to 20% of the deferred compensation amount, plus an underpayment interest (for not including the deferred compensation in income in the year the compensation was first deferred).⁵

For more information, please contact Haynes Benefits PC at 816-875-1919 or visit www.haynesbenefits.com.

¹Treas.Reg. §1-409A-1(c)(3)(i) and (vii)

²Treas.Reg. §1.409A-1(b)(1)

³I.R.C. §409A(d)

⁴Treas.Reg. §1.409A-1(b)(4)

⁵I.R.C. §409A(a)(1)