

Part III – Administrative, Procedural, and Miscellaneous

Interim Guidance on the Application of Section 409A to Accelerated Payments to Satisfy Federal Conflict of Interest Requirements

Notice 2006-64

I. Background

Section 409A was added to the Internal Revenue Code as part of the American Jobs Creation Act of 2004, Pub. Law No. 108-357, 118 Stat. 1418. Section 409A generally provides that all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are met. The IRS issued Notice 2005-1, 2005-2 I.R.B. 274, on December 20, 2004 (published as modified on January 6, 2005) and issued proposed regulations under section 409A on September 29, 2005 (70 Fed. Reg. 57930 (Oct. 4, 2005)). The proposed regulations do not limit the application of the guidance provided in Notice 2005-1.

II. Accelerated Payments of Nonqualified Deferred Compensation to Satisfy Federal Conflict of Interest Requirements

Section 409A(a)(3) provides that a plan may not permit acceleration of the

time or schedule of payment for nonqualified deferred compensation subject to section 409A except as provided in regulations by the Secretary. The legislative history to section 409A provides that it was intended that the Secretary would provide limited exceptions to the prohibition on acceleration of payments, including, for example, a distribution necessary to comply with Federal conflict of interest requirements. H.R. Conf. Rep. No. 108-755, at 731 (2004). Both Notice 2005-1, Q&A-15(c) and § 1.409A-3(h)(2)(ii) of the proposed regulations provide that a plan may permit such acceleration of the time and schedule of a payment of nonqualified deferred compensation subject to the requirements of section 409A as may be necessary to comply with a certificate of divestiture (as defined in section 1043(b)(2)).

Commentators, including the Office of Government Ethics, expressed concern about the indication in Notice 2005-1 and the proposed regulations that a “certificate of divestiture” (as defined in section 1043(b)(2)) would be effective to permit an accelerated payment of nonqualified deferred compensation subject to section 409A. However, the Office of Government Ethics issues such certificates of divestiture so that an employee may defer recognition of capital gains when property is sold to comply with conflict of interest provisions. Because payment under a nonqualified deferred compensation plan is treated as ordinary income, rather than as capital gain, the Office of Government Ethics could not issue a certificate of divestiture in connection with an accelerated payment under such a plan.

Accordingly, until further guidance is issued, a nonqualified deferred compensation arrangement subject to section 409A may permit such acceleration of the time or schedule of payment as is necessary to satisfy requirements established pursuant to a written determination by the Office of Government Ethics that: (1) divestiture of the financial interest or termination of the financial arrangement is reasonably necessary to comply with any Federal conflict of interest statute, regulation, rule or executive order (including section 208 of title 18, United States Code), or is requested by a congressional committee as a condition of confirmation; and (2) specifies the financial interest to be divested or terminated. Of course, amounts actually paid pursuant to such acceleration generally will be includible in income by the recipient.

III. Drafting Information

The principal author of this notice is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact Stephen Tackney at (202) 927-9639 (not a toll-free call).