

THE NONQUALIFIED ADVISOR

An Independent Resource for Plan Sponsors and Participants of Nonqualified Plans

Client News Bulletin

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NQDC Regs Finalized: What's New, What's Not

On April 10, 2007, the IRS released the long awaited final regulations for IRC Section 409A. The regulations under Section 409A set forth strict compliance rules for nonqualified deferred compensation plans, and other plans that defer compensation into later year.

For the most part, the final regulations follow the proposed rules and regulations issued in 2005 and 2006; however, the final regulations added clarification to old issues and addressed a few new issues. The following are some of the more interesting changes/clarifications affecting nonqualified plans:

- 1) Non-compete agreements constitute deferred compensation that is subject to the provisions of 409A.
- 2) . (The IRS later clarified that savings clauses were okay.)
- 3) Employees receiving the right to a tax gross up payment to cover a tax liability incurred under section 409A is deferred compensation that satisfies the requirements of 409A.
- 4) Separation from service was clarified to address issues surrounding part-time employment. For purposes of Section 409A, separation of service will be presumed if the employee's service level is reduced to 20% or less of the average level of services provided during the previous 36 months.
- 5) The period of time after a terminated plan can restart was shortened from 5 years to 3 years.
- 6) The cash-out provision for small plans was increased from \$10,000 to the elective deferral limitation for qualified plans, (currently \$15,500.) The final regulations also do not require separation from service before the employee can cash out the amount deferred.
- 7) Split dollar plans are not subject to 409A unless there is an equity component involved, (i.e. collateral split dollar.)
- 8) Taxpayers with operational failures in 2006 or 2007 may limit the amount included in income to the year of failure, provided there are no prior operational failures.

Unchanged Provisions

The following proposed regulations/requirements that did not change with the final regulations:

- 1) All plans subject to section 409A must be brought into operational and documentary compliance by December 31, 2007. The IRS will not be granting any further extensions.
- 2) The IRS did not relax any penalties associated with Section 409A violations. Plan failure subjects all deferrals and earnings under the plan to immediate taxation, plus a 20% excise tax and interest for the underpayment of tax.

The release of the final regulations is by no means the final word on Section 409A. The IRS is expected to address the calculation and timing of amounts includable in income, as well as other issues brought up during public comment.

For a summary of the requirements of Section 409A, see [Final 409A Regulations](#). To read the final regulations in its entirety, see [Final Regs](#)

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