



WRNewswire

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The *WRNewswire* is created exclusively for AALU Members by insurance experts led by Steve Leimberg, Lawrence Brody and Linas Sudzius. *WRNewswire* #15.05.21 was written by Linas Sudzius of [Advanced Underwriting Consultants](#).

TOPIC: Nonqualified Deferred Compensation Section 409A Compliance

CITATION: [Chief Counsel Advice 201518013](#) (May 1, 2015).

SUMMARY: A Chief Counsel Advice memorandum of the Internal Revenue Service advises that a pre-vesting plan correction will not “save” a nonqualified deferral plan’s failure to comply with Section 409A of the Internal Revenue Code (“Section 409A”) if benefits vest before the last day of the tax year in which the correction was made.

RELEVANCE: AALU Members should be aware that failure to structure non-qualified compensation arrangements to comply with the requirements of Section 409A may result in substantial penalties, and that corrections may not be effective to prevent penalties in the year benefits vest. Corrections made in the same tax year that benefits vest (even if made *before* the date of vesting) may still result in the acceleration of taxes and imposition of penalties.

FACTS: A company entered into a retention agreement with one of its employees. Under the agreement, the employee was entitled to a retention bonus if he remained employed by the company until the third anniversary of the agreement. Under the agreement, the retention bonus was to be paid out in two installments on the first and second anniversaries of the vesting date (i.e. the fourth and fifth anniversaries of the agreement’s effective date).

However, the original agreement gave the company the right, in its discretion, to accelerate the payments, and pay the bonus in a single lump sum on the first anniversary of the vesting date. The company realized that this acceleration provision violated Section 409A and amended the agreement to correct the provision in the third calendar year of the agreement, but prior to the first vesting date. Later in that same year, the employee vested in the bonus on the third anniversary of the agreement.

The Office of Chief Counsel determined that, although the correction cured the defect in the agreement and brought it into full compliance with Code Section 409A, the bonus must still be included in the employee’s income in the third year of the agreement because his right to the payments had vested before the end of that year. The Memorandum advises that vesting (i.e. the lapse of a “substantial risk of forfeiture”) is determined under Section 409A as of the last day of the employee’s tax year. Since the

employee's bonus vested in the third year of the agreement and a Section 409A violation existed at the beginning of that tax year, the correction came too late to avoid recognition of income in that year.

There does not appear to be a clear policy rationale behind this fairly narrow interpretation of existing guidance. While the result is arguably consistent with the text of existing regulations and notices, the Chief Counsel discussion acknowledges that the situation is not explicitly addressed in existing guidance. While memoranda from the Office of Chief Counsel may not be used or cited as precedent, this is one of the first indications we have regarding how the Service is likely to view correction of Section 409A violations.

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