

Client Alert

New Proposed Section 409A Regulations

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Independent Board and
Management Advisors

On June 22, 2016, the Treasury Department and the Internal Revenue Service issued new proposed regulations under Section 409A as well as withdrew certain portions of previously issued proposed regulations under Section 409A.¹

Implications and Next Steps

Generally, the changes wrought by these new regulations should help companies more easily comply with Section 409A. These new proposed regulations are highly technical and unlikely to have a material impact on the administration of most deferred compensation plans. Nevertheless, companies should have their legal counsel review their compensation plans, policies, and practices to see how these new proposed regulations might impact them and what, if any, changes will be necessary to ensure continued compliance with Section 409A requirements.

Key Changes in the New Proposed Regulations

The changes wrought by these new proposed regulations include:

- Modifying the definition of the term “eligible issuer of service recipient stock” to provide that it includes a corporation for which a person is reasonably expected to begin, and actually begins, providing services within 12 months after the grant date of a stock right.
- Clarifying that a service provider who ceases providing services as an employee and begins providing services as an independent contractor is treated as having a separation from service if, at the time of the change in employment status, the level of services reasonably anticipated to be provided after the change would result in a separation from service under the rules applicable to employees.
- Providing that a plan under which a service provider has a right to payment or reimbursement of reasonable attorneys’ fees and other expenses incurred to pursue a bona fide legal claim against the service recipient with respect to the service relationship does not provide for a deferral of compensation.
- Providing a rule that is generally applicable to determine when a “payment” has been made for purposes of Section 409A, i.e., when any taxable benefit is actually or constructively received.

¹ *Application of Section 409A to Nonqualified Deferred Compensation Plans*, June 22, 2016, available at: <https://www.federalregister.gov/articles/2016/06/22/2016-14331/application-of-section-409a-to-nonqualified-deferred-compensation-plans>.

- Modifying the short-term deferral rules to permit a delay in payments to avoid violating Federal securities laws or other applicable law.
- Modifying the rules applicable to amounts payable following death so that such payments will be treated as timely made for purposes of Section 409A if paid at any time from the date of death until December 31 of the calendar year following the calendar year in which the death occurred.
- Clarifying that the rules for transaction-based compensation apply to stock rights that do not provide for a deferral of compensation and statutory stock options.
- Providing that the addition of the death, disability, or unforeseeable emergency of a beneficiary who has become entitled to a payment due to a service provider's death as a potentially earlier or intervening payment event will not violate the prohibition on the acceleration of payments.
- Modifying the conflict of interest exception to the prohibition on the acceleration of payments to permit the payment of all types of deferred compensation (and not only certain types of foreign earned income) to comply with bona fide foreign ethics or conflicts of interest laws.
- Clarifying that the rules under Section 409A apply to nonqualified deferred compensation plans separately and in addition to the rules under Section 457A.
- Clarifying that a stock right that does not otherwise provide for a deferral of compensation will not be treated as providing for a deferral of compensation solely because the amount payable under the stock right upon an involuntary separation from service for cause, or the occurrence of a condition within the service provider's control, is based on a measure that is less than fair market value.
- Clarifying that certain separation pay plans that do not provide for a deferral of compensation may apply to a service provider who had no compensation from the service recipient during the year preceding the year in which a separation from service occurs.
- Modifying the rules regarding recurring part-year compensation, designed to provide an accommodation for pay arrangements for certain teaching positions, such as those covering college and university faculty members.
- Clarifying that a stock purchase treated as a deemed asset sale under Section 338 is not a sale or other disposition of assets for purposes of determining whether a service provider has a separation from service.
- Clarifying the provision permitting payments upon termination and liquidation of a plan in connection with bankruptcy.
- Clarifying other rules permitting payments in connection with the termination and liquidation of a plan.
- Providing that a plan may accelerate the time of payment to comply with Federal debt collection laws.
- Clarifying and modifying Section 1.409A-4(a)(1)(ii)(B) of the proposed income inclusion regulations regarding the treatment of deferred amounts subject to a substantial risk of forfeiture for purposes of calculating the amount includible in income under Section 409A(a)(1).
- Clarifying various provisions of the final regulations to recognize that a service provider can be an entity as well as an individual.

When Will the New Proposed Regulations Apply?

The new proposed regulations generally will apply on or after the date on which they are published as final regulations in the *Federal Register*. However, taxpayers may rely on these new proposed regulations until final regulations are published.



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