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Missed Your Section 409A Deferral Election Deadline? – Maybe Not.

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Recently enacted Internal Revenue Code Section 409A (Section 409A) revolutionized the legal environment in which nonqualified deferred compensation arrangements must operate. A major Section 409A requirement is that employees and other service providers who elect to defer compensation must irrevocably do so by deadlines that vary based on the nature of the compensation being deferred and other facts and circumstances. This client alert explains that creative deferral election approaches may alleviate the impact of Section 409A's deferral deadline rigidity.

As noted above, the deadline for making deferral elections normally is determined by the source of the deferral (i.e., salary, bonus, or commission).[1] If the source of the deferral, however, is "delinked" from the amount of the deferral, it sometimes will be possible to extend the deferral election deadline.

Here is a straightforward example: If an employee wants to defer 50% of his or her 2005 calendar year performance-based compensation that is paid in January 2006 (Bonus), the employee must make the deferral election no later than June 30, 2005. If the employee misses this deadline, he or she may still defer an amount equal to 50% of the Bonus by deferring that amount out of salary rather than out of the Bonus if the employee elects to do so by December 31, 2005. As of December 31, 2005, the employee would be able to estimate the Bonus amount, and accordingly make a salary deferral election equal to 50% of the expected Bonus amount. If the employee cannot estimate the bonus, he or she could elect, for example, to defer post-January 2006 salary in an amount equal to 50% of the January 2006 Bonus he or she receives.

Here is another example: Assume an employee is eligible for commissions and a performance-based bonus that is paid in December for the fiscal year ending November 30. The Section 409A deadline for deferring commissions is the December 31st preceding the year in which commission-generating payments are made by customers. If a customer makes payment in 2006 and the employee fails to make a commission deferral election by December 31, 2005, he or she may still be able to defer the commission amount out of the bonus payment, assuming the bonus payment equals or exceeds the specific commission amount. The employee would have until May 31, 2006 to make the bonus deferral election.

Note:

1. For a more detailed explanation of the initial deferral election rules, please see our previously published client alert "Deferred Compensation: Elections and Distributions Under the Proposed 409A Regulations" (10/27/05) available at www.paulhastings.com.

If you are interested in these or similar strategies, or if we can be of assistance with any other Section 409A issue, please contact any of our attorneys listed below.

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