Internal Revenue Code Section 409A

Inclusion in gross income of deferred compensation under nonqualified deferred compensation plans

(a) Rules relating to constructive receipt.

(1) Plan failures.

(A) Gross income inclusion.

(i) In general. If at any time during a taxable year a nonqualified deferred compensation plan-

(I) fails to meet the requirements of paragraphs (2) , (3) , and (4) , or

(II) is not operated in accordance with such requirements,

all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income.

(ii) Application only to affected participants. Clause (i) shall only apply with respect to all compensation deferred under the plan for participants with respect to whom the failure relates.

(B) Interest and additional tax payable with respect to previously deferred compensation.

(i) In general. If compensation is required to be included in gross income under subparagraph (A) for a taxable year, the tax imposed by this chapter for the taxable year shall be increased by the sum of-

(I) the amount of interest determined under clause (ii) , and

(II) an amount equal to 20 percent of the compensation which is required to be included in gross income.

(ii) Interest. For purposes of clause (i) , the interest determined under this clause for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.

(2) Distributions.

(A) In general. The requirements of this paragraph are met if the plan provides that compensation deferred under the plan may not be distributed earlier than-

(i) separation from service as determined by the Secretary (except as provided in subparagraph (B)(i)),

(ii) the date the participant becomes disabled (within the meaning of subparagraph (C)),

(iii) death,

(iv) a specified time (or pursuant to a fixed schedule) specified under the plan at the date of the deferral of such compensation,

(v) to the extent provided by the Secretary, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation, or

(vi) the occurrence of an unforeseeable emergency.

(B) Special rules.

(i) Specified employees. In the case of any specified employee, the requirement of subparagraph (A)(i) is met only if distributions may not be made before the date which is 6 months after the date of separation from service (or, if earlier, the date of death of the employee). For purposes of the preceding sentence, a specified employee is a key employee (as defined in section 416(i) without regard to paragraph (5) thereof) of a corporation any stock in which is publicly traded on an established securities market or otherwise.

(ii) Unforeseeable emergency. For purposes of subparagraph (A)(vi) -

(I) In general. The term "unforeseeable emergency" means a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

(II) Limitation on distributions. The requirement of subparagraph (A)(vi) is met only if, as determined under regulations of the Secretary, the amounts distributed with respect to an emergency do not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(C) Disabled. For purposes of subparagraph (A)(ii) , a participant shall be considered disabled if the participant-

(i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or

(ii) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the participant's employer.

(3) Acceleration of benefits.
The requirements of this paragraph are met if the plan does not permit the acceleration of the time or schedule of any payment under the plan, except as provided in regulations by the Secretary.

(4) Elections.

(A) In general. The requirements of this paragraph are met if the requirements of subparagraphs (B) and (C) are met.

(B) Initial deferral decision.

(i) In general. The requirements of this subparagraph are met if the plan provides that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer such compensation is made not later than the close of the preceding taxable year or at such other time as provided in regulations.

(ii) First year of eligibility. In the case of the first year in which a participant becomes eligible to participate in the plan, such election may be made with respect to services to be performed subsequent to the election within 30 days after the date the participant becomes eligible to participate in such plan.

(iii) Performance-based compensation. In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than 6 months before the end of the period.

(C) Changes in time and form of distribution. The requirements of this subparagraph are met if, in the case of a plan which permits under a subsequent election a delay in a payment or a change in the form of payment-

(i) the plan requires that such election may not take effect until at least 12 months after the date on which the election is made,

(ii) in the case of an election related to a payment not described in clause (ii) , (iii) , or (vi) of paragraph (2)(A) , the plan requires that the payment with respect to which such election is made be deferred for a period of not less than 5 years from the date such payment would otherwise have been made, and

(iii) the plan requires that any election related to a payment described in paragraph (2)(A)(iv) may not be made less than 12 months prior to the date of the first scheduled payment under such paragraph .

(b) Rules relating to funding.

(1) Offshore property in a trust.

In the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary) for purposes of paying deferred compensation under a nonqualified deferred compensation plan, for purposes of section 83 such assets shall be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors-

(A) at the time set aside if such assets (or such trust or other arrangement) are located outside of the United States, or

(B) at the time transferred if such assets (or such trust or other arrangement) are subsequently transferred outside of the United States.

This paragraph shall not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such jurisdiction.

(2) Employer's financial health.

In the case of compensation deferred under a nonqualified deferred compensation plan, there is a transfer of property within the meaning of section 83 with respect to such compensation as of the earlier of-

(A) the date on which the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a change in the employer's financial health, or

(B) the date on which assets are so restricted,

whether or not such assets are available to satisfy claims of general creditors.

(3) Treatment of employer's defined benefit plan during restricted period.

(A) In general. If-

(i) during any restricted period with respect to a single-employer defined benefit plan, assets are set aside or reserved (directly or indirectly) in a trust (or other arrangement as determined by the Secretary) or transferred to such a trust or other arrangement for purposes of paying deferred compensation of an applicable covered employee under a nonqualified deferred compensation plan of the plan sponsor or member of a controlled group which includes the plan sponsor, or

(ii) a nonqualified deferred compensation plan of the plan sponsor or member of a controlled group which includes the plan sponsor provides that assets will become restricted to the provision of benefits under the plan to an applicable covered employee in connection with such restricted

period (or other similar financial measure determined by the Secretary) with respect to the defined benefit plan, or assets are so restricted,

such assets shall, for purposes of section 83 , be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors. Clause (i) shall not apply with respect to any assets which are so set aside before the restricted period with respect to the defined benefit plan.

(B) Restricted period. For purposes of this section, the term "restricted period" means, with respect to any plan described in subparagraph (A) -

(i) any period during which the plan is in at-risk status (as defined in section 430(i));

(ii) any period the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law, and

(iii) the 12-month period beginning on the date which is 6 months before the termination date of the plan if, as of the termination date, the plan is not sufficient for benefit liabilities (within the meaning of section 4041 of the Employee Retirement Income Security Act of 1974).

(C) Special rule for payment of taxes on deferred compensation included in income. If an employer provides directly or indirectly for the payment of any Federal, State, or local income taxes with respect to any compensation required to be included in gross income by reason of this paragraph-

(i) interest shall be imposed under subsection (a)(1)(B)(i)(I) on the amount of such payment in the same manner as if such payment was part of the deferred compensation to which it relates,

(ii) such payment shall be taken into account in determining the amount of the additional tax under subsection (a)(1)(B)(i)(II) in the same manner as if such payment was part of the deferred compensation to which it relates, and

(iii) no deduction shall be allowed under this title with respect to such payment.

(D) Other definitions. For purposes of this section-

(i) Applicable covered employee. The term "applicable covered employee" means any-

(I) covered employee of a plan sponsor,

(II) covered employee of a member of a controlled group which includes the plan sponsor, and

(III) former employee who was a covered employee at the time of termination of employment with the plan sponsor or a member of a controlled group which includes the plan sponsor.

(ii) Covered employee. The term "covered employee" means an individual described in section 162(m)(3) or an individual subject to the requirements of section 16(a) of the Securities Exchange Act of 1934.

(4) Income inclusion for offshore trusts and employer's financial health.
For each taxable year that assets treated as transferred under this subsection remain set aside in a trust or other arrangement subject to paragraph (1) , (2) , or (3) , any increase in value in, or earnings with respect to, such assets shall be treated as an additional transfer of property under this subsection (to the extent not previously included in income).

(5) Interest on tax liability payable with respect to transferred property.

(A) In general. If amounts are required to be included in gross income by reason of paragraph (1) , (2) , or (3) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the sum of-

(i) the amount of interest determined under subparagraph (B) , and

(ii) an amount equal to 20 percent of the amounts required to be included in gross income.

(B) Interest. For purposes of subparagraph (A) , the interest determined under this subparagraph for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the amounts so required to be included in gross income by paragraph (1) , (2) , or (3) been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such amounts are not subject to a substantial risk of forfeiture.

(c) No inference on earlier income inclusion or requirement of later inclusion.
Nothing in this section shall be construed to prevent the inclusion of amounts in gross income under any other provision of this chapter or any other rule of law earlier than the time provided in this section . Any amount included in gross income under this section shall not be required to be included in gross income under any other provision of this chapter or any other rule of law later than the time provided in this section .

(d) Other definitions and special rules.
For purposes of this section -

(1) Nonqualified deferred compensation plan.
The term "nonqualified deferred compensation plan" means any plan that provides for the deferral of compensation, other than-

(A) a qualified employer plan, and

(B) any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.

(2) Qualified employer plan.
The term "qualified employer plan" means-

(A) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of section 219(g)(5) (without regard to subparagraph (A)(iii)),

(B) any eligible deferred compensation plan (within the meaning of section 457(b)), and

(C) any plan described in section 415(m) .

(3) Plan includes arrangements, etc.
The term "plan" includes any agreement or arrangement, including an agreement or arrangement that includes one person.

(4) Substantial risk of forfeiture.
The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual.

(5) Treatment of earnings.
References to deferred compensation shall be treated as including references to income (whether actual or notional) attributable to such compensation or such income.

(6) Aggregation rules.
Except as provided by the Secretary, rules similar to the rules of subsections (b) and (c) of section 414 shall apply.

(e) Regulations.
The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section , including regulations-

(1) providing for the determination of amounts of deferral in the case of a nonqualified deferred compensation plan which is a defined benefit plan,

(2) relating to changes in the ownership and control of a corporation or assets of a corporation for purposes of subsection (a)(2)(A)(v) ,

(3) exempting arrangements from the application of subsection (b) if such arrangements will not result in an improper deferral of United States tax and will not result in assets being effectively beyond the reach of creditors,

(4) defining financial health for purposes of subsection (b)(2) , and

(5) disregarding a substantial risk of forfeiture in cases where necessary to carry out the purposes of this section .