July 6, 2015

MEMORANDUM

TO: Chief Business Officers, Payroll Officers, Personnel Officers

FROM: Jason W. Forlines, CFE, Director of Systems Accounting & Special Projects

RE: IRC §409A and Deferred Compensation Policy

Numbered memo CC08-141 outlined the requirements of Internal Revenue Code (IRC) §409A, which regulates the payment and reporting of non-qualified deferred compensation. Non-qualified deferred compensation is compensation that is earned in one tax year but deferred until the next tax year without being part of a qualified plan, such as a 401(k), 403(b), or 457(b) plan. For colleges, this would typically be the payment of earnings over twelve months for employees on contracts shorter than twelve months. This memo revises and replaces the guidance of the earlier memo.

As with the earlier memo, colleges are not required to offer the option to spread contract pay over twelve months (sometimes called “option pay”), but they may elect to offer the option to some employees or require it of all employees.

At the time that memo CC08-141 was written, all employers who elected to allow option pay had to require participating staff to enter into a written or electronic agreement prior to the start of the work period and to prohibit participants from terminating or otherwise changing the agreement once the work period began. Though the form did not need to be filed with IRS, it did need to specify how and when the compensation would be paid. Optionally, the agreement could span multiple work periods and years, but any revision or cancellation had to occur prior to the start of the next work period.

In response to questions and concerns, IRS issued Notice 2008-62 to clarify that part-year compensation paid on a recurring, deferral basis such as option pay will not be considered deferred compensation for tax purposes if all of the compensation is paid by the end of the thirteenth month following the start of the work period and the amount deferred does not exceed the maximum dollar amount authorized by IRC §402(g)(1)(b) for the calendar year in which the work period begins.

CC15-019

Email
This means that if the work period begins in August of 2015, all of the earnings for the work period must be paid to the employee no later than August 31, 2016, and that the reduction in reported taxable wages for 2015 as a result of implementing option pay for an employee cannot exceed $18,000.

If these conditions provided in Notice 2008-62 are met, option pay is not classified as non-qualified deferred compensation and is therefore not subject to the provisions of IRC §409A. Therefore, colleges may allow participants in option pay to cancel or modify such agreements during the work period without risk of penalty but are not required to do so. Regardless of the college’s decision, any changes to the internal option pay policy should be made accordingly.

Colleges should still obtain a written or electronic agreement from the participating employee. The agreement between the college and employee may read as follows, with the bracketed portion being optional based on the college’s decision to allow or not allow modifications to the agreement once executed:

“I, (employee name), elect to spread my contracted total salary over twelve months beginning on the first day of the work period (date). I understand that a pro-rata portion of my salary earned in this calendar year will be deferred until next calendar year. This election shall remain in place until such time that I notify the college of my intent to change this pay arrangement. [I understand that this election is irrevocable for the current work period and can only be changed prior to the beginning of the future work period for which I submit a new election.] I understand that if I want to receive my contracted total salary over twelve months, but do not submit such an election [or submit an election after the deadline] my contracted total salary will be paid in the same manner as other employees who do not make an election.”

The full text of IRS Notice 2008-62 may be found at http://www.irs.gov/irb/2008-29_IRB/ar12.html. The 2015 deferral cap, authorized by IRC §402(g)(1) may be found at http://www.irs.gov/uac/Newsroom/IRS-Announces-2015-Pension-Plan-Limitations-1. Please direct questions to Jason Forlines at (919) 807-7071 or forlinesj@nccommunitycolleges.edu. This information has been added to the Accounting Procedures Manual.

CC15-019
Email