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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9321]

RIN 1545-BE79

Application of Section 409A to Nonqualified Deferred Compensation Plans; Correction

ACTION: Correcting amendments.

AGENCY: Internal Revenue Service (IRS), Treasury.

SUMMARY: This document contains corrections to final regulations that were published in the Federal Register on Tuesday, April 17, 2007 (73 FR 19234), relating to section 409A.

DATES: This correction is effective July 31, 2007.

FOR FURTHER INFORMATION CONTACT: Stephen Tackney, (202) 622-9639 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under section 409A of the Internal Revenue Code.

Need for Correction

As published, final regulations (TD 9321) contain errors that may prove misleading and are in need of clarification.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendments:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

§1.409A-1 [Corrected]

Par. 2. Section 1.409A-1 is amended as follows:

1. Paragraph (a)(3)(i) is revised.
2. The first and second sentences of paragraph (a)(5) are revised.
3. The first sentences of paragraphs (b)(4)(i) and (b)(4)(i)(D) are revised.
4. Examples 3 and 5 in paragraph (b)(4)(iii) are amended by revising the last sentences of the paragraphs.
5. Paragraph (b)(5)(iv)(B)(2)(ii) is revised.
6. In paragraph (b)(8)(iii) the first sentence is revised.
7. The first sentence of paragraph (b)(9)(v)(A) is revised.
8. Paragraph (c)(2)(i)(H) is revised.
9. Paragraph (c)(3)(viii) is revised.
10. The last sentence of paragraph (f)(1) is revised.
11. The ninth sentence of paragraph (h)(1)(ii) is revised.
12. The first sentence of paragraph (i)(2) is revised.

§1.409A-1 Definitions and covered plans.

(a) * * *

(3) * * *

(i) * * * With respect to an individual for a taxable year, the term nonqualified deferred compensation plan does not include any scheme, trust, arrangement, or plan maintained with respect to such individual, to the extent contributions made by or on behalf of such individual to such scheme, trust, arrangement, or plan, or credited allocations, accrued benefits, earnings, or other amounts constituting income, of such individual under such scheme, trust, arrangement, or plan, are excludable by such individual for Federal income tax purposes pursuant to any bilateral income tax convention, or other bilateral or multilateral agreement, to which the United States is a party.

* * * * *

(5) * * * The term nonqualified deferred compensation plan does not include a plan, or a portion of a plan, to the extent that the plan provides bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefits. For these purposes, the terms "disability pay" and "death benefits" have the same meanings as provided in §31.3121(v)(2)-1(b)(4)(iv)(C) of this chapter, provided that for purposes of this paragraph, such disability pay and death benefits may be provided through insurance and the lifetime benefits payable under the plan are not treated as including the value of any taxable term life insurance coverage or taxable disability insurance

coverage provided under the plan. * * *

(b) * * *

(4) * * * (i) In general. A deferral of compensation does not occur under a plan with respect to any payment (as defined in §1.409A-2(b)(2)) that is not a deferred payment, provided that the service provider actually or constructively receives such payment on or before the last day of the applicable 2 1/2 month period. * * *

* * * * *

(D) A payment is a deferred payment if it is made pursuant to a provision of a plan that provides for the payment to be made or completed on or after any date, or upon or after the occurrence of any event, that will or may occur later than the end of the applicable 2 1/2 month period, such as a separation from service, death, disability, change in control event, specified time or schedule of payment, or unforeseeable emergency, regardless of whether an amount is actually paid as a result of the occurrence of such a payment date or event during the applicable 2 1/2 month period. * * *

* * * * *

(iii) * * *

Example 3. * * * The bonus plan will not be considered to have provided for a deferral of compensation if the bonus is paid or made available to Employee C on or before March 15, 2011.

* * * * *

Example 5. * * * The bonus plan provides for a deferral of compensation, and will not qualify as a short-term deferral regardless of whether the bonus is paid or made available on or before March 15, 2011 (and generally any payment before June 1, 2011 would constitute an impermissible acceleration of a payment).

* * * * *

(5) * * *

(iv) * * *

(B) * * *

(2) * * *

(ii) A valuation based upon a formula that, if used as part of a nonlapse restriction (as defined in §1.83-3(h)) with respect to the stock, would be considered to be the fair market value of the stock pursuant to §1.83-5, provided that such stock is valued in the same manner for purposes of any transfer of any shares of such class of stock (or any substantially similar class of stock) to the issuer or any person that owns stock possessing more than 10 percent of the total combined voting power of all classes of stock of the issuer (applying the stock attribution rules of §1.424-1(d)), other than an arm's length transaction involving the sale of all or substantially all of the outstanding stock of the issuer, and such valuation method

is used consistently for all such purposes, and provided further that this paragraph (b)(5)(iv)(B)(2)(ii) does not apply with respect to stock subject to a stock right payable in stock, where the stock acquired pursuant to the exercise of the stock right is transferable other than through the operation of a nonlapse restriction.

* * * * *

(8) * * *

(iii) * * * A tax equalization agreement does not provide for a deferral of compensation if payments made under such tax equalization agreement are made no later than the end of the second taxable year of the service provider beginning after the taxable year of the service provider in which the service provider's U.S. Federal income tax return is required to be filed (including any extensions) for the year to which the compensation subject to the tax equalization payment relates, or, if later, the second taxable year of the service provider beginning after the latest such taxable year in which the service provider's foreign tax return or payment is required to be filed or made for the year to which the compensation subject to the tax equalization payment relates. * * *

* * * * *

(9) * * *

(v) * * *

(A) * * * To the extent a separation pay plan (including a plan providing payments upon a voluntary separation from service) entitles a service provider to payment by the service recipient of reimbursements that are not otherwise excludible from gross income for expenses that the service provider could otherwise deduct under section 162 or section 167 as business expenses incurred in connection with the performance of services (ignoring any applicable limitation based on adjusted gross income), or of reasonable outplacement expenses and reasonable moving expenses actually incurred by the service provider and directly related to the termination of services for the service recipient, such plan does not provide for a deferral of compensation to the extent such rights apply during a limited period of time (regardless of whether such rights extend beyond the limited period of time). * * *

* * * * *

(c) * * *

(2) * * *

(i) * * *

(H) All deferrals of compensation with respect to that service provider under all plans of the service recipient to the extent such plans are stock rights (as defined in paragraph (1) of this section) subject to section 409A, are treated as deferred under a single plan.

* * * * *

(3) * * *

(viii) * * * The plan aggregation rules of paragraph (c)(2)(i) of this section do not apply to the written plan requirements of this paragraph (c)(3). Accordingly, deferrals of compensation under an agreement, method, program, or other arrangement that fails to meet the requirements of section 409A solely due to a failure to meet the written plan requirements of this paragraph (c)(3) are not aggregated with deferrals of compensation under other agreements, methods, programs, or other arrangements that meet such requirements.

* * * * *

(f) * * *

(1) In general. * * * The term service provider generally includes a person who has separated from service (a former service provider).

* * * * *

(h) * * *

(l) * * *

(ii) Termination of employment. * * * Notwithstanding the foregoing provisions of this paragraph (h)(1)(ii), a plan may treat another level of reasonably anticipated permanent reduction in the level of bona fide services as a separation from service, provided that the level of reduction required must be designated in writing as a specific percentage, and the reasonably anticipated reduced level of bona fide services must be greater than 20 percent but less than 50 percent of the average level of bona fide services provided in the immediately preceding 36 months. * * *

* * * * *

(i) * * *

(2) * * * For purposes of identifying a specified employee by applying the requirements of section 416(i)(1)(A)(i), (ii), and (iii), the definition of compensation under §1.415(c)-2(a) is used, applied as if the service recipient were not using any safe harbor provided in §1.415(c)-2(d), were not using any of the elective special timing rules provided in §1.415(c)-2(e), and were not using any of the elective special rules provided in §1.415(c)-2(g). * * *

* * * * *

§1.409A-2 [Corrected]

Par. 3. Section 1.409A-2 is amended as follows:

1. The first sentences of paragraphs (a)(6) and (a)(9) are revised.
2. The third sentence of paragraph (b)(2)(ii)(A) is revised.
3. A new sentence is added after the third sentence of paragraph (b)(2)(ii)(A).

§1.409A-2 Deferral elections.

(a) * * *

(6) * * * In the case of a service recipient with a taxable year that is not the same as the taxable year of the service provider, a plan may provide that fiscal year compensation may be deferred at the service provider's election if the election to defer such compensation is made not later than the close of the service recipient's taxable year immediately preceding the first taxable year of the service recipient in which any services are performed for which such compensation is payable. * * *

* * * * *

(9) * * * If a nonqualified deferred compensation plan provides that the amount deferred under the plan is determined under the formula for determining benefits under a qualified employer plan (as defined in §1.409A-1(a)(2)) or a broad-based foreign retirement plan (as defined in §1.409A-1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan or the broad-based foreign retirement plan, an increase in amounts deferred under the nonqualified deferred compensation plan that results directly from the operation of the qualified employer plan or broad-based foreign retirement plan (other than service provider actions described in paragraphs (a)(9)(iii) and (iv) of this section) including changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law does not constitute a deferral election under the nonqualified deferred compensation plan, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that such change in the amounts deferred under the nonqualified deferred compensation plan does not exceed that change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. * * *

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(A) * * * For purposes of §1.409A-1, this section, and §§1.409A-3 through 1.409A-6, the term life annuity means a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider, or a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider, followed upon the death or end of the life expectancy of the service provider by a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider's designated beneficiary (if any). Notwithstanding the foregoing, a schedule of payments does not fail to be an annuity

solely because such plan provides for an immediate payment of the actuarial present value of all remaining annuity payments if the actuarial present value of the remaining annuity payments falls below a predetermined amount, and the immediate payment of such amount does not constitute an accelerated payment for purposes of §1.409A-3(j), provided that such feature, including the predetermined amount, is established by no later than the time and form of payment is otherwise required to be established, and provided further that any change in such feature, including the predetermined amount, is a change in the time and form of payment. * * *

* * * * *

§1.409A-3 [Corrected]

Par. 4. Section 1.409A-3 is amended as follows:

1. The first sentence of paragraph (c) is revised.
2. The last sentence of paragraph (i)(1)(ii)(B) is revised.
3. The fourth sentence of paragraph (i)(3)(ii) is revised.
4. The last sentence of paragraph (j)(4)(vi) is revised.
5. The last sentence of paragraph (j)(4)(ix)(B) is revised.
6. The first sentence of paragraph (j)(5) is revised.
7. Paragraph (j)(5)(iv) is revised.

§1.409A-3 Permissible payments.

* * * * *

(c) * * * Except as otherwise provided in this paragraph (c), for an amount of deferred compensation under a plan, the plan may designate only one time and form of payment upon the occurrence of each event described in paragraph (a)(1), (2), (3), (5), or (6) of this section. * * *

* * * * *

(i) * * *

(1) * * *

(ii) * * *

(B) * * * A change in the limitation or a change in the time and form of payment of any payment that is not otherwise made at the scheduled payment date due to application of the formula limitation is subject to the requirements of §1.409A-2(b) (subsequent deferral elections) and paragraph (j) of this section (accelerated payments).

* * * * *

(3) * * *

(ii) * * * However, the determination of amounts reasonably necessary

to satisfy the emergency need is not required to take into account any additional compensation that is available from a qualified employer plan as defined in §1.409A-1(a)(2) (including any amount available by obtaining a loan under the plan), or that due to the unforeseeable emergency is available under another nonqualified deferred compensation plan (including a plan that would provide for deferred compensation except due to the application of the effective date provisions under §1.409A-6). * * *

* * * * *

(j) * * *

(4) * * *

(vi) * * * However, the total payment under this acceleration provision must not exceed the aggregate of the FICA or RRTA amount, and the income tax withholding related to such FICA or RRTA amount.

* * * * *

(ix) * * *

(B) * * * Solely for purposes of this paragraph (j)(4)(ix)(B), the applicable service recipient with the discretion to liquidate and terminate the agreements, methods, programs, and other arrangements is the service recipient that is primarily liable immediately after the transaction for the payment of the deferred compensation.

* * * * *

(5) * * * If a nonqualified deferred compensation plan provides that the amount deferred under the plan is the amount determined under the formula determining benefits under a qualified employer plan (as defined in §1.409A-1(a)(2)), or a broad-based foreign retirement plan (as defined in §1.409A-1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan or broad-based foreign retirement plan, a decrease in amounts deferred under the nonqualified deferred compensation plan that results directly from the operation of the qualified employer plan or broad-based foreign retirement plan (other than service provider actions described in paragraphs (j)(5)(iii) and (iv) of this section) including changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law does not constitute an acceleration of a payment under the nonqualified deferred compensation plan, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that the change in the amounts deferred under the nonqualified deferred compensation plan does not exceed such change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. * * *

* * * * *

(iv) A service provider's action or inaction under a qualified employer plan with respect to elective deferrals and other employee pre-tax contributions subject to the contributions restrictions under section 401(a)(30) or section 402(g), and after-tax contributions by the service provider to a qualified employer plan that provides for such contributions, that affects the amounts that are credited under one or more nonqualified deferred compensation plans as matching amounts or other similar amounts contingent on such elective deferrals, pre-tax contributions, or after-tax contributions, provided that the total of such matching or contingent amounts, as applicable, never exceeds 100 percent of the matching or contingent amounts that would be provided under the qualified employer plan absent any plan-based restrictions that reflect limits on qualified plan contributions under the Internal Revenue Code.

* * * * *

§1.409A-6 [Corrected]

Par. 5. Section 1.409A-6 is amended by revising paragraphs (a)(3)(i) and (ii) and (a)(4)(iv) to read as follows:

§1.409A-6 Application of section 409A and effective dates.

* * * * *

(a) * * *

(3) * * *

(i) * * * The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in §1.409A-1(c)(2)(i)(C)), equals the present value of the amount to which the service provider would have been entitled under the plan if the service provider voluntarily terminated services without cause on December 31, 2004, and received a payment of the benefits available from the plan on the earliest possible date allowed under the plan to receive a payment of benefits following the termination of services, and received the benefits in the form with the maximum value. * * *

(ii) * * * The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is an account balance plan (as defined in §1.409A-1(c)(2)(i)(A)), equals the portion of the service provider's account balance as of December 31, 2004, the right to which was earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, plus any future contributions to the account, the right to which was earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, to the extent such contributions are actually made.

* * * * *

(4) * * *

(iv) * * * With respect to an account balance plan (as defined in §1.409A-1(c)(2)(i)(A)), it is not a material modification to change a notional investment measure to, or to add to an existing investment

measure, an investment measure that qualifies as a predetermined actual investment within the meaning of §31.3121(v)(2)-1(d)(2) of this chapter or, for any given taxable year, reflects a reasonable rate of interest (determined in accordance with §31.3121(v)(2)-1(d)(2)(i)(C) of this chapter). * * *

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