Steps Eligible Tax-Exempt and Governmental Employers Should Take Regarding the New Proposed Deferred Compensation Requirements For Such Employers

What Guidance Has Been Issued Regarding the New Proposed Deferred Compensation Requirements for Eligible Tax-Exempt and Governmental Employers?

After more than nine years of waiting, eligible tax-exempt, state government and local government employers (collectively, "Tax-Exempt and Governmental Employers") finally have received the guidance long promised by the Internal Revenue Service on how to apply the deferred compensation requirements in Section 457 of the Internal Revenue Code ("Deferred Compensation Requirements"). This guidance appeared in proposed regulations that were issued by the Internal Revenue Service on June 21, 2016 ("Proposed Regulations"). The Proposed Regulations provide important information for Tax-Exempt and Governmental Employers that either currently have, or are thinking of establishing, arrangements that provide taxable compensation or benefits in a future calendar year, including, but not limited to, employment agreements, certain bonus agreements and plans, certain incentive compensation agreements and plans, separation agreements, certain deferred compensation agreements and plans, severance plans, and certain other types of compensation-related agreements, plans, and programs. Among the more important new requirements described in the Proposed Regulations are the following:

- new information about how to establish a substantial risk of forfeiture that will enable certain types of compensation to be deferred, including the possible use of (1) certain non-compete conditions, and (2) certain conditions that are related to a purpose of the compensation;
- new requirements regarding conditioning the receipt of deferred compensation on an involuntary severance from employment without cause, including allowing, for the first time, an eligible employee's election to terminate for a permissible good reason to be treated as an involuntary severance from employment without cause under the Deferred Compensation Requirements;
- new requirements regarding the right of employees to voluntarily elect to defer current compensation;
- new requirements regarding how to delay a scheduled payment date of certain types of deferred compensation; and
- new information about the types of arrangements that are exempt from the Deferred Compensation Requirements, including certain recurring part-year compensation arrangements, bona fide severance pay plans, bona fide death benefit plans, bona fide disability pay plans, and bona fide sick and vacation leave plans.

What Are the Current Statutory Deferred Compensation Requirements That Apply Only to Tax-Exempt and Governmental Employers?

The current nonqualified deferred compensation requirements for Tax-Exempt and Governmental Employers under Section 457 of the Internal Revenue Code ("Code") establish separate requirements for:

- eligible nonqualified deferred compensation plans under Section 457(b) of the Code (such plans will be referred to as "Eligible Plans," and such requirements will be referred to as the "Eligible Plan Requirements"); and
- nonqualified deferred compensation plans that do not satisfy the Eligible Plan Requirements (such plans will be referred to as "Ineligible Plans," and such requirements will be referred to as the "Ineligible Plan Requirements").

Under an Eligible Plan, an annual deferral of compensation can be made for certain eligible employees in an amount equal to the lesser of: (1) the applicable dollar amount (which, in 2016, is $18,000); or (2) 100 percent of an employee's includible compensation, subject to certain exceptions and requirements. If a Tax-Exempt or Governmental Employer would like to provide nonqualified deferred compensation benefits in excess of the permitted amount under an Eligible Plan, it will have to structure that deferred compensation to satisfy the Ineligible Plan Requirements under Section 457(f) of the Code or else qualify under one of the permitted exemptions to the Ineligible Plan Requirements.

The Ineligible Plan Requirements generally apply to agreements, plans, or programs of Tax-Exempt and Governmental Employers that provide for taxable compensation or benefits to be provided in a future calendar year, subject to certain exemptions. If an agreement, plan, or program is subject to the Ineligible Plan Requirements, Section 457(f) of the Code generally provides that the applicable taxable compensation or benefits for an employee will be taxed in the first calendar year in which the employee's right to receive such compensation or benefits is no longer contingent on the future performance of substantial services by that employee. For example, if a tax-exempt employer establishes in 2016 a bonus or incentive compensation arrangement for an employee that provides for a payment in a future calendar year and does not require the employee to continue to perform substantial services through a specified date in that future calendar year, the present value of that payment generally will be taxable to the employee in 2016. The statute provides several exemptions to these general tax requirements.

The Deferred Compensation Requirements also apply to independent contractors, subject to the applicable exemptions.

If the New Guidance is In the Form of Proposed Regulations, Why Should a Tax-Exempt or Governmental Employer Be Reviewing the New Guidance Now?

Although the Proposed Regulations have been issued in proposed form and generally will not be effective until the calendar year that begins after the date the Proposed Regulations are finalized and published in the Federal Register (special effective dates apply to certain collectively bargained plans and certain governmental plans that require legislation to be amended), Tax-Exempt and Governmental Employers are allowed to rely on the Proposed Regulations now if they would like to do so. Reasons why Tax-Exempt and Governmental Employers should review the Proposed Regulations now include the following:

- when the Proposed Regulations are finalized, they currently are not expected to apply to applicable deferred compensation to which a legally binding right arose in prior calendar years and which was not included in gross income in a prior calendar year (thus there would be no "grandfathering" of deferred compensation arrangements entered into prior to the date the Proposed Regulations are finalized);
- the lack of guidance that existed prior to the issuance of the Proposed Regulations may have resulted in certain assumptions being made when deciding how to structure an agreement, plan, or program subject to the Deferred Compensation Requirements, and it may be appropriate to revise those assumptions in light of the new guidance issued in the Proposed Regulations;
- as further described below, the Proposed Regulations provide new planning opportunities when structuring an agreement, plan, or program to comply with the Deferred Compensation Requirements that were not clearly available before the issuance of the Proposed Regulations; and
- the Proposed Regulations provide valuable information on how best to structure any new agreement, plan, or program that will be subject to the Deferred Compensation Requirements.

What Steps Should Tax-Exempt and Governmental Employers Take Regarding the New Requirements in the Proposed Regulations?

Steps that Tax-Exempt and Governmental Employers should take regarding the new requirements in the Proposed Regulations include the following:

- Review the Requirements In the Proposed Regulations – The Deferred Compensation Requirements have a very broad scope, and should be considered whenever a Tax-Exempt or Governmental Employer enters into an employment agreement, a separation agreement, or other agreement, plan, or program that provides for possible taxable compensation or benefits in a future calendar year. If any such compensation or benefit is present, an analysis should be made as to whether it qualifies for an exemption from the Deferred Compensation Requirements or whether it must be structured to comply with the Deferred Compensation Requirements. When doing that analysis, the requirements in the Proposed Regulations should be taken into account. If not already done, Tax-Exempt and Governmental Employers should identify which person(s) will be responsible for making sure all applicable agreements, plans, or programs are structured to either comply with the Deferred Compensation Requirements or be exempt from the Deferred Compensation Requirements. As part of that responsibility, the applicable person(s) should review and understand the requirements in the Proposed Regulations.

- Identify All Existing Agreements, Plans, and Programs That Are Subject to the Deferred Compensation Requirements – If not already done, Tax-Exempt and Governmental Employers should identify all existing agreements, plans, or programs that provide for taxable compensation or benefits in a future calendar year, and should determine which are subject to the Deferred Compensation Requirements and which are exempt from the Deferred Compensation Requirements.
- Review the Existing Agreements, Plans, and Programs That Are Subject to the Deferred Compensation Requirements, and Determine if Any Compliance Changes Will Be Needed – The existing agreements, plans, and programs of Tax-Exempt and Governmental Employers that are subject to the Deferred Compensation Requirements should be reviewed to see if any changes will be needed to help ensure compliance when the Proposed Regulations are finalized. Although it is likely there will be some revisions to the Proposed Regulations when they are finalized, most of the current requirements in the Proposed Regulations likely will remain unaltered. Doing such a review sooner rather than later will provide additional time to do any amendment that might be required for an applicable agreement, plan, or program.
- Review the Existing Agreements, Plans, and Programs That Are Subject to the Deferred Compensation Requirements To See If Any New Planning Opportunities Are Available – The Proposed Regulations provide guidance on how to implement several types of deferred compensation features in an Ineligible Plan that were uncertain prior to the issuance of the Proposed Regulations. These include, but are not limited to: (1) using a properly structured noncompete provision to create a substantial risk of forfeiture; (2) allowing an eligible employee's election to terminate employment for a permissible good reason to be a permitted distribution event if certain requirements are satisfied; (3) allowing an eligible employee to voluntarily defer current compensation through elective deferrals if certain procedures are followed; and (4) postponing a scheduled date of payment of deferred compensation if certain requirements are satisfied. Tax-Exempt and Governmental Employers should consider reviewing their existing agreements, plans, and programs that are subject to the Ineligible Plan Requirements to see if any of them should be revised to take advantage of these new planning opportunities.
- Before Entering Into Any New Arrangement Subject to the Deferred Compensation Requirements, Review Whether It Will Comply with the Proposed Regulations – Any new agreement, plan, or program that will be subject to the Deferred Compensation Requirements generally should be structured by a Tax-Exempt or Governmental Employer to comply with the Proposed Regulations. Such compliance could help avoid tax exposure with respect to the Deferred Compensation Requirements, and could also reduce the number of changes that might be needed when the Proposed Regulations are finalized.
- Verify That All Deferred Compensation Arrangements Also Comply With Any Applicable Requirements Under Code Section 409A – A second set of deferred compensation requirements exists under Section 409A of the Code ("409A Requirements"), and the 409A Requirements generally apply to all types of employers having deferred compensation that does not qualify for an applicable exemption. When a Tax-Exempt or Governmental Employer structures its deferred compensation arrangements to either comply with or be exempt from the requirements of Section 457 of the Code, it should verify that such arrangements also will comply with any applicable 409A Requirements. Caution will need to be exercised when doing such verification, because the Deferred Compensation Requirements, the requirements in the Proposed Regulations, and the 409A Requirements do not always coordinate well.
- Correct Any Errors Discovered With Respect to the Deferred Compensation Requirements – If a Tax-Exempt or Governmental Employer discovers any error in complying with the Deferred Compensation Requirements, it should correct that error as soon as reasonably possible. Internal Revenue Service ("IRS") audits regarding the Deferred Compensation Requirements are likely to increase after the Proposed Regulations are finalized.

What Constitutes a Deferral of Compensation?

An agreement, plan, or program of a Tax-Exempt or Governmental Employer generally provides for a deferral of compensation for purposes of the Deferred Compensation Requirements if an employee has a legally binding right during a calendar year to taxable compensation or benefits that is, or may be, paid or provided in a later calendar year.

There are several statutory and regulatory exemptions to the definition of a deferral of compensation, as further described below.

What are the Main Exemptions to the Deferral of Compensation Definition and to the Ineligible Plan Requirements?

Section 457 of the Code and the Proposed Regulations have several exemptions to the deferral of compensation definition that relieve Tax-Exempt and Governmental Employers of the obligation to comply with the Ineligible Plan Requirements. Among the more important of these exemptions are the following:

- Nontaxable Compensation and Benefits – If compensation or a benefit provided pursuant to an agreement, plan, or program is nontaxable from the date it first becomes a legally binding right, it will not be subject to the Deferred Compensation Requirements.
- Compensation and Benefits That Are Not Subject to a Legally Binding Right – Under the Proposed Regulations, an employee generally will not have a legally binding right to any taxable compensation or benefits that can be unilaterally reduced or eliminated by his or her employer after the date he or she has performed the services creating the right.
- Short-Term Deferrals – The Proposed Regulations explicitly authorize, for the first time, the exemption of short-term deferrals from the Ineligible Plan Requirements. Short-term deferrals generally are payments that an eligible employee actually or constructively receives on or before the later of: (1) the March 15th date that immediately follows the end of the calendar year in which the employee's right to the payment is no longer subject to a permissible substantial risk of forfeiture; or (2) the 15th day of the third month after the end of the employer's tax year in which the employee's right to the payment is no longer subject to a permissible substantial risk of forfeiture. This exemption is often referred to as the short-term deferral exemption, and has long been part of the 409A Requirements. The Proposed Regulations generally incorporate the short-term deferral exemption requirements from the 409A Requirements, except that it uses the definition of substantial risk of forfeiture that appears in the Proposed Regulations rather than the definition of substantial risk of forfeiture used in the 409A Requirements. The definition of substantial risk of forfeiture in the Proposed Regulations is described in a separate question below, and allows (among other things) certain non-competition provisions to qualify as a substantial risk of forfeiture. Tax-Exempt and Governmental Employers should note, however, that the 409A Requirements do not allow non-competition provisions to qualify as a substantial risk of forfeiture. If a Tax-Exempt or Governmental Employer would like to use a permissible non-competition provision to qualify as a substantial risk of forfeiture under the Proposed Regulations, before implementing that provision it should first verify that the provision has been structured in a way that will not violate the 409A Requirements.
- Recurring Part-Year Compensation – The Proposed Regulations provide that recurring part-year compensation (e.g., employees of educational organizations that work less than 12 months a year, and are paid substantially equal installments during the 12 month period) generally will be exempt from the Ineligible Plan Requirements if: (1) the compensation is paid for services rendered in a position that the employer and employee reasonably anticipate will continue in a similar manner in the following years, and will require services to be provided during successive yearly periods of less than 12 months that begin in one calendar year and end in the subsequent calendar year; (2) payment of any part of an employee's recurring part-year compensation is not deferred beyond the end of the 13th month following the employee's first day of service during the applicable recurring part-year compensation period; and (3) the total amount of the recurring part-year compensation is not greater than the annual compensation limit under Section 401(a)(17) of the Code (that compensation limit is $265,000 in 2016, and is periodically adjusted by the IRS for cost-of-living increases) for the calendar year in which the applicable recurring part-year compensation period first commenced.
- Bona Fide Severance Pay Plan – A bona fide severance pay plan is exempt from the Deferred Compensation Requirements under Section 457(e)(11)(A)(i) of the Code. The Proposed Regulations define a bona fide severance pay plan as a plan that: (1) provides severance benefits only if an employee's employment ends as a result of either an involuntary severance from employment, participation in a permissible window program, or participation in a permissible voluntary early retirement incentive plan; (2) does not pay more than two times the employee's annualized compensation (based on the employee's annual rate of pay for the calendar year that immediately preceded the calendar year in which the employee's employment ended, or for the calendar year in which the employee's employment ended if there was no compensation during that preceding calendar year), adjusted for any increase during the applicable calendar year that was expected to continue indefinitely if the employee's employment had not ended; and (3) provides, as part of its written terms, that the severance benefits must be paid no later than the end of the second calendar year that follows the calendar year in which the employee's employment ends. The Proposed Regulations define an involuntary severance from employment, and allow for the first time under the Deferred Compensation Requirements an employee's election to terminate employment for a good reason to qualify as an involuntary severance from employment if

certain requirements are satisfied as described in the Proposed Regulations (those requirements are similar to the good reason requirements under the 409A Requirements). The Proposed Regulations also define what constitutes a permissible window program or voluntary early retirement incentive plan for purposes of this bona fide severance pay plan exemption. Although the bona fide severance pay plan exemption in the Proposed Regulations is similar to the bona fide severance pay plan exemption in the 409A Requirements, there are certain differences (e.g., the compensation limit is different). If the bona fide severance pay plan exemption in the Proposed Regulations is going to be used, the applicable 409A Requirements should be reviewed for compliance prior to any such use.

- Bona Fide Death Benefit Plan – A bona fide death benefit plan is exempt from the Deferred Compensation Requirements under Section 457(e)(11)(A)(i) of the Code. The Proposed Regulations provide, for the first time, a definition of what constitutes a bona fide death benefit plan under the Deferred Compensation Requirements. Under that definition, the present value of the total benefits payable under a bona fide death benefit plan in the event of death must exceed the present value of any lifetime benefits payable under the plan. The Proposed Regulations also provide that the death benefits under a bona fide death benefit plan may be provided through insurance, and that any lifetime benefits payable under that plan are not treated as including the value of any term life insurance coverage provided under that plan that are required to be included in an employee's gross income.
- Bona Fide Disability Pay Plan – A bona fide disability pay plan is exempt from the Deferred Compensation Requirements under Section 457(e)(11)(A)(i) of the Code, and the Proposed Regulations provide for the first time a definition of such a plan. A bona fide disability pay plan is defined in the Proposed Regulations as a plan that pays benefits only if a plan participant is disabled. Such a plan can be insured or uninsured, and if it is insured, the value of any disability insurance coverage that might be included in a plan participant's gross income will be disregarded. An employee in such a plan will only be considered disabled if one of the following three requirements is satisfied: (1) the employee has a medically determinable physical or mental impairment that likely will either result in death or last at least 12 continuous months, and as a result is not able to engage in any substantial gainful activity; (2) the employee has a medically determinable physical or mental impairment that likely will either result in death or last at least 12 continuous months, and as a result is receiving at least three months of income replacement benefits under an employer accident and health plan for employees; or (3) the Social Security Administration or the Railroad Retirement Board has made a determination that the employee is totally disabled.
- Bona Fide Sick and Vacation Leave Plans – A bona fide sick leave plan and a bona fide vacation leave plan are exempt from the Deferred Compensation Requirements under Section 457(e)(11)(A)(i) of the Code. Such plans have not been previously defined for purposes of the Deferred Compensation Requirements. The Proposed Regulations provide that a plan will qualify as a bona fide sick or vacation leave plan if the applicable facts and circumstances demonstrate that the primary purpose of the plan is to provide employees with paid time off from employment as a result of sickness, vacation, or other personal reasons. Among the factors that should be reviewed as part of this facts and circumstances analysis are the following: (1) whether the amount of leave granted can reasonably be expected to be used by the employee while employed; (2) whether an employee can exchange any unused accumulated leave for cash or other benefits; (3) whether any restraints exist on an employee's ability to carry forward to future years any unused accumulated leave that potentially could be exchanged for cash or other benefits; (4) whether unused accumulated leave can be exchanged for in-service cash payments or benefits, and, if so, in what amounts and how often; (5) whether any payment of unused accumulated leave is made shortly after an employee's employment ends, or over a period of time; and (6) whether the plan only covers a limited number of employees.
- Statutory Exemptions – Section 457 has numerous statutory exemptions to the Deferred Compensation Requirements, including, but not limited to, exemptions for qualified retirement plans under Section 401(a) of the Code, an annuity plan or contract under Section 403 of the Code, the portion of a plan that includes a transfer of property under Section 83 of the Code, a trust under Section 402(b) of the Code, a qualified governmental excess benefit arrangement under Section 415(m) of the Code, an employment retention plan that satisfies certain requirements, certain length of service award plans for volunteers, certain voluntary early retirement incentive plans, certain "grandfathered" plans, and certain churches and church organizations.

When is Deferred Compensation Under an Ineligible Plan Taxed?

Compensation deferred under an Ineligible Plan will, if one of the statutory or regulatory exemptions doesn't apply, be included in an employee's gross income for tax purposes on the later of:

- the date the employee first has a legally binding right to the deferred compensation; or
- the date the deferred compensation ceases to be subject to any applicable substantial risk of forfeiture, to the extent such compensation was subject to a substantial risk of forfeiture from the date it was first deferred (the definition of substantial risk of forfeiture is described in the following question).

When a Tax-Exempt or Governmental Employer is required to include deferred compensation in an employee's gross income pursuant to the preceding paragraph, such inclusion will include the present value of any of that deferred compensation that is scheduled to be paid after the date of inclusion (including any of that deferred compensation scheduled to be paid in a future calendar year) as well as any earnings on the amounts deferred under the deferred compensation plan through the date of inclusion. The Proposed Regulations provide detailed rules on how to make that present value computation. Subsequent earnings on that deferred compensation generally will be includable in an employee's gross income when paid or made available to the employee, in accordance with the requirements under Section 72 of the Code.

How is a Substantial Risk of Forfeiture Defined?

The Proposed Regulations provide that a deferral of compensation under an Ineligible Plan generally will be subject to a substantial risk of forfeiture if an employee's right to receive the applicable deferred compensation is contingent on: (1) the future performance of substantial services by the employee; or (2) a condition occurring that is related to a purpose of that deferred compensation, as long as there is a substantial possibility that such condition will not occur and a forfeiture of that deferred compensation will result. The Proposed Regulations also describe how an involuntary severance from employment without cause and certain types of noncompetition provisions can qualify as a substantial risk of forfeiture, and the factors that should be considered when determining whether a substantial risk of forfeiture has occurred. Additional information about these qualifying events and factors for a substantial risk of forfeiture is provided in the Proposed Regulations, and includes the following:

- Future Performance of Substantial Services Condition – The Proposed Regulations provide that whether the receipt of deferred compensation is conditioned on the future performance of substantial services will be based on all of the applicable facts and circumstances, "such as whether the hours required to be performed during the relevant period are substantial in relation to the amount of compensation." The Proposed Regulations do not describe what other facts and circumstances should be considered when making this determination. With respect to determining whether the hours required to be performed are "substantial" in relation to the amount of compensation, the Proposed Regulations do not define "substantial" or provide other guidance on how to make this determination.
- Condition Related to a Purpose of the Compensation – The Proposed Regulations provide that: (1) a condition related to a purpose of the compensation must relate to either an applicable employee's performance of services for his or her employer or to the employer's tax-exempt or governmental activities (whichever is applicable) or organizational goals; and (2) the possibility that the condition will not occur and will result in a forfeiture must be substantial.
- Involuntary Severance From Employment Without Cause Condition – If deferred compensation under an Ineligible Plan is conditioned on an employee's involuntary severance from employment without cause, such a condition will constitute a substantial risk of forfeiture under the Proposed Regulations as long as the possibility of forfeiture is substantial. If an employee elects to sever employment for a permissible good reason in accordance with the requirements of the Proposed Regulations, it will be treated in the same manner as an involuntary severance from employment without cause under the Proposed Regulations. The Proposed Regulations provide detailed good reason requirements that are similar to the good reason requirements in the 409A Requirements.
- Noncompetition Condition – Prior to the issuance of the Proposed Regulations, the law was unclear about the extent to which noncompetition conditions could be used to establish a substantial risk of forfeiture for purposes of the Ineligible Plan Requirements and the applicable exemptions. The Proposed Regulations allow noncompetition conditions to be used to establish a substantial risk of forfeiture only if certain requirements are satisfied. An employee's deferral of compensation under the Ineligible Plan Requirements and the applicable exemptions can be contingent upon an employee refraining from the future performance of certain services (e.g., agreeing not to work for certain competitors for a specified period) if all of the following conditions are satisfied: (1) the noncompetition condition must be in an enforceable written agreement; (2) reasonable ongoing efforts must be made by the employer to ensure that the requirements in its noncompetition conditions (including the one for the applicable

employee) are being followed; (3) the employer must be able to demonstrate that it has a substantial and bona fide interest in keeping the employee from competing (among the factors that will be considered is whether the employer can demonstrate that if the employee performs the prohibited services, it is likely that such performance would result in significant adverse consequences for the employer); and (4) the employee has a bona fide interest in, and the ability, to perform the prohibited services (among the factors that will be considered is how marketable the employee is based on his or her skills, reputation, and other credentials, and whether the employee has an interest, a financial need, and an ability to compete). This noncompetition condition does not appear in the Section 409A Requirements, and thus any reliance on the noncompetition condition for purposes of the Deferred Compensation Requirements will require a separate analysis be made to ensure the Section 409A Requirements are satisfied.

- Other Factors That Should Be Considered When Determining Whether a Substantial Risk of Forfeiture Has Occurred – The Proposed Regulations provide that a deferral of compensation will only be subject to a substantial risk of forfeiture if (1) the chances of a forfeiture occurring are substantial, and (2) it is likely that if a forfeiture occurred, it would be enforced. Among the factors that will be considered regarding the likelihood of enforcement is the employer's past practice on such enforcement, and whether the employee whose compensation is being deferred has any control or influence that could interfere with such enforcement.

What Do the Proposed Regulations Say About the Right of Employees To Voluntarily Elect to Defer Current Compensation?

For years the IRS has raised questions about whether employees of Tax-Exempt and Governmental Employers can voluntarily elect to defer current compensation as part of an Ineligible Plan. The IRS has been skeptical about why employees would voluntarily put money at risk they otherwise were going to receive, and about whether such deferrals would really be subject to a substantial risk of forfeiture. However, in the Proposed Regulations, the IRS surprisingly provided more flexibility on establishing such deferrals than had been anticipated.

The Proposed Regulations will allow eligible employees of Tax-Exempt and Governmental Employers to voluntarily defer current compensation as part of an Ineligible Plan if certain requirements are satisfied. Current compensation, for purposes of these requirements, is defined as compensation that is payable to an employee on a current basis (e.g., salary and bonuses), and excludes deferred compensation. The four main requirements that have to be satisfied in order for initial deferrals of current compensation to be subject to a substantial risk of forfeiture are:

- 125 Percent Payment Requirement – The present value of the deferred compensation benefit that will be paid when the substantial risk of forfeiture lapses must be greater than 125 percent of the amount the employee otherwise would have received had there been no deferral subject to a substantial risk of forfeiture.
- Two Year Deferral Requirement – The period during which the compensation is being deferred generally must be at least two years, with a Tax-Exempt or Governmental Employer having the option to allow a shorter deferral period in the event of an eligible employee's death, disability, and/or involuntary severance from employment.
- Substantial Services or Noncompete Requirement – The substantial risk of forfeiture that will apply to an employee's deferral of compensation must be based on either the employee's future performance of substantial services or compliance with a permissible noncompetition condition, and is not allowed to be based upon compliance with a condition related to the purpose of the transfer.
- Advance Written Agreement Requirement – An employee's voluntary election to defer initial compensation must be evidenced by a written agreement prior to the start of the calendar year in which the employee will perform the services that will make him or her eligible to receive the compensation that will be deferred. Special requirements apply with respect to new employees.

The rules under the Proposed Regulations regarding an employee's right to voluntarily elect to defer current compensation are different than the applicable rules for such deferrals under the 409A Requirements, and will need to be properly coordinated with the 409A Requirements.

What Do the Proposed Regulations Say About the Right to Delay a Scheduled Deferred Compensation Payment Date?

The Proposed Regulations provide important new guidance on how to delay a scheduled payment date of deferred compensation in an Ineligible Plan. In order for such a delay to occur, and in order to extend the deferral period covered by the applicable substantial risk of forfeiture (such an extension is often referred to as a rolling risk of forfeiture), the Proposed Regulations require that such a delay and extension must satisfy requirements very similar to the four requirements described in the preceding question:

- 125 Percent Payment Requirement – The present value of the deferred compensation benefit that will be paid when the extended substantial risk of forfeiture period lapses must be greater than 125 percent of the amount the employee otherwise would have received had there been no extension of the substantial risk of forfeiture period.
- Two Year Deferral Requirement – The proposed extension of the substantial risk of forfeiture period generally must be at least two years, with a Tax-Exempt or Governmental Employer having the option to allow a shorter extension period in the event of an eligible employee's death, disability, and/or involuntary severance from employment.
- Substantial Services or Noncompete Requirement – The substantial risk of forfeiture that will apply during the extension period must be based on either the employee's future performance of substantial services or compliance with a permissible noncompetition condition, and is not allowed to be based upon compliance with a condition related to the purpose of the transfer.
- Advance Written Agreement Requirement – An eligible employee's agreement to extend the substantial risk of forfeiture period must be made at least 90 days prior to the date the substantial risk of forfeiture would have lapsed had such an extension not been made. Special requirements apply with respect to new employees.

Any delay of a scheduled deferred compensation payment date under the Proposed Regulations will need to be properly coordinated with the Section 409A Requirements.

In conclusion, the Proposed Regulations provide new requirements, and new planning opportunities, for Tax-Exempt and Governmental Employers, and should be considered by a Tax-Exempt and Governmental Employer whenever it decides to provide taxable compensation or benefits in a future calendar year.

If you have any questions about this memorandum, please contact any member of our Employee Benefits and Executive Compensation Group listed below.

Albany: 518.533.3000
Amelia M. Klein aklein@bsk.com
Suzanne D. Smith ssmith@bsk.com

Buffalo: 716.416.7000
John C. Godsoe jgodsoe@bsk.com
Michele O. Heffernan mheffernan@bsk.com
Robert W. Patterson rpatterson@bsk.com
Daniel R. Sharpe dsharpe@bsk.com

Long Island: 516.267.6300
Terry O'Neil toneil@bsk.com

New York City: 646.253.2300
Michael P. Collins mcollins@bsk.com

Rochester: 585.362.4700
John C. Godsoe jgodsoe@bsk.com
James Holahan jholahan@bsk.com

Syracuse: 315.218.8000
Lisa A. Christensen lchristensen@bsk.com
Stephen C. Daley sdaley@bsk.com
Brian K. Haynes bhaynes@bsk.com
Richard D. Hole rhole@bsk.com
Ted Lewkowicz tlewkowicz@bsk.com
Aaron M. Pierce apierce@bsk.com

Commitment · Service · Value · Our Bond

Bond, Schoeneck & King PLLC (Bond, we, or us), has prepared this communication to present only general information. This is not intended as legal advice, nor should you consider it as such. You should not act, or decline to act, based upon the contents. While we try to make sure that the information is complete and accurate, laws can change quickly. You should always formally engage a lawyer of your choosing before taking actions which have legal consequences.

For information about our firm, practice areas and attorneys, visit our website, www.bsk.com. • Attorney Advertising • © 2016 Bond, Schoeneck & King, PLLC

CONNECT WITH US ON LINKEDIN: SEARCH FOR BOND, SCHOENECK & KING, PLLC
FOLLOW US ON TWITTER: SEARCH FOR BONDLAWFIRM