Employment and Labor Law ALERT

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Opportunity to Amend Certain Severance-Related Release Agreements to Comply with Section 409A Expires at Year End

Companies commonly condition the payment of severance benefits upon the terminated individual's execution of an agreement containing a release of claims against the employer. Many release provisions permit a former employee to control the timing of a severance payment – and in particular the tax year in which the payment is made – based upon when the employee returns the executed release agreement. The IRS has indicated that these types of release provisions violate Internal Revenue Code Section 409A (Section 409A) and has given employers until December 31, 2012, to correct non-compliant release provisions in agreements in effect before January 1, 2011.

Section 409A provides certain permissible triggers (*i.e.*, separation from service, disability, death, payment at a specified time or according to a fixed payment schedule, certain changes of corporate ownership, and certain unforeseeable emergencies) for the payment of "deferred compensation," which may include severance payments. Section 409A generally permits the scheduling of these payments on the trigger date or within a period of not more than 90 days, based on the timing of the occurrence, provided that if the post-trigger period spans two different tax years of the individual (*e.g.*, separation from service occurs on November 15 and the agreement calls for payment within 90 days thereafter), only the employer (not the employee) may determine the timing of the payment and, in particular, whether to make the payment in the earlier or later tax year.

Pursuant to Section 409A and IRS regulatory guidance, various approaches exist for correcting compensation agreements containing non-compliant release provisions to comply with the Section 409A requirements applicable to the timing of severance payments. If the existing release provision provides for payment within a specified period, the employer must correct the provision to provide either for payment on the last day of that period or for payment in the second year if the period begins in one year and ends in the next. If the existing release provision does not provide for payment within a specified period, the employer must correct the provision to provide either for payment only at the end of the period designated for execution of the release following separation from service or for payment during a specified period of no longer than 90 days following separation from service, except that payment must be made in the second year if the specified period begins in one year and ends in the next. Certain payments are exempt from Section 409A. For example, severance payments that result from involuntary termination or termination in connection with a window program, do not exceed the lesser of two times the individual's annualized compensation from the tax year preceding the year of termination or the qualified plan compensation limit ($500,000 in 2012), *and* are paid by December 31 of the second year following termination.

Non-compliant release provisions can arise in many different non-qualified deferred compensation arrangements, including employment agreements, severance agreements, equity plans and award agreements, and change in control agreements. Existing compensation agreements in effect before January 1, 2011, should be reviewed promptly for this issue, as significant tax consequences can result for payments that run afoul of Section 409A. If any of the above concerns are applicable, Loeb & Loeb's Employment and Tax attorneys can offer solutions for both new and existing arrangements and agreements that have sensible commercial results and are Section 409A-compliant. We recommend that you call your regular Loeb contact for

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assistance as soon as possible to ensure that you meet the IRS deadline.

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