

Publications

Are You Prepared? Uncertainty of Section 409A's Impact on Multinational Corporations Looms

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The American Jobs Creation Act of 2004, which primarily was focused on corporate tax matters for multinational companies, also made far-reaching changes to the U.S. tax rules for nonqualified deferred compensation plans. These changes are contained in new section 409A of the Internal Revenue Code. Under Section 409A, deferred compensation arrangements must comply with strict standards with regard to timing of deferrals and distributions and Section 409A puts limits on the use of foreign trusts and funding triggered by the company's financial health. Failure to comply with these standards will mean current taxation of the deferred compensation with a 20% excise tax added.

It is important to note that Section 409 is applicable to worldwide income earned by U.S. citizens working abroad (i.e., expatriates) and resident aliens working inside or outside of the U.S., and U.S.-source income earned by foreign employees working temporarily in the U.S. (i.e., nonresident aliens). In addition, since Section 409A generally prohibits funding deferred compensation through a foreign trust, this prohibition will inevitably result in unintended tax consequences for expatriates and resident and nonresident aliens. As a result, it is imperative that multinational corporations understand Section 409's impact. On December 20, 2004, the Treasury Department and the Internal Revenue Service issued Notice 2005-1 which provided initial transitional guidance intended to assist plan sponsors in implementing the new requirements for new and existing nonqualified deferred compensation arrangements. The Notice requires plan sponsors to amend their plans in order to comply with Section 409A in form by December 31, 2005. Although a second round of guidance on the new rules is expected late this summer, this guidance is not expected to fully address Section 409's impact on multinational corporations.

Despite the lack of guidance on Section 409A, multinational corporations and foreign governments must be aware of the several important issues, which are addressed in the attached article.

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