

Publications

View from Groom: An Open or Closed Section 409A Case

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It has been nearly thirteen years since the American Jobs Creation Act added Section 409A (“Section 409A”) to the Internal Revenue Code (the “Code”) and transformed the legal landscape regarding taxation of nonqualified deferred compensation. In the ensuing years, employers and practitioners have spent considerable time and energy updating nonqualified deferred compensation plans and practices to comply with the requirements of this complex law and its related regulations. But despite their best efforts, inadvertent mistakes happen in plan administration. These errors can lead to severe tax consequences to an employee under Section 409A, including immediate income inclusion for all vested deferred compensation owed the employee under the plan, plus a 20 percent additional tax on the included compensation and premium interest (collectively, “409A Taxes”).

However, not all errors are treated similarly under Section 409A and the related Internal Revenue Service (“IRS”) guidance. One unresolved issue that has caused significant concern among practitioners is whether a failure to timely distribute an amount of deferred compensation in a taxable year that becomes time-barred by the statute of limitations for tax assessments (a “closed” year) continues to result in liability under Section 409A in a subsequent taxable year that is not time-barred (an “open” year). The attached article briefly describes the applicable law and available guidance, illustrates the issue in an example, and provides two plausible analyses that result in dramatically divergent tax results.

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