O'NEILCANNON
HOLLMAN DEJONG & LAING S.C.

EMPLOYMENT LAWSCENE ALERT: INTERNAL REVENUE CODE SECTION 409A SURVIVES REPEAL-AND-REPLACE ATTEMPT

Employer sponsors of nonqualified deferred compensation (NQDC) plans, as well as the executives and other service providers, who benefit from them, can breathe a sigh of relief. The ability to reward and retain key employees with incentive and compensation plans that provide a current opportunity to earn a payment to be provided (and taxed) in the future, will continue to be available, as it has been under American tax law for more than 80 years. Since late 2004, NQDC agreements have been regulated primarily by Internal Revenue Code (Code) Section 409A.

The House Tax Bill

The ongoing viability of NQDC came under direct threat in the initial draft of the Tax Cuts and Jobs Creation Act (TCJA) as proposed by the U.S. House of Representatives Ways and Means Committee on November 2, 2017 (the House Tax Bill). Section 3801 of the House Tax Bill, which was proposed in substantially similar form to the Section 409A repeal-and-replace proposal introduced in a proposed Tax Reform Act of 2014, would have drastically reduced the ability of employers to reward key employees with deferred compensation arrangements.

As drafted, the House Tax Bill would have eliminated Section 409A and supplanted it with a new Section 409B. These changes, intended to be effective for services performed on and after January 1, 2018, would have meant, as of the New Year, that all NQDC arrangements would become fully taxable upon vesting, with only very limited opportunity to defer taxation until a future year. The proposed law would have applied not only to the common elective, nonelective, incentive payment, and phantom stock forms of NQDC, but would have also expressly *included* the (currently) sometimes-exempt equity-based compensation forms such as stock options, restricted stock units, and stock and stock appreciation rights.

The Joint Tax Committee had estimated that the proposed change would increase revenues by $16.2 billion between 2018 and 2027.

2017 Senate Tax Bill

The language that would repeal section 409A and replace it with a new Section 409B was

removed from the final version of the House Ways and Means Committee's Tax House Bill, as issued on November 9, 2017. The Chairman's Mark of the Senate tax reform proposal issued on the same day, however, resurrected the proposals. As unveiled on November 9, 2017 by Senator Orrin Hatch, Chairman of the Senate Finance Committee, the initial Senate version of the TCJA (the Senate Tax Bill) contained the identical Section 409A repeal-and-replace provisions.

Senate Finance Committee Mark Up

Finally, upon the successful amendment offered by Senator Rob Portman, the Section 409A repeal-and-replace proposal was stricken in its entirety from the legislation. This action preserves the current, well-established system, which would have been rendered virtually extinct by the repeal-and-replace proposal. The proposal's demise became known concurrent with the Joint Committee on Taxation's issuance of the Chairman's Modification to the Chairman's Mark of the TCJA late in the day on November 14, 2017.

Impact

The retention of the existing system of taxation for NQDC arrangements is great news for employers and key employees, who can now continue to offer (and benefit from) compensation packages as appropriate to reward and retain top talent. It is also good policy, in that it does not impose limitations on the ability to earn and save for retirement at a time when the general retirement savings rates of Americans across nearly all income levels are widely reported to be insufficient.