

Application of Code Section 409A to Back-to-Back Arrangement

June 29, 2017

On June 23, 2017, the IRS Office of Chief Counsel issued Chief Counsel Memorandum Number 201725027 (the “Memorandum”) addressing the application of Section 409A of the Internal Revenue Code (“Section 409A”) to certain back-to-back arrangements. The taxpayer in the Memorandum managed investment funds, including the funds of a foreign corporation, with whom the taxpayer had entered into an arrangement to defer some of its management and/or performance fees from the foreign corporation (referred to as an “ultimate service recipient plan” or “USR plan”). The taxpayer also sponsored a deferred compensation arrangement for its investment professional employees (referred to as an “immediate service recipient plan” or “ISR Plan”). While the deferral elections and payment triggers of the USR Plan and ISR Plan were coordinated, the USR Plan provided that payment would be made to the taxpayer under the USR Plan even when amounts were forfeited by a participant under the ISR Plan upon a separation from service. The IRS found that this feature caused the arrangement to violate the requirements for back-to-back arrangements under Section 409A because the regulations under Section 409A provide that the payment under a USR Plan cannot exceed the amount paid under the ISR Plan, and by including this feature, the amount of the payment under the USR Plan could potentially exceed the amount of the payment to the participants under the ISR Plan. In addition, the USR Plan further violated the requirements of Section 409A by allowing for payment to the taxpayer under the USR Plan relating to unvested amounts forfeited upon separation from service of a participant in the ISR Plan, which is not a permissible payment event under Treasury Regulation 1.409A-3(a). [View the IRS Chief Counsel Memorandum.](#)