

Severance Arrangements and Code Section 409A

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We recently posted an item that discussed when a severance policy would be subject to ERISA and the potential benefits of the policy being subject to ERISA (that post is available [here](#)). Another potential issue employers should consider is whether their severance arrangements are subject to Code Section 409A, which applies to certain deferred compensation arrangements. If a severance arrangement is subject to Code Section 409A, it must comply with Code Section 409A's various documentary and operational requirements to avoid the additional 20% tax and underpayment penalty that may be assessed for any compliance failures. Severance arrangements can be drafted to be exempt from Code Section 409A, such as under its short-term deferral and separation pay exceptions. If the severance arrangement is subject to Code Section 409A, some of the potential issues employers should consider include, among others:

- Any changes to the time or form of payments must comply with Code Section 409A's subsequent deferral requirements (*i.e.*, changes must be made at least 12 months prior to the original payment date and payments must be deferred by at least five years).
- Benefits should only be payable if a termination constitutes a "separation from service" as defined in Code Section 409A (there are certain presumptions under the applicable Treasury Regulations to determine whether a separation from service has occurred when it is anticipated that a former employee will continue to provide a certain level of services to the employer post-termination, whether as an employee, independent contractor, or otherwise).
- If payments are to be paid in installments, does the severance arrangement state that such payments will be treated as separate payments, which may permit a portion of the severance payments to be treated as exempt under one of the Code Section 409A exceptions?
- Does an employee qualify as a "specified employee" under Code Section 409A such that any severance payments must be delayed for six months or, if earlier, until the employee's death?

Any severance arrangement that is subject to an employee executing a release of claims in favor of the employer should provide that when the time period for an employee to deliver an irrevocable release of claims to the employer spans two tax years, severance payments will not commence until either (i) a fixed date in the future (*e.g.*, the first payroll date on or next following the 60th day after the termination date) or (ii) in the second tax year. Employers should consult with their counsel to review their severance arrangements to determine whether they are exempt from or otherwise compliant with Code Section 409A.