

# IRS CHIEF COUNSEL ADVICE ADDRESSES MEANING OF "SUBSTANTIAL RISK OF FORFEITURE" UNDER CODE SECTION 409A

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**Practices & Industries**

Employee Benefits

Section 409A of the Internal Revenue Code ("Section 409A") generally provides that if certain requirements related to the timing of elections, distributions, and funding are not met at any time during a taxable year, amounts deferred under a nonqualified deferred compensation plan for that year and all previous taxable years are currently includible in the service provider's gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. Amounts includible in gross income under Section 409A are also subject to a 20% additional income tax and potentially a premium interest tax.

In the case of a calendar year taxpayer, if an amount is paid to the taxpayer no later than March 15 of the year following the year the amount is no longer subject to a substantial risk of forfeiture, then the amount is exempt from Section 409A. Under the Section 409A regulations, the addition of a risk of forfeiture is generally disregarded. Thus, salary deferrals are generally not viewed as being subject to a substantial risk of forfeiture. However, if the amount subject to a risk of forfeiture is materially greater than the present value the service provider otherwise could have elected to receive absent such risk of forfeiture, then the amount may be viewed as subject to a substantial risk of forfeiture.

A recent Chief Counsel Advice ("CCA") addressed an arrangement where an employee entered into an agreement to defer \$15,000 of the employee's salary that otherwise would have been paid to the employee in 2015. The deferred amount under the agreement is to be paid in a single lump sum on January 1, 2018, but only if the employee continues to provide services to the employer through December 31, 2017. Under the agreement, the employer agreed to match 25% of the employee's salary deferrals.

The CCA concludes that, because the present value of the amount deferred on behalf of the employee is 25% greater than the amount the employee otherwise could have elected to receive absent the risk of forfeiture, all amounts deferred under the agreement are treated as being subject to a substantial risk of forfeiture through December 31, 2017. Since the deferred amounts are to be paid January 1, 2018, amounts payable under the agreement should be exempt from Section 409A. (CCA 201645012)