2016 TNT 202-4 PRACTITIONERS SEEK CHANGES TO TAX-EXEMPT DEFERRED COMP REGS. (Section 409A -- Inclusion in Gross Income of Deferred Compensation) (Release Date: OCTOBER 18, 2016) (Doc 2016-21039)

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Abstract:

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Summary:

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The proposed deferred compensation rules for tax-exempt organizations have been well received but several adjustments to the regulations would improve understanding, administration, and compliance, practitioners said October 18.

Kirk Sherman of Sherman & Patterson Ltd. attributed the positive reception of the proposed section 457(f) regulations (REG-147196-07) to the IRS's decision to soften the rules from previous guidance. Speaking at an IRS hearing on the proposed regs, Sherman said there is still room for improvement despite the favorable reactions.

The IRS in June released the proposed section 457(f) regs alongside the proposed section 409A income inclusion regs (REG-123854-12).

Sherman asked that the IRS consider extending to section 457(f) an exemption from section 409A that applies to loan regime split-dollar life insurance agreements. According to Sherman, the exemption has been helpful in the section 409A context to clients considering split-dollar life insurance by eliminating expensive and detailed legal analysis.

A provision in the proposed regs that noncompete restrictions would not be effective "unless certain conditions are satisfied" was a pleasant surprise, Sherman said, adding that practitioners were convinced the proposed regs would eliminate noncompete provisions as a method to defer taxation. A noncompete provision in a deferral plan "is the single most efficient way to protect the employer from unfair competition" because it makes clear the economic consequences of violating the provision, he said.

Sherman recommended that the IRS eliminate one of the factors in the proposed regs -- financial need -- used to determine whether a noncompete provision provides a substantial risk of forfeiture. The factor will lead to awkward conversations about an employee's net worth and how financial need is evaluated, he said.

Body

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The proposed deferred compensation rules for tax-exempt organizations have been well received, but several adjustments to the regulations could improve understanding, administration, and compliance, practitioners said October 18.

Kirk Sherman of Sherman & Patterson Ltd. attributed the positive reception of the proposed section 457(f) regulations (REG-147196-07 (Doc 2016-12691)) to the IRS's decision to soften the rules from previous guidance (Notice 2007-62, 2007-32 IRB 331 (Doc 2007-17147)). Speaking at an IRS hearing on the proposed regs, Sherman said there still is room for improvement despite the favorable reactions. (Hearing transcript (Doc 2016-21023).)

The IRS released the proposed section 457(f) regs in June, alongside the proposed section 409A income inclusion regs (REG-123854-12 (Doc 2016-12692)). (Prior coverage (Doc 2016-12724).)

Sherman asked that the IRS consider extending to section 457(f) an exemption from section 409A that applies to loan regime split-dollar life insurance agreements. According to Sherman, the exemption has been helpful in the section 409A context to clients considering split-dollar life insurance by eliminating expensive and detailed legal analysis.

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Sherman recommended that the IRS eliminate one of the factors in the proposed regs -- financial need -- used to determine whether a noncompete provision provides a substantial risk of forfeiture. That factor will lead to awkward conversations about an employee's net worth and how financial need is evaluated, he said.

Stephen Tackney, deputy associate chief counsel (employee benefits), IRS Office of Associate Chief Counsel (Tax-Exempt and Government Entities), said the IRS intended that factor to be based on knowledge the employer already possesses, such as retirement benefits currently available to the employee. The IRS has seen many cases involving lower- and mid-level employees with noncompete provisions that are not being enforced and that financial need would be a significant factor in whether someone would need to compete, he said.

James Patterson, also of Sherman & Patterson Ltd., said the IRS should clarify the impact on deferrals that occur before the section 457(f) regs are finalized. According to Patterson, there are different interpretations of how the regs should be applied to deferrals with a legally binding right that arose in previous calendar years but have not been included in income.

Tackney said he didn't think the effective date is unclear and the rule in the proposed regs includes amounts deferred in prior years that have not yet been included in income as of the effective date.

Patterson also requested that the IRS change one of the requirements to satisfying the substantial risk of forfeiture rule for deferrals of amounts of current compensation. The proposed regs require that the amount deferred be materially greater, which is defined in the regs as "more than 125 percent of the amount" the employee would otherwise receive, he said.

Patterson said the standard should be changed to "at least 125 percent" because "25 percent is an easy target to understand" and it will avoid plan documents requiring nominal amounts above the threshold.

Tackney said the IRS has heard this comment before and it's "well taken."

References

Subject Area:
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