

employee plans news

PROTECTING RETIREMENT BENEFITS THROUGH EDUCATING CUSTOMERS

Back to School Guidance

The Treasury Department and IRS released [Notice 2008-62](#) in advance of the forthcoming Code §457(f) proposed regulations to provide relief to schools as they begin their 2008/2009 school year.

The use of a 12-month pay period that spans two calendar years for employees that actually only work for 9 or 10 months results in compensation earned in one year being deferred to a second year.

The notice establishes criteria which, if met, excludes arrangements in which school employees are compensated on a 12-month pay period in lieu of the 9 or 10-month actual work period from being considered as deferred compensation and, therefore, not subject to the rules under Code §§457(f) and 409A. In fact, the notice provides that this arrangement wouldn't result in deferred compensation as long as the employee earns less than \$186,000.

Under the notice, stretching an employee's annual compensation over a period which goes into a subsequent tax year will not constitute deferred compensation for purposes of §§457(f) and 409A as long as the arrangement does not:

- 1) defer payment of any compensation beyond the last day of the 13th month following the beginning of the service period and
- 2) defer from one taxable year to the next taxable year the compensation payment of more than the applicable 401(k), 403(b), and 457(f) deferral limit in effect for the calendar year in which the service period begins (\$15,500 for 2008).

For example, assume a school district employee works during a school year that begins on August 1, 2008, and ends on May 31, 2009 (a 10-month school year). The employee is paid over the 12-month period beginning August 1, 2008 (either because the school pays over a 12-month period or because the employee has elected over the 12-month period). Since five months of the school year are in 2008 and five months are in 2009, an employee whose salary for the school year is \$60,000 **earns** \$30,000 ($\$60,000/10 \text{ months} \times 5 \text{ months}$) in 2008 and \$30,000 in 2009. Under the 12-month payment schedule, the employee actually **receives** only \$25,000 ($\$60,000/12 \text{ months} \times 5 \text{ months}$) in 2008 and the balance of \$35,000 ($\$60,000/12 \text{ months} \times 7 \text{ months}$) in 2009. Because \$5,000 ($\$30,000 - \$25,000$) of what the employee earned during 2008 is actually paid in 2009, a deferral of income from 2008 to 2009 is created. However, this arrangement would not be considered to be deferred compensation for purposes of §457(f) as the deferred amount ($\$30,000 - \$25,000$, or \$5,000) does not exceed the applicable dollar amount for 2008 (\$15,500) and the full amount of the pay would be received by July 31, 2009.

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To compute the amount of deferred compensation based on salary of \$186,000 earned in a 10-month period, but paid over a 12-month period:

Divide annual compensation by earning months (10): ($\$186,000/10 = \$18,600$)

Divide annual compensation by annual payments (12): ($\$186,000/12 = \$15,500$)

Multiply monthly compensation by number of months that employee earns in 2008:
($\$18,600 \times 5 = \$93,000$)

Multiply monthly compensation by number of months that employee is actually paid in 2008:
($\$15,500 \times 5 = \$77,500$)

Compare amount of compensation earned during the 10 earning months to the amount of compensation paid in 2008: ($\$93,000 - \$77,500 = \$15,500$).

Since the amount of deferred compensation (\$15,500) does not exceed the applicable \$15,500 limit and payments are made to the employee by the end of the 13th month after payments begin, it is not deferred compensation for §§457(f) and 409A.

For additional information, see the [IRC 409A](#) web reference page located under our [IRC 403\(b\)](#) web page.

Employees that have deferred compensation in excess of the limit specified in Notice 2008-62 may not be subject to the additional tax if they follow the provisions spelled out in the previously released [Frequently Asked Questions- 409A and Deferred Compensation](#).