



December 27, 2018

Incorrectly Deferring The Last Payroll Period In Your Nonqualified Plan Could Lead to Penalties

As we approach the end of 2018, you may be wondering how to defer your employees' compensation for the last payroll period of the year under a Nonqualified Deferred Compensation Plan ("NQDC Plan"). This is particularly relevant when the last payroll period includes days from the end of 2018 and the beginning of 2019. Should the last paycheck be deferred pursuant to your employees' 2018 elections? Their 2019 elections? Should the check be split in two?

Internal Revenue Code ("Code") Section 409A, which governs how NQDC Plans are to be operated, provides guidance regarding this issue.

Under Code Section 409A, when compensation is paid after the last day of the year for services performed during the final payroll period that contains the last day of the year, the compensation is to be treated as compensation for the subsequent year, unless otherwise provided in the Plan. In other words, if your payroll period that includes December 31, 2018 is paid in 2019, that compensation should be subject to your employees' 2019 deferral elections (unless your plan provides for different treatment). This is true even if the 2019 paycheck includes days of work in 2018. Deferring under any other deferral election could lead to all deferrals and contributions to the plan being subject to a 20% excise tax (in addition to regular income taxes).

Please note, this rule only applies to compensation paid for service performed during the final payroll period – it does not apply to other payments made in 2019 for work performed in 2018, such as annual bonuses.

Recommended Action

In order to make sure your employees avoid penalties, we recommend the following action:

- Review your deferral procedures and contact your NQDC Plan recordkeeper to assure the last payroll period is being deferred correctly (and has been done correctly in the past).
- If you've been deferring the last payroll period incorrectly, contact us for advice on the best way to correct the problem to minimize penalties to your employees.
- If you would like to change how the last payroll period is deferred, this can be done through plan amendment, but there are specific rules that apply – let us know if we can help you amend your NQDC Plan.

Additional Information

If you have any questions regarding how to handle your last payroll period in your NQDC Plan, or you would like help amending your plan to change how the last payroll period is handled, please contact a member of our Employee Benefits Practice Group listed below. For more information concerning our employee benefits practice, please visit us at www.KutakRock.com.

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