

409A – 10 vs. 12 months pay

How does spreading a teacher's salary over 12 months create deferred compensation?

- Generally, deferred comp is compensation earned in one year but paid in a later year
- Teachers generally earn pay in 10 months spanning two calendar years (i.e., August – May)
- If pay is spread over 12 months (i.e., August – July) less money is received each month and thus less is paid in year 1 (i.e., August – December)

Notice 2008-62

Interim Guidance on 10 vs. 12 months pay

Example: **August 1, 2008 - May 31, 2009** school year
(10 months) - Teacher earns \$186,000 per year

- If paid over **10 months** (\$18,600/mo)
 - **\$93,000** in **2008** (5 months August - December)
 - **\$93,000** in **2009** (5 months January - May)
- If paid over **12 months** (\$15,500/mo)
 - **\$77,500** in **2008** (5 months August - December)
 - **\$108,500** in **2009** (7 months January - July)
 - **\$15,500** of 2008 comp is **DEFERRED** to **2009**
 - **\$93,000 - \$77,500 = \$15,500**
- Because deferral is \$15,500 or less (2008 402(g) limit) it is not considered deferred compensation subject to §409A rules

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Example: **September 1, 2008 - June 30, 2009** school year (10 months) - Teacher earns \$232,500 per year

- If paid over **10 months** (\$23,250/mo)
 - **\$93,000** in 2008 (4 months September - December)
 - **\$139,500** in 2009 (6 months of January - June)
- If paid over **12 months** (\$19,375/mo)
 - **\$77,500** in 2008 (4 months June - December)
 - **\$155,000** in 2009 (8 months January - August)
 - **\$15,500** of 2008 comp is **DEFERRED** to 2009
 - **\$93,000** - **\$77,500** = \$15,500
- Because deferral is \$15,500 or less (2008 402(g) limit) it is not considered deferred compensation subject to §409A rules

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In advance of §457 Proposed Regulations, this notice provides the expectation that IRC 457(f) and 409A will not apply to conforming arrangements:

- 1) does not defer payment of any compensation beyond the last day of the 13th month following the beginning of the service period and
- 2) does not defer from one taxable year to the next taxable year the payment of more than the applicable 401(k), 403(b), and 457(b) deferral limit in effect for the calendar year in which the service period begins (\$15,500 for 2008).

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What does section 409A require if the Notice 2008-62 limit is exceeded?

- Generally, the schedule under which a teacher will be paid must be established in writing before the beginning of the school year.
- Under final §409A regulations, special rules allow teachers (or others with similar part-year work periods) to make an election to spread their compensation for up to 12 months, if their employer is willing to give them that choice.

409A –

FAQ issued on 10 vs. 12 months pay

Generally, the regulations require the following:

- Employee must give a written election to notify employer that he/she wants to spread out the compensation.
- Election must be made before the beginning of the work period (i.e., before the first day of the school year).
- Election must be irrevocable, so that it can't be changed after the work period begins.
- Election must state how the compensation is going to be paid if the election is made (for example, ratably over the 12 months starting with the beginning of the school year).
- No particular form is necessary for the election and it does not have to be filed with the IRS.