

## An IRS Trap for the Unwary: Severance Pay and Releases

Section 409A requires that deferred compensation be payable only upon certain specified events (including termination of service) or on a date certain. Many employment agreements that provide for payment upon involuntary termination of employment (or termination by an employee for good reason) also condition the actual date of payment upon the former employee's delivery of a release of any claims for breach of contract, employment discrimination or the like and the expiration of any period during which a law (such as the Age Discrimination in Employment Act) permits the former employee to rescind the release. The Regulations under Section 409A permit an employer to impose such a condition and to defer payment beyond the termination date for a stated period of up to 90 days pending satisfaction of the condition. The IRS, however, has warned that such arrangements may impermissibly allow the employee to select the year of payment where the 90 day period spans two calendar years. In that event, the additional tax obligation and withholding and reporting requirements will be triggered.

To provide guidance on avoiding violation of Section 409A in this circumstance, the IRS recently issued a release concerning the appropriate drafting of such termination provisions to ensure compliance with Section 409A.

Agreements may be amended to comply with the IRS pronouncements without any penalty so long as the amendment is made before the event giving rise to a payment right has occurred. Accordingly, employers (as well as executives) should review their existing employment agreements and severance payment agreements to insure that they either comply with the IRS announcements or are not subject to Section 409A.

If you have questions concerning this Alert, please contact **Steven J. Glaser** at 212.554.7820 or [sglaser@mosessinger.com](mailto:sglaser@mosessinger.com).

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