Determining if Six-Month Delay Applies

Where deferred compensation is paid to a “specified employee” (generally one of the top 50 most highly-compensated employees of a publicly traded company) as a result of such employee’s separation from service, the plan must provide that the payment of the deferred compensation must be delayed for six months following the specified employee’s separation from service (or, if earlier, the specified employee’s death). The mandatory six-month delay, however, applies only to amounts that constitute deferred compensation under Section 409A. If the amount is excluded from Section 409A because the amount is a short-term deferral, constitutes a payment under a “separation pay plan,” or is otherwise excluded from Section 409A, the six-month delay requirement does not apply. The following flowcharts may assist in determining whether severance payments may be paid during the six-month period following termination. Chart 1 outlines the basic six-month delay rule and refers to the short-term deferral and separation pay plan exceptions. To determine whether a particular payment is exempt from Section 409A because it constitutes a short-term deferral or a payment under a separation pay plan, refer to Charts 2 and 3, respectively.
Chart 1 - Determining if Six-Month Delay Applies

Is the employee a specified employee?

Yes

Is any of the severance payable within the six-month period following termination?

No six-month delay.

Is any of the severance payable within the six-month period following termination of employment exempt as short-term deferral?* (See Chart 2)

Yes

No six-month delay.

No

Is all of the severance which is payable within the six-month period following termination of employment exempt as short-term deferral?* (See Chart 2)

Yes

No six-month delay.

No

Is any of the severance exempt as separation pay plan? (See Chart 3)

Yes

Six-month delay applies to any payments made after March 15** of the year following year of termination.***

No

Is any of the severance which is payable within the six-month period following termination of employment exempt as a short-term deferral?* (See Chart 2)

Yes

Six-month delay applies to any payments made after March 15** of the year following year of termination.

No

Disregard all severance covered by short-term deferral exception. Is all of the remaining severance which is payable during the six-month period following termination exempt under the separation pay plan exception?

Yes

No six-month delay.

No

Six-month delay applies to any payments made after March 15** of the year following year of termination that are NOT exempt as severance pay plan payment.***

* See Chart 2 entitled “Application of Short-Term Deferral Exception to Severance” for impact of installment payments treated as separate payments.

** Special rules apply to fiscal year employers.

*** An additional amount equal to the Section 402(g)(1) limitation for the year of termination ($16,500 in 2010) is also exempt from the six-month delay.
Chart 2 - Application of Short-Term Deferral Exception to Severance*

Does termination of employment constitute a separation from service?

- Yes
  - Does arrangement (or any other arrangement providing for severance to this employee) provide for severance upon non-compliant good reason or other "voluntary" termination in any circumstances (for example, after a change in control)?
    - Yes
      - Payment subject to 409A, including six-month delay if applicable unless another exception applies.
    - No
      - Severance not payable by reason of separation. Determine whether other permissible 409A payment triggers or exceptions may apply.

- No
  - Severance not payable by reason of separation. Determine whether other permissible 409A payment triggers or exceptions may apply.

Are all amounts payable by March 15 following year of separation?** (i.e., payments are completed by March 15)

- Yes
  - Exempt from 409A as a short-term deferral.
  - Payments made prior to March 15 following year of separation** are exempt from 409A under short-term deferral exception. Remaining payments subject to 409A, including six-month delay if applicable, unless another exception applies.

- No
  - Are any of the payments to be made prior to March 15?
    - Yes
      - Does the plan provide for installment payments AND specifically state that installments are treated as separate payments?
        - Yes
          - Not a short-term deferral; payment subject to 409A, including six-month delay if applicable, unless another exception applies.
        - No
          - Not a short-term deferral; subject to 409A, including six-month delay if applicable, unless another exception applies.
    - No
      - Are any of the payments to be made prior to March 15 following year of separation?**
        - Yes
          - Not a short-term deferral; subject to 409A, including six-month delay if applicable, unless another exception applies.
        - No
          - Not a short-term deferral; subject to 409A, including six-month delay if applicable, unless another exception applies.

Addresses cash severance only. Does not address payments which would also be made in circumstances other than employment termination, for example, on a future fixed date or on a change in control on a single trigger basis. Payment triggered by other events, even if coincident with separation from service, may be subject to a different analysis.

** Special rules apply to fiscal year employers.
Chart 3 - Application of Separation Pay Plan Exception to Severance*

Does termination of employment constitute a separation from service?

Yes

Does arrangement provide for severance upon termination for disability, termination for non-compliant good reason or other "voluntary" termination, or for any other reason other than involuntary termination or termination for compliant good reason?

Yes

Payment subject to 409A, including six-month delay if applicable, unless another exception applies.

No

Severance not payable by reason of separation. Determine whether other permissible 409A payment triggers or exceptions may apply.

No

Are all amounts payable by December 31 of second year following year of termination (e.g., if terminated in 2009 are all amounts paid by December 31, 2011)?

Yes

Is the total amount of severance more than Exempted Limit?**

Yes

Severance exempt from 409A as separation pay plan.

No

Severance payable by December 31 of second year following the year of termination is exempt from 409A under separation pay plan exception. Remaining payments subject to 409A (unless another exception applies) but six-month delay inapplicable.

No

Severance up to the Exempted Limit** is exempt from 409A as a separation pay plan; remainder is subject to 409A, including six-month delay if applicable, unless another exception (such as short-term deferral) applies.

No

Severance up to the Exempted Limit** which is payable by December 31 of second year following year of termination is exempt from 409A under separation pay plan exception. Remaining payments subject to 409A, including six-month delay if applicable, unless another exception applies.

No

Severance not payable by reason of separation. Determine whether other permissible 409A payment triggers or exceptions may apply.

No

Are all amounts payable by December 31 of second year following year of termination (e.g., if terminated in 2009 are all amounts paid by December 31, 2011)?

Yes

Is the total amount payable by December 31 of second year following year of termination (i.e., if terminated in 2009, paid by December 31, 2011) more than the Exempted Limit?**

Yes

Severance exempt from 409A as separation pay plan.

No

Severance payable by December 31 of second year following the year of termination is exempt from 409A under separation pay plan exception. Remaining payments subject to 409A (unless another exception applies) but six-month delay inapplicable.

Addresses cash severance only and does not address window programs or collectively bargained or foreign separation pay plans.

** Exempted Limit equals two times the lesser of:
- the employee's annualized compensation for year preceding year of termination (adjusted for increases during that year anticipated to continue).
- 401(a)(17) limit for year of termination ($245,000 in 2010).