

COLLEGE OF CHARLESTON
Frequently Asked Questions:
Deferred Compensation under IRS Code 409A

Deferred Compensation Election Information

Section 409A of the Internal Revenue Code (the "Code") established certain requirements for deferred compensation (*i.e.*, amounts earned in one year, but paid in a later year). Effective with the 2008 academic year, Section 409A of the Code applied to faculty members who work under a nine-month contract, but voluntarily elect to receive their compensation over a twelve-month period. The election to spread nine months of compensation over a twelve-month period is considered deferred compensation subject to Section 409A of the Code because the election results in compensation earned in one calendar year (*i.e.*, between August and December) to be paid in the following calendar year (*i.e.*, between May and August). This FAQ briefly describes the changes in the tax laws and the requirements that you must satisfy in order to make an election to receive your compensation earned during a nine-month academic year over a twelve-month period.

Please note that this FAQ is a brief summary of a change in the tax laws and how it impacts our payroll practices. This FAQ is not intended to provide you with tax advice. You should consult with your own advisor regarding any questions about the impact of electing to receive your compensation over twelve months.

What is Section 409A of the Code? Section 409A of the Internal Revenue Code (the "Code") imposes certain restrictions on an individual's ability to defer compensation. Specifically, Section 409A of the Code only allows an individual to defer the tax on compensation earned in one year, but paid in a later year, if the timing and the form of payment are fixed prior to the time the compensation is earned. Deferred compensation that does not meet the requirements of Section 409A of the Code is taxed when earned and is subject to an additional 20% excise tax and interest.

How am I deferring income if I elect to spread my compensation over a twelve-month period? Assume you are earning \$54,000 per academic year. If you are paid over nine months, you would earn \$6000 per month and would earn \$27,000 between August 16 and December 31 of 2008. You would earn \$27,000 between January 1 and May 15, 2009. If you elect to be paid over a twelve-month period, you would receive \$4,500 per month for 12 months. Accordingly, you would be paid \$20,250 during 2008 and \$33,750 in 2009. Essentially, you would have deferred \$6,750 earned in 2008 to 2009 (*i.e.*, \$27,000 - \$20,250).

If I elect to receive my compensation over a twelve-month period, what requirements do I need to satisfy in order to avoid immediate taxation on the amount deferred into the subsequent tax year (*i.e.*, \$6,750 in the example above)? Tax liability for any deferred

compensation can be deferred until such compensation is paid if you satisfy the following requirements:

1. You elect in writing to spread the payment of your compensation over a twelve-month period. Attached is an election form to be used for that purpose. (Please note that while a written election is expected, the default is a twelve-month payment schedule, as outlined on the form. If you do not file an election form, your nine-month faculty salary will be paid out on a 12-month schedule.)
2. You make this election prior to the first day of the academic year to which the election applies, *i.e.*, by no later than August 15, 2013 for the 2013-14 academic year.
3. Your election is irrevocable for the given academic year. In other words, once you elect to spread payment of your compensation over a twelve-month period, you cannot later request that you receive payment of your compensation for that contract period over a nine-month period.
4. Your election must state how your compensation will be paid (e.g., in equal semi-monthly installments or in accordance with payroll practice).

What is the College's default payment schedule for faculty members working under a nine-month contract? Effective August 16, 2013, the default payment schedule for College of Charleston employees on nine-month appointments will be a twelve-month schedule. If you would like to change your payment schedule, you must make a written election to do so, using our "Deferred Compensation Election Form" available online at hr.cofc.edu/forms under Payroll and Taxes.

I am an existing employee and do not want to change my current payment schedule; do I have to file an election form? Please read the following scenarios carefully.

- If you are currently on a twelve-month payment schedule, that will remain unchanged unless you complete an election form to select a different option.
- If you are currently on a nine-month payment schedule, that will remain unchanged only if you file an election form (or have previously filed a form with Human Resources) indicating that choice.
- In either case, you may change your payment schedule for the coming academic year by filing a new election form by the stated deadline.

How do I elect a different compensation option? Please complete a "Deferred Compensation Election Form." Your election must be made prior to the first day of the contract period for which the election is to be in effect, which means typically by August 15. Our "Deferred Compensation Election Form" can be found at hr.cofc.edu/forms under Payroll and Taxes.

What happens if I do not submit a Deferred Compensation Election form? Effective August 16, 2013, the College's default payment schedule for nine-month faculty appointments will be a twelve-month schedule, with payments made on the 15th and the last day of the month, with the first payment on August 31 and the last on August 15 of the subsequent year. You

will be on a twelve-month payment schedule unless: (a) you file an election form, prior to the first day of the contract period, generally August 16, electing a nine-month payout, or (b) you have an election form on file that has not been changed or revoked, indicating a nine-month payout choice.

Can I change my election during the academic year? No, your election for that academic year is irrevocable after the commencement of the academic year.

Will I need to complete an election form every year? Your election will remain in effect for all future academic years unless you submit an updated election form indicating a different election prior to the commencement of the ensuing academic year or unless 409A deferral requirements change.

Do I need to complete a new form if I elected to receive my compensation over twelve months in a previous year? No, your election will remain in effect for all future academic years. However, this election is irrevocable for an academic year once the academic year begins. So, if you want to change your election and receive your compensation over a 9-month period, or if you have previously received your compensation over a 9-month period and wish to receive your compensation for a given academic year over a 12-month period, you must submit a new election form indicating your new election prior to the commencement of the academic year.

What happens if I decide to retire or resign at the end of the academic year after electing to receive my academic compensation over twelve months? Any accrued but unpaid compensation will be paid in a lump sum upon termination of employment or retirement as soon as administratively possible. A lump sum of any accrued but unpaid compensation may also be paid upon death, disability and in the occurrence of an unforeseen emergency.

How will this impact my taxes? Please consult with your own advisor regarding any questions about the impact of electing to receive your compensation over twelve months.