



NORTH CAROLINA COMMUNITY COLLEGE SYSTEM
R. Scott Ralls, President

June 20, 2008

IMPORTANT!

MEMORANDUM

TO: Chief Business Officers
Personnel Officers

FROM: Tracy Williams Pender, Systems Accountant
Kim Van Metre, Systems Accounting and Special Projects Manager

SUBJECT: IRS § 409A and Deferred Compensation Policy

IRS § 409A applies to compensation that workers earn in one year but that is not paid until a future year, deemed nonqualified deferred compensation by the IRS. College employees who opt to spread their nine-month compensation up to twelve months are constructively receiving nonqualified deferred compensation. Colleges are not required to offer employees any election regarding pay arrangements, and IRS § 409A does not apply where such elections are not offered. However, colleges who do offer the election to spread nine-month compensation up to twelve months must require the employee to specifically make that election, beginning for school year 2008-09, prior to the beginning of the work period. The work period is defined as the first day of the school year for which the employee is paid (i.e., not necessarily the first day that students arrive or the first day of class).

For example, assume a teacher earns \$36,000 per year. If the teacher were paid over 10 months, the teacher would receive \$18,608.70 in 2008 for the 15 days worked in August through the end of December, and would receive \$17,391.30 in 2009 for January through the school year's completion in early May. If, instead, the teacher were paid over 12 months, the teacher would receive \$13,956.52 in 2008 for August through December and \$22,043.48 in 2009 for January through July. The IRS concludes that the difference between what is received in 2008 under the nine-month term versus the amount received in 2008 over a twelve-month term is salary earned in 2008 but paid in 2009, resulting in \$4,652.18 of 2008 nonqualified deferred compensation subject to IRS § 409A rules. Without the properly documented election by the teacher, colleges would be required to report the nonqualified deferred compensation amount on the teacher's W-2 in the year earned rather than the year paid, and the employee would be subject to additional taxes, including a 20 percent additional income tax.

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There is no prescribed form for making this election and nothing must be filed with the IRS regarding these elections. The election cannot be changed after the work period begins. If an employee fails to submit a timely election, the employee must be paid in the same way as other employees who do not make the election. An employee is not required to make this election every year where the pre-existing authorization specifies that the election shall remain in place until the employee designates a change.

If the employee wants to change the election, the change must be made prior to the beginning of the work period to which the change applies, and can only apply to a future school year. Changes in these pay arrangements cannot be made in the middle of the school year.

Colleges who offer the election to spread nine-month compensation up to twelve months should update any existing payroll and/or human resources forms in an appropriate location, or create a new authorization form, to allow employees to properly authorize the election, using verbiage similar to the following:

I, *(employee name)*, elect to spread my contracted total salary over *(number of)* months beginning on the first day of the work period *(date – mm/dd/yyyy)*. I understand that a pro-rata portion of my salary earned in this calendar year will be deferred until next calendar year. This election shall remain in place until such time that I notify the college of my intent to change this pay arrangement. I understand that this election is irrevocable for the current work period and can only be changed prior to the beginning of the future work period for which I submit a new election. I understand that if I want to receive my contracted total salary over *(number of)* months, but do not submit such an election, or submit an election after the deadline, my contracted total salary will be paid in the same manner as other employees who do not make an election.

The form on which the election is made should be signed and dated by the employee. For more information, please see <http://www.irs.gov/newsroom/article/0,,id=172884,00.html>, noting the “Frequently Asked Questions” link at the bottom of the news article. Questions can be directed to Tracy Williams Pender via email pendert@nccommunitycolleges.edu or phone (919) 807-7230, or Kim Van Metre via email vanmetrek@nccommunitycolleges.edu or phone (919) 807-7071.

/kvm

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