

Separation Pay Exclusions

The Proposed Regulations provide that certain types of separation pay arrangements will not constitute deferred compensation and, as such, will not be subject to the rules of 409A. Among the arrangements that are excluded are the following:

1. **Separation Pay.** Separation pay due to an involuntary separation from service or participation in a "window program" so long as:
 - (A) the payments do not exceed 2x the lesser of (a) the individual's annual compensation (as defined in Code Section 415) for the calendar year preceding the calendar year of separation from service, or (b) the maximum amount that may be taken into account under Code Section 401(a)(17) for the year (e.g., for 2005, the 401(a)(17) limit is \$210,000); and
 - (B) the payments are completed no later than the end of the second calendar year following the calendar year of separation from service.

Thus, if a separation occurs in 2005 and the individual's compensation for 2004 was \$250,000, severance payments would be limited to \$420,000 and would have to be paid out by December 31, 2007.

A "window program" is defined as a program, for a period lasting no longer than one year, to provide separation pay to individuals who separate from service (even if voluntarily) during that period or who separate from service during that period under specified circumstances.

Separation pay for involuntary terminations should not be included in an agreement that provides separation pay for other reasons, such as termination of employment for "good reason," since government officials have indicated that inclusion of such other reasons in the same agreement may disqualify the involuntary termination part of the arrangement from the deferred compensation exclusion.

2. **Reimbursements.** The following reimbursements may be made upon either voluntary or involuntary separation from service:
 - reimbursements of certain expenses that are otherwise excludible from gross income;
 - reimbursements for expenses that could be deductible as business expenses by the individual;
 - reimbursements for reasonable outplacement services and moving expenses directly related to the separation from service.

There is no dollar limit on these reimbursements.

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- reimbursements of medical expenses.*

3. **In-Kind Benefits**. Provision of in-kind benefits or payment to a person to provide the benefits, if reimbursement for the individual's payment of the benefits would be covered by the permissible reimbursements described in paragraph 2 above. For example, coverage under a medical plan or direct provision of outplacement services would be excluded in the same way as reimbursement to the employee for payment for that coverage or those services.

Reimbursements under paragraphs 2 and 3 above must be for expenses incurred and paid no later than the end of the second calendar year following the calendar year in which the individual separated from service.

Certain de minimis reimbursements of up to \$5,000 in total also do not constitute deferred compensation within Section 409A and the Regulations.

* Section 1.409A-1(a)(5) states that 409A does not apply to any medical reimbursement arrangement, including a health reimbursement arrangement, that satisfies the requirements of Code Sections 105 and 106. If all of the requirements of these Sections are met, including any applicable nondiscrimination requirements, then it is unnecessary to rely on the medical expense reimbursement exception described above in paragraph 2, with its time limits. On the other hand, if the discrimination or other requirements of Sections 105 and 106 cannot be met (making certain amounts potentially subject to taxation), then it appears you can rely on the medical expense reimbursement exception described above.

If you have any questions regarding the foregoing, or for assistance in complying with 409A and the Regulations, please feel free to contact one of the attorneys listed below.

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