Executive Compensation
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IRS Gives the Green Light to Contributions of the Value of Unused Leave Time to Retirement Plans

by Keith R. Kost

Revenue Rulings 2009-31 and 2009-32 (the "Rulings") describe ways that employers may permit or require the contribution of the value of unused leave time to tax qualified defined contribution retirement plans.

Although they do not alter existing law, the Rulings provide six examples dealing with retirement plan contributions funded with the value of unused leave time. Revenue Ruling 2009-31 deals with contributions for active employees and Revenue Ruling 2009-32 covers contributions for terminated employees. Each of the Rulings provide examples of arrangements which either require plan contributions or give the participant an election to receive some or all of the value of their leave balance in cash. In each of the scenarios, the Rulings confirm that implementation of the described strategies will not result in violation of the retirement plan rules and will not cause the leave to be treated as deferred compensation for purposes of Code Section 409A.

The Rulings remind employers that all such contributions remain subject to all of the other rules applicable to other retirement plan contributions of like character. These include the limitations on annual additions under Code Section 415(c), the limitation on employer deductions under Code Section 404(a)(3) and the limitation on elective deferrals under Code Section 402(g).

Furthermore, the Rulings highlight the fact that the normal nondiscrimination testing rules apply to such contributions. This means that a plan that provides for mandatory plan contributions of unused leave balances will be required to satisfy the general nondiscrimination test under Code Section 401(a)(4). Plans that permit participants to elect to receive some or all of the value of their unused leave in cash will be required to include any elective plan contributions in the actual deferral percentage test or qualify for a safe harbor exemption.

Before deciding to adopt a leave contribution strategy, interested employers will need to assess the likely impact of such a change on future nondiscrimination testing. Employers will also need to ensure that the desired approach is consistent with the Rulings, applicable regulations and any state laws applicable to leave programs. After a decision has been made, employers may need to amend their plans to implement the change and ensure that it is appropriately communicated to participants.

Even those employers with no interest in adopting a leave time contribution strategy should nevertheless take this opportunity to review the compensation definitions used by their retirement plans to ensure that they are consistent with current law. For example, permitting elective deferrals from severance amounts paid after the termination of employment is no longer permitted under current regulations. Employers should also periodically verify that their payroll systems are correctly capturing the amounts required by each of the compensation definitions included in their retirement plans. In addition, employers should take this opportunity to confirm that their leave policies are compliant with applicable state law.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work or any of the members of the Executive Compensation & Benefits group.

New York

Susan P. Serota (bio)
+1.212.858.1125
susan.serota@pillsburylaw.com

Peter J. Hunt (bio)
+1.212.858.1139
peter.hunt@pillsburylaw.com

Scott E. Landau (bio)
+1.212.858.1598
scott.landau@pillsburylaw.com

John J. Battaglia (bio)
+1.212.858.1738
john.battaglia@pillsburylaw.com

Mark C. Jones (bio)
+1.212.858.1430
mark.jones@pillsburylaw.com

Kathleen D. Bardunias (bio)
+1.212.858.1905
kathleen.bardunias@pillsburylaw.com

Bradley A. Benedict (bio)
+1.212.858.1523
bradley.benedict@pillsburylaw.com

Washington, DC / Northern Virginia

Howard L. Clemons (bio)
+1.703.770.7997
howard.clemons@pillsburylaw.com

Keith R. Kost (bio)
+1.703.770.7799
keith.kost@pillsburylaw.com

San Diego—North County

Jan H. Webster (bio)
+1.858.509.4012
jan.webster@pillsburylaw.com

Daniel N. Riesenberg (bio)
+1.858.847.4130
daniel.riesenberg@pillsburylaw.com

Kenneth E. Bonus (bio)
+1.858.847.4206
kenneth.bonus@pillsburylaw.com

Lori Partrick (bio)
+1.858.509.4087
lori.partrick@pillsburylaw.com

San Francisco

Christine L. Richardson (bio)
+1.415.983.1826
crichardson@pillsburylaw.com

Silicon Valley

Cindy V. Schlaefer (bio)
+1.650.233.4023
cindy.schlaefer@pillsburylaw.com

Grace Chen (bio)
+1.650.233.4873
grace.chen@pillsburylaw.com