 Deferred Compensation under Semesters
 Frequently Asked Questions
 August 2017

What’s the background of this issue?
   The Internal Revenue Code’s Section 409A, part of the American Jobs Creation Act of 2004, resulted in regulations that affected the University due to semester conversion. IRC Section 457 also covers deferred compensation rules.
   These regulations prohibit an employee from deferring from one tax year to the next any compensation in excess of a “safe‐harbor” amount (currently $18,000). In other words, compensation earned in one calendar year should generally be paid in that calendar year (so that it can be taxed in that year), and if it is not, the amount deferred must be less than the safe harbor amount; otherwise, a tax penalty will be levied on the deferred amount that exceeds the safe harbor.

Who will be affected by the plan to address IRS requirements?
   Only faculty with 2‐semester (“9‐month”) appointments are affected.
   Of those, only faculty earning base pay (coded 0FAC‐Faculty Salary) and administrative stipends (0ADM‐Salary 2) totaling more than $108,000 per academic year are currently affected. That threshold is determined through a calculation of the safe harbor, which the IRS periodically adjusts.
   Employees on 12‐month appointments will not be affected.

What is the University’s plan for addressing the IRS requirements?
   For the affected faculty, the University will increase that person’s monthly pay for the paychecks from September through December and will decrease the monthly pay for the eight paychecks from January through August. The total of all monthly paychecks will equal the faculty member’s annual salary and administrative stipend (if any).
   The four fall‐semester paychecks will not be increased sufficiently to equal all compensation
accrued in fall, but they will come close enough to ensure that the deferred compensation does not exceed the safe-harbor amount.

**What would happen if UC just ignored the issue and continued to pay in 12 equal monthly installments?**
- The affected faculty would be subject to a 20% penalty on that portion of the deferred compensation that exceeds the safe-harbor amount.

**Will those affected be notified and will they have to do anything?**
- Individual faculty who are affected by a pay adjustment whereby their base pay (coded 0FAC-Faculty Salary) and administrative stipends (0ADM-Salary 2) totals more than $108,000 per academic year should use the “409A Calculator” that will enable them to calculate the distribution of their annual pay over the academic year.
- They will not have to do anything. Payroll will automatically adjust the pay distribution for those who are affected.

**May faculty opt out of this process if they wish to take their chances with the IRS?**
- No

**What about those faculty not affected?**
- They will continue to receive 12 equal installments of their annual pay across the year.
- If a faculty member receives a salary increase or stipend that would result in a deferral that exceeds the safe-harbor amount, he/she should use the “409A Calculator” that will enable them to calculate the distribution of their annual pay over the academic year.

**May an affected faculty member avoid the uneven pay distribution by increasing tax withholding in fall to match the amount of that year’s accrued income?**
- No, the regulations apply to the deferral of compensation, not to the deferral of taxes.

**Why is this an issue?**
- On semesters, a faculty member with a 9-month appointment will earn one-half of his/her salary in the fall semester but will receive only one-third of his/her annual pay installments in fall, resulting in a deferral of about 17% of his/her annual compensation from one tax year to the next. If that 17% exceeds the safe-harbor amount, the employee will incur a penalty.

**What types of compensation will be affected?**
Of the 17 wage types that faculty may earn, only two will be affected: (0FAC)-Faculty Salary and (0ADM)-Salary 2; so only when those two types of pay exceed $108,000 will this process come into play.

Extra compensation from grants (EXC) and from non-grant sources (EXN, ADL) will not be affected because they will generally not be deferred.

**Will this adjustment affect benefits or STRS service credit?**

- No, the adjustment will not affect the monthly credits or deductions for benefits.
- No, the adjustment will not affect STRS service credit, but variations in monthly pay will cause STRS monthly contributions to vary; total STRS annual contributions will not change.

**Why didn’t I have to deal with this at my previous university?**

- Several circumstances may account for different experiences at other universities:
  - The regulations were not enforceable at UC until fall 2009.
  - Because the IRS has been saying for several years that it will issue new regulations addressing deferred compensation issues raised by 409A and 457 in the very near future, some universities may have decided to wait for final regulations before implementing changes.
  - IRS guidance related to the currently existing regulations is complicated, confusing and, at times, contradictory.

Note that UC sought guidance on the matter from outside counsel specializing in compensation tax law. We are following his advice because this approach best protects faculty from the possibility of facing a substantial tax penalty.