Deferral timing requirements for rehired employees

Internal Revenue Code Section 409A has very specific timing rules for when a participant can defer their earned income into a nonqualified deferred compensation plan. Generally, a deferral election must be made in the calendar year prior to the year in which the compensation is earned.[1] One of the exceptions to this rule states that newly eligible participants may defer 30 days after being made eligible by their employer.[2]

Eligibility for rehired participants

Some participants may be newly eligible if they have been previously employed by the employer and are subsequently rehired. Regulations state that a person who has been rehired will be treated as newly eligible if the person has been completely paid out of the plan and is currently not eligible to participate.[3] If the participant has not been completely paid out, the participant will be considered newly eligible only after not having participated in the plan (except for earnings credits) for 24 months.[3]

Example One: A participant in a nonqualified deferred comp plan separates from service on July 1, 2022. The participant's balance was timely distributed in a lump sum in August 2022. The participant has a zero balance in the plan. The participant is rehired on March 1, 2023. The participant is eligible for a 30-day window as a newly eligible participant because the balance has been completely paid out.

Example Two: Assume the same as in Example 1, except that upon separation, the plan provides for the account to be distributed as five annual installments. When the participant is rehired on March 1, 2023, there is still a balance in the plan; consequently, the participant will not have a 30-day window in 2023. Instead, the participant will have to wait until 2024 to defer any income because at the time of rehire, the participant's balance has not been completely paid out, and the participant had participated in the plan (beyond earnings) within the past 24 months.

Example Three: A participant in a nonqualified plan separated from service on July 1, 2022, ending active eligibility. The account balance is to be distributed over five annual installments. The participant is rehired in March 2025, with a balance under the plan. The participant will be given a 30-day window because the participant has not been eligible to participate in the plan for more than 24 months.

The dates used in the example are for illustrative purposes only.

[1] IRC Sec. 409A(a)(B)(i): Treas. Reg. §1.409A-2(a)(3).
[2] IRC Sec. 409A(a)(4)(B)(ii); Treas. Reg. §1.409A-2(a)(7)(i).
[3] Treas. Reg. §1.409A-2(a)(7)(ii).

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