

6th Circuit Case Emphasizes Potential Employer Liability to Participants for 409A Violations

Although employees face additional taxes and decreased benefits resulting from employer failures involving nonqualified deferred compensation (NQDC) plans, they may sue employers to recover their losses. For ERISA-covered NQDC plans, such claims may be brought under ERISA; whereas claims for non-ERISA NQDC plans may be brought under state contract law.

A recent 6th Circuit case – *Wilson v. Safelite Group, Inc.* (July 10, 2019) – helps taxpayers distinguish between ERISA and non-ERISA NQDC plans, while serving as a reminder of the potential employer liability to plan participants for violations of Section 409A of the Code.

In *Wilson*, the Safelite NQDC plan permits the deferral of several types of employee compensation: base salaries, annual and long-term incentives, and transaction bonuses. The former CEO incurred substantial penalties on his \$9.1 million NQDC plan account due to deferral election failures under Section 409A that were identified in a 2014 federal audit. Wilson sued the employer in federal court, asserting state law claims for breach of contract and negligent representation. The district court (as affirmed by the 6th Circuit) found the NQDC plan to be an “employee pension benefit plan” covered under ERISA, which preempts the state law claims, and granted the employer relief by summary judgment.

Although the NQDC plan allowed in-service distributions, it qualifies as an ERISA employee pension benefit plan because it also provides options to pay deferred compensation after termination of employment. The Safelite Plan did not fall under the bonus plan exemption from ERISA coverage because it was designed to defer non-bonus income as well.

Although in this case the employer defeated action, a different outcome may occur for differently-designed NQDC plans. Therefore, employers sponsoring NQDC plans should review all areas of plan administration (e.g., deferral elections, distributions and FICA withholding) for compliance with the Section 409A rules and to optimize tax savings and plan benefits for the participants.