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TAX UPDATE – January 2010

To Our Clients, Business Partners and Friends...

By a show of hands, who thinks that income tax rates will go up in 2011?!? Now that you are all sitting at your desks with hands in the air – our work here is done! Actually, even if Congress does nothing in 2010 – which is the one thing they are really good at – then income tax rates will increase in 2011 as a result of the expiration of the so-called Bush tax cuts from 2001. And that doesn't even take into account what may happen with State income tax rates...

Other Tax Proposals in Congress

Of course, Congress may not wait until 2011 to increase tax rates given the health care and other proposals flying about the Beltway – but it is pretty safe to assume that an increase in 2011 is the “best” we can hope for at this point. So why should you be thinking about the effective income tax rate 12 or more months from now? Well, if you participate in a deferred compensation plan – or if your company is considering the adoption of such a plan – here is the major issue:

2010 Bonus Compensation

Under IRC Section 409A regulations that govern nonqualified deferred compensation plans, any election to defer bonus compensation must be made no later than 6 months into the 12-month earnings period – even if it would be paid months after the end of the earnings period.

In plain English, this means that under a calendar-year bonus plan, you must elect to defer from any bonus you will earn in 2010 (which would usually be payable in early 2011) on or before June 30 of 2010. Further, any 2010 bonus that is paid in 2011 will be subject to the new higher rates of income tax in effect at the time of payment.

The Bottom Line...

You may already be earning bonus compensation that will be subjected to higher Federal (and State?) income tax rates in 2011. And if you don't want to pay those rates, you need to make elections to defer the funds into a nonqualified plan prior to June 30 of this year!

If your company is thinking about putting a new plan in place before the deadline – that process should be starting now, since it takes a few months to complete the plan design, documentation, enrollment, and implementation process. By the way, this is the plan design / process that we help our clients with 90% of the time. If we aren't already working with your company – we'd really like the opportunity to talk with you.

Thank you for the chance to be of service. Please let us know if we can provide you with any additional information related to these or other management compensation / benefit issues.