

# Executive Compensation and Benefits Alert

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If you have any questions regarding the matters discussed in this memorandum, please contact any of the attorneys listed below, or call your regular Skadden contact.

**Boston**

Timothy F. Nelson  
617.573.4817  
timothy.nelson@skadden.com

**Los Angeles**

Barbara Mirza  
213.687.5614  
barbara.mirza@skadden.com

**New York**

Neil M. Leff  
212.735.3269  
neil.leff@skadden.com

Regina Olshan  
212.735.3963  
regina.olshan@skadden.com

Erica Schohn  
212.735.2823  
erica.schohn@skadden.com

Berit R. Freeman  
212.735.2112  
berit.freeman@skadden.com

David C. Olstein  
212.735.2627  
david.olstein@skadden.com

**Palo Alto**

Joseph M. Yaffe  
650.470.4650  
joseph.yaffe@skadden.com

Kristin M. Davis  
650.470.4568  
kristin.davis@skadden.com

Alessandra K. Murata  
650.470.3194  
alessandra.murata@skadden.com

**Washington, D.C.**

Michael R. Bergmann  
202.371.7133  
michael.bergmann@skadden.com

**WWW.SKADDEN.COM**

Four Times Square  
New York, NY 10036

## California Reduces Its 409A Income Tax

In a rare piece of good news relating to Section 409A of the Internal Revenue Code, on October 4, 2013, California reduced its additional state tax on income failing to comply with Section 409A from 20 percent to 5 percent. This reduction is effective for taxable years beginning January 1, 2013 and later.

Section 409A was added to the Internal Revenue Code by the American Jobs Creation Act of 2004, and was intended to regulate deferred compensation — that is, compensation in which the right to payment arises in one year but the amounts are to be paid in a future year. Section 409A can apply to compensation arrangements as diverse as employment agreements, severance arrangements and equity awards, as well as to traditional deferred compensation plans. Violation of the provisions of Section 409A generally causes the amounts in question to be subject to accelerated income taxation and an additional 20 percent federal income tax under Section 409A.

California's Revenue and Taxation Code incorporates a parallel income tax of 20 percent, thereby increasing the total additional income tax imposed on California taxpayers for violating Section 409A to 40 percent, double the rate applicable to taxpayers in other states. This newly announced rate change reduces the 409A income tax applicable to California taxpayers to a level much closer to that applicable to non-California taxpayers.

We encourage any companies that have experienced Section 409A violations giving rise to Section 409A income taxes in 2013 and later years to revisit their calculations to reflect the revised rates. We are available to discuss any questions you may have relating to this new development and to any general Section 409A compliance of your compensation arrangements.