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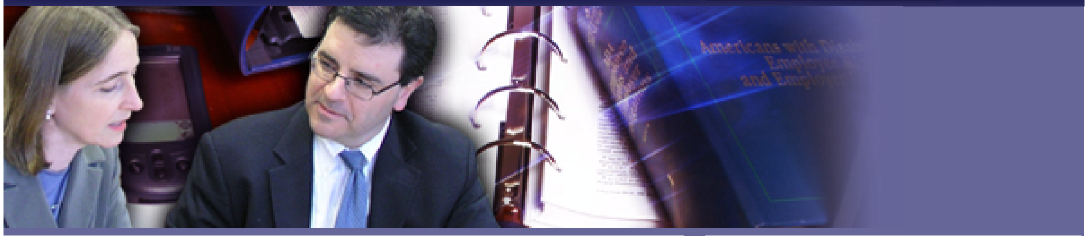

Labor & Employment Legal Update

SEPTEMBER 12, 2008

Guidance Issued by the IRS Regarding Recurring Part-Year Compensation for School Employees

Recently, the Internal Revenue Service ("IRS") announced in Notice 2008-62 ("Notice") its intent to permit the deferral of recurring part-year compensation from proposed regulations that will be issued in the future. One type of recurring part-year compensation that the regulations are expected to address is arrangements involving school employees who typically work 9 or 10 months but choose to be paid ratably over 12 months. Such recurring part-year compensation will now be permitted as long as certain conditions are satisfied.

The Notice states that the IRS expects that the regulations to be proposed will state that compensation will not be considered deferred compensation if two conditions are satisfied. First, the recurring part-year compensation plan may not permit deferral of payment past the last day of the 13th month following the beginning of the service period. Second, the recurring part-year compensation plan may not permit deferral from one tax year to the next of more than a specific amount, which is currently $15,500, from one taxable year to the next.

School teachers are prime examples of employees with recurring part-year compensation arrangements. For instance, a teacher's recurring part-year compensation typically consists of the compensation the teacher earned during a service period of 9 to 10 months, which begins in one calendar year and ends in the following calendar year. Schools may pay all of their teachers, or teachers may decide on an individual basis to be paid, on a 12-month payment schedule. If a 12-month payment schedule is adopted, some of the compensation the teacher earns for working during one calendar year will be paid in the following calendar year either at or after the end of the school year. Based on the expected regulations to be proposed, none of the compensation the teacher receives would constitute deferred compensation as long as the amount the teacher earns during the first calendar year that is paid in the second calendar year does not exceed the specific amount, which is $15,500 for 2008.

For example, suppose a school teacher works from August 1, 2008 until May 31, 2009 (a period of 10 months) and is paid on a 12-month payment schedule, beginning on August 1, 2008. The teacher's recurring part-year compensation arrangement would not provide for a deferral of compensation unless the teacher earns more than $186,000 for the school year. Given that five months of the school year are in 2008 and five months are in 2009, a teacher whose salary is $186,000 earns $93,000 in 2008 and $93,000 in 2009. However, under a 12-month payment schedule, the teacher would receive $77,500 in 2008 and $108,500 in 2009. Because the amount the teacher earns in 2008 ($93,000) that is paid in 2008 ($77,500) does not exceed the specified dollar amount for 2008, ($93,000 - $77,500 = $15,500), the arrangement would not provide for deferred compensation.

Effective Date of Proposed Changes

Until further guidance is given, the IRS states that taxpayers may immediately rely on the guidance issued in the Notice, beginning with the first taxable year that includes July 1, 2008.

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