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## ALERT – TRAPS FOR THE UNWARY IN DRAFTING ADEA RELEASES

Labor and employment attorneys should be aware of a “tax trap” that exists in drafting standard Age Discrimination in Employment releases of claims. This trap for the unwary arises under Section 409A of the Internal Revenue Code. ***If an ADEA release is not drafted properly – complying with the technical rules of Section 409A – then the employee will be hit with a 20% excise tax***, in addition to his ordinary income tax, on severance pay received upon delivery of the release.

- **What’s the Problem?**

The IRS considers severance pay to be “deferred compensation” if the timing of the payment can be controlled by the recipient. This possibility – that the recipient could defer severance pay into a subsequent tax year – is the problem that the IRS perceives in standard ADEA releases.

- **What Terms of the Release Create the Problem?**

An ADEA release typically provides that the severance pay will be paid in a lump sum as soon as the release has become final – ie., after the revocation period required by law. The release does not set a “fixed” date by which the release must be signed and delivered. The possibility to defer the payment into the following tax year is evident if the employment termination happens, say, in December.

- **What’s the Fix?**

It’s fairly simple but can be tricky: the release must state a fixed date for the payment.

An ADEA release form may appear in an employee’s employment agreement. Its terms may not comply with the IRS position, putting the employee at risk of incurring the 20% penalty on his severance pay. The IRS recently announced that, if an agreed form for a release agreement is amended before employment termination, this Section 409A violation is fixed. The employee will not incur the penalty.

- **Contact Us**

When drafting standard ADEA releases, protect yourself by having the agreement reviewed by a tax attorney with specialized expertise in Section 409A.

*Linda A. Wilkins is a tax attorney specializing in employee benefits and executive compensation.*