

ALSTON + BIRD LLP

**EMPLOYEE BENEFITS &
EXECUTIVE COMPENSATION ADVISORY**

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Deadline for Code Section 409A Compliance – December 31, 2008

Background

By December 31, 2008, all plans and arrangements subject to Code Section 409A must be in writing *and* the written terms of those arrangements must comply with Code Section 409A.

Based on our experience, we believe many plans and arrangements subject to Code Section 409A will require amendments. In many cases, the amendments are extensive and require discussion. In addition, it will be very difficult to amend an arrangement subject to Code Section 409A after 2008. The process of identifying and obtaining all plans and arrangements potentially subject to Code Section 409A, and then evaluating the proper amendment, can take time. Finally, employers must also leave sufficient lead time to seek board, compensation committee and/or individual approvals, where applicable, and to communicate changes to affected employees.

In short, action to identify and amend plans and arrangements potentially subject to Code Section 409A should start very, very soon (if you have not already started the 409A review process).

What Must Be Done in 2008?

1. Identify all arrangements potentially subject to Code Section 409A.

Code Section 409A defines “deferred compensation” very broadly. Basically, a deferral of compensation exists if a participant has a legally binding right in one year to receive a payment of compensation that will or could be made in a later year. This broad definition encompasses arrangements that would not normally be considered deferred compensation plans, such as offer letters, severance benefits, reimbursement policies, certain stock rights, noncompete agreements and bonus plans. Companies should perform a comprehensive review to ensure that all arrangements potentially subject to Code Section 409A are identified and brought into compliance.

2. Prepare amendments to make arrangements compliant with Code Section 409A or exempt from its requirements.

Companies must adopt the amendments necessary to comply with Code Section 409A by December 31, 2008. If plans are not amended in a timely fashion, executives and employees may suffer significant adverse tax consequences. Keep in mind that plans and arrangements

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subject to Code Section 409A must be in writing; some of your current plans and arrangements may not be in writing or may be in the form of an informal policy.

The IRS has granted some flexibility in amending plans this year, but the flexibility ends on December 31, 2008. After that date, it may be very difficult to amend a plan or other deferred compensation arrangement. Thus, careful thought and consideration need to part of the amendment process.

3. Consider changes to time and form of payment for amounts to be paid in 2009.

Elections or plan amendments that alter the time or form of payments of amounts otherwise payable in 2009 or later must be made by December 31, 2008. Likewise, elections or amendments that would accelerate into 2009 the time and form of payments of amounts otherwise payable in 2010 or later must be made by December 31, 2008. After this deadline, changes to time and form of payments are permitted in only very limited circumstances.

4. Develop administrative procedures to comply with Code Section 409A.

Companies should craft procedures for the administration of nonqualified deferred compensation plans in compliance with Code Section 409A and the final regulations. The following are a few significant examples of Code Section 409A issues that such administrative procedures should address:

- **Initial Deferral Elections:** In general, Code Section 409A requires that elections regarding the time and form of payment of deferred compensation be made before the beginning of the taxable year in which the individual renders the services that give rise to the deferred compensation, and that these elections be irrevocable. Companies should have procedures that prescribe the timing and revocability of such elections to comply with this general rule.
- **Distributions:** To satisfy the permissible payment requirements of Code Section 409A, distributions from nonqualified deferred compensation plans may not be distributed *except* upon (i) separation from service, (ii) disability, (iii) death, (iv) a specific time or pursuant to a fixed schedule, (v) certain change in control events, or (vi) unforeseeable emergency. Plans subject to Code Section 409A should not provide for distributions upon events not included in this list.
- **Specified Employees:** For certain specified employees (generally this means officers of public companies), Code Section 409A provides that payment of deferred compensation due to separation from service may not occur until six months *after* the date of separation from service (or, if earlier, the death of the specified employee). Companies should have procedures in place to (a) annually identify specified employees and (b) ensure that distributions to specified employees comply with the six-month delay restriction.

5. Review good faith compliance with Code Section 409A.

Plans have been required to operate in good faith compliance with Code Section 409A since January 1, 2005. The relevant IRS guidance for determining good faith compliance through December 31, 2008, includes the final regulations and Notice 2005-1. Taxpayers may not rely on the proposed regulations—reliance on the *proposed* regulations is *not* considered good faith compliance in 2008. Employers and plan sponsors that previously amended their deferred compensation arrangements to comply with the proposed regulations should review these arrangements to ensure that the plans are compliant with the *final* regulations.

Will There Be Any Relief if There Are Mistakes in Complying with Code Section 409A?

The IRS and Treasury have announced a voluntary correction program for Code Section 409A violations. However, the relief applies only in very limited circumstances. For example, correction is allowed only if the error and correction occur during the same calendar year. This underscores the importance of ensuring plans are compliant with the final regulations by the end of the year.

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