

Section 409A Deadlines Extended

The IRS has extended until December 31, 2008 the deadline for amending nonqualified deferred compensation arrangements to comply with Section 409A of the Internal Revenue Code. The broad relief of Notice 2007-86 significantly expands and largely replaces the partial extension announced in September, which was widely criticized as providing insufficient relief in light of the complexity of the final regulations under Section 409A.

Section 409A affects a broad range of plans, agreements and other arrangements, such as traditional “nonqualified” deferred compensation programs, supplemental retirement plans, stock units and other equity based awards, severance plans, bonus programs, and employment agreements, among others. A failure to comply with Section 409A, which has been in effect since the beginning of 2005, can lead to acceleration of taxable income and a 20% (or in some cases higher) additional tax.

The relief provided by Notice 2007-86 extends for another year, through calendar 2008, most of the important transition periods as well as the deadlines for adopting plan amendments to bring plans into compliance with the final Section 409A regulations. In the interim, programs subject to Section 409A must still be operated in reasonable, good faith compliance with the statute and applicable guidance, including but not limited to the final regulations. (After December 31, 2007, the earlier *proposed* regulations can no longer be relied upon as the basis for reasonable, good-faith compliance.) Among the highlights of Notice 2007-86:

- *No formal amendments required until December 31, 2008.* Unlike the partial extension announced by the IRS in September, which continued to require written action in 2007, Notice 2007-86 gives employers and employees until December 31, 2008 to adopt written plans that comply formally with the requirements of the final regulations.
- *Practice Tip:* Amending some programs may require board or even stockholder action, necessitating attention well before year-end 2008.
- *Changes in existing payment terms still possible in 2008.* Earlier transition rules, which were set to expire on December 31, 2007, had allowed employers and employees to “reset” payment terms without regard to Section 409A restrictions provided that the affected payments were not deferred from, or accelerated into, the year of the change. Notice 2007-86 extends this ability to reset payment terms by one year, through December 31, 2008. Consistent with the earlier transition rules, a reset occurring in 2008 cannot accelerate payment into 2008 or defer to a later year a payment that would otherwise have been made in 2008.
- *Other transition relief also extended.* Notice 2007-86 also extends other critical transition-period rules contained in earlier guidance:
 - *Linkage with qualified plans.* Before Section 409A, supplemental retirement programs were often designed to link benefit payments to elections made under the related tax-qualified plan. Although this linkage would no longer be permissible under Section 409A, transition rules allowed it to continue for a limited period for many existing plans. For those plans, linkage to payout elections under the related tax-qualified plan may now continue through calendar 2008.
 - *Correction of in-the-money stock option grants.* Employers with outstanding stock options issued with a strike price of less than fair market value will now have another year (until December 31, 2008) to take corrective action with respect to unexercised options. The relief does not extend to certain key officers of public companies, for whom the correction period expired in 2006.

- *Correction of “good reason” definitions.* Employers and employees wishing to bring “good reason” quit provisions within a safe harbor definition provided by the final regulations, or otherwise to tighten up those provisions, now have until December 31, 2008 to do so.
 - *Practice Tip:* The IRS still takes the position that to be eligible for correction, the current “good reason” definition cannot have been drafted so broadly that the employee’s right to payment is effectively vested.
- *No additional relief for funding arrangements.* Notice 2007-86 does not change the Section 409A rules applicable to impermissible funding arrangements, including off-shore trusts and economic-distress funding triggers. However, existing relief already permits taxpayers to rely upon a reasonable, good-faith interpretation of the statutory rules (there are as yet no regulations) until further guidance is issued.

The IRS this week also issued guidance (Notice 2007-89) on Section 409A-related reporting and withholding requirements for 2007. The guidance generally extends for one year rules that the IRS first provided in late 2006.

Contact Information

For more information concerning these developments, please contact a member of the Tax & Benefits Department.

