

Countdown to Compliance Extension of Section 409A

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In April of 2007, the IRS released the long-awaited final Section 409A regulations for nonqualified deferred compensation plans. The issuance of the final regulations marked the beginning of the end of the transition period and the uncertainty that began over three years ago when Section 409A was enacted as part of the American Jobs Creation Act of 2004.

On October 22, 2007 the IRS extended compliance relief from Section 409A with the publication of Notice 2007-86. This notice extended the transitional relief that was due to expire on December 31, 2007 by one year, to December 31, 2008. It was a welcome relief for all involved with nonqualified deferred

compensation arrangements. Many considered completing Section 409A compliance by the end of 2007 an overwhelming task due to the complexity of the final regulations. Notice 2007-86 provides employers who maintain nonqualified deferred compensation plans an additional year to bring their plans into compliance with the final regulations.

During 2008, employers are not required to comply with the requirements of the final IRC Section 409A regulations. Instead, employers are required to operate their plans in good faith compliance with Section 409A and subsequent regulatory guidance.



Background

Section 409A generally applies to compensation that was deferred or which vested on or after January 1, 2005. Amounts that were earned and vested as of December 31, 2004 generally are exempt from Section 409A, as long as there is no material modification to the plan after December 31, 2004. This means that employers may continue to administer their pre-2005 deferred compensation arrangements in accordance with the original terms, even if the terms are no longer permitted under Section 409A.

The sweep of Section 409A is extremely broad, and it reaches beyond the traditional nonqualified deferred compensation plan. The final regulations include many helpful provisions that will assist with compliance and decrease the risk of inadvertent failure, a positive development given the adverse consequences of a failure to comply. Yet the rules remain lengthy (over 400 pages), and as a result are somewhat complicated.

The balance of this article will identify the appropriate steps required to bring your nonqualified deferred compensation arrangements into compliance.

Step 1—Identify Arrangements Subject to Section 409A

A crucial first step is to understand and identify all compensation arrangements—both written and verbal—subject to Section 409A. Some types of arrangements that are potentially subject to Section 409A, absent a regulatory exception, include the following:

- Nonqualified deferred compensation plans, excess plans, 401(k) mirror and wrap plans, 457(f) plans, nonqualified defined benefit plans and traditional SERPs
- Split dollar arrangements that include an element of deferred compensation
- Employment agreements, change in control and severance plans or agreements
- Stock options, stock appreciation rights, restricted stock units and other equity awards
- Post-retirement reimbursement and in-kind benefit arrangements
- Non-U.S. benefit plans that cover U.S. employees
- Annual bonus and long-term incentive plans
- Employee stock purchase plans not covered by Section 423 of the Code
- Earn-outs and other arrangements entered into in connection with corporate transactions

Step 2—Determine plan provisions that must be changed.

Step 3—Identify and determine if amounts earned and vested prior to December 31, 2004 should be grandfathered.

Step 4—Aggregate plans subject to Section 409A into the appropriate categories and segregate grandfathered amounts.

Step 5—Determine if shareholder approval is required for new plans, agreements or amendments and identify areas that require board of directors' approval and add to the appropriate meeting agenda.

Step 6—Identify or revise the list of key employees subject to the six-month distribution delay rule.

Step 7—Consider securities law issues for public companies and determine if SEC reporting requirements apply.

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Step 8—Communicate to participants the changes and actions required with participants.

Step 9—Allow changes in elections under the transition rules, which generally permit changes to the time and form of payment elections during 2008 without regard to subsequent deferral or anti-acceleration rules, provided the changes do not apply to any amounts that would otherwise be payable in 2008.

Step 10—Ensure that all “material terms” are included in each written plan document and complete all amendments to comply with Section 409A by **December 31, 2008**.

Step 11—Implement procedures for operational compliance and establish systems to comply with reporting and withholding requirements.

With Section 409A, the IRS and Treasury have formalized best practices for deferred compensation. The stability of this post-regulation environment should have a positive impact on plan sponsors and plan participants.