

Client Advisory

IRS Issues Final Regulations on Section 409A

April 20, 2007

Employers Must Prepare for Full Compliance by January 1, 2008

On April 17, 2007, the Internal Revenue Service ("IRS") published final regulations under Section 409A of the Internal Revenue Code ("Section 409A"). The final regulations are effective January 1, 2008 but may be relied upon as early as April 17, 2007. The current "good faith" compliance standard for Section 409A remains in effect for the remainder of 2007.

The final regulations made several significant changes to the proposed regulations, including: clarification of the rules for identifying specified employees; revision of plan aggregation rules; liberalization of definition of "service recipient" stock; clarification of the definition of "separation from service"; expansion of the separation pay exclusion (including certain "good reason" terminations); and the extension of the period that a stock option's exercise period may be extended without triggering Section 409A consequences.

Also, the final regulations maintain the December 31, 2007 deadline for documentary compliance for all plans or arrangements that are subject to Section 409A. The Treasury Department has said that this deadline will not be extended. This means that all deferred compensation arrangements must comply **in writing** with the new rules by December 31, 2007.

Section 409A applies to a plan, arrangement or individual contract which provides for a deferral of compensation. A deferral of compensation generally occurs if a service provider (which includes employees, independent contractors, consultants and non-employee directors) has a legally binding right to a payment during a taxable year that, pursuant to the terms of the plan or arrangement, will be paid in a later taxable year.

Some of the types of nonqualified deferred compensation arrangements which may be included within this definition and which should be reviewed for Section 409A compliance, include:

- Elective Salary Deferral Plans
- Bonus Deferral Plans
- Bonus or Incentive Plans
- Supplemental Executive Retirement Plans (SERPs)
- Excess Benefit Plans
- Individual Employment and Severance Contracts
- Change in Control Plans
- Severance Pay Plans
- Certain Stock Options
- Certain Stock Appreciation Rights (SARs)
- Restricted Stock Units (RSUs)
- Phantom Stock Awards
- Deferred Stock
- Section 457(f) Plans

Employers should **immediately** begin to identify all compensation arrangements which may be subject to Section 409A. All arrangements must be reviewed to determine whether they qualify for an exemption from Section 409A coverage. If they are subject to Section 409A, they must be reviewed to determine whether they must be amended by December 31, 2007. The "good faith" compliance standard may not be relied upon once the final regulations become effective January 1, 2008. Employers should begin to act now to ensure compliance with Section 409A.

Additional Client Advisories will be issued to provide more detail regarding the final regulations and Section 409A compliance.

For Additional Information

If you would like assistance in identifying and addressing issues regarding nonqualified deferred compensation arrangements, please contact any of the following Katten Muchin Rosenman LLP attorneys:

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