
New Section 409A Transition Rules Offer Little Relief-- Immediate Action May Be Required

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On September 10, 2007, the IRS released Notice 2007-78 (the Notice), which offers limited additional transition relief for compliance with Section 409A of the Internal Revenue Code (Section 409A). The Notice extends the deadline for documentary compliance with Section 409A to December 31, 2008; however, the period to designate Section 409A compliant times and forms of payment has not been extended. Thus, all deferred compensation arrangements must include, or be amended to include, permissible times and forms of payment before December 31, 2007, in order for the arrangement to comply with Section 409A.

Highlights of the Notice

The following are the highlights of the Notice:

- The transition relief provided in prior IRS guidance has not been extended. December 31, 2007, remains the deadline for transition elections, the decoupling of linked plans and the substitution of non-discounted stock options and stock appreciation rights for discounted stock options.
- After December 31, 2007, no changes may be made to the time and form of any payment unless otherwise allowed by Section 409A or the Notice. As a result, adding or removing potential payment events after December 31, 2007, will trigger the anti-acceleration and subsequent deferral election provisions under Section 409A (though some flexibility is provided for switching to an alternative definition of a permissible payment trigger event in 2008).
- Operational compliance with Section 409A is required during 2008 (including the six-month delay rule for "specified employees").
- Documentary compliance is not required until December 31, 2008 (except for the specification of time and form of payment). Plan terms that are not consistent with Section 409A will be disregarded through December 31, 2008, so long as the plan is operationally compliant.
- Deferrals made during 2008 must designate in writing a time and form of payment in accordance with Section 409A.

- Separation arrangements that include a "good reason" definition that does not satisfy either the facts and circumstances test or the safe harbor definition for "good reason" under Section 409A must be carefully reviewed to determine whether the arrangement may be modified (even in 2007) to take advantage of those exceptions.
- Additional guidance is provided regarding the application of Section 409A to "cash out" provisions (requiring participants to take benefits if they are below a certain amount) and employment agreements that are extended, renewed or renegotiated.
- A voluntary compliance program may be implemented to permit taxpayers to correct unintentional operational violations of 409A.

Due to the limited relief provided by the Notice, practitioners and taxpayers are actively seeking additional transition relief from the IRS and Treasury. The prospects are uncertain.

Our Recommendations

Because the transition period for designating Section 409A compliant times and forms of payment has not been extended, employers must proceed with reviewing, and possibly amending, all deferred compensation arrangements before December 31, 2007. While some arrangements may require only minor amendments that are permitted to be made in 2008 pursuant to the Notice, employers will not know what amendments are required to be made--and therefore whether those amendments are permitted to be made during 2008--until the arrangements are reviewed.

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