

Client Alert: December 31, 2008 Section 409A Compliance Deadline Approaches

December 31, 2008 is the deadline for full compliance with the broad restrictions on non-qualified deferred compensation arrangements issued under Section 409A of the Internal Revenue Code.

Operational compliance with these rules has been required since 2005. However, employers have only until the end of 2008 to bring all non-qualified deferred compensation arrangements into documentary compliance with 409A, including the requirement under Section 409A that compensation arrangements must be in writing.

Therefore, certain plan documents, agreements, and amendments will need to be adopted by the corporate body with the authority to adopt and/or amend the relevant arrangement (e.g., board of directors or compensation committee). Amendments also might require the consent of affected employees and, for public companies, the filing of forms with appropriate government authorities.

Significance of Section 409A

Compliance with Section 409A is crucial for the following reasons, among others:

- The penalties for noncompliance with 409A are substantial – immediate inclusion in employee income for all vested benefits and a 20% excise tax on all such amounts. For this reason, it is important to identify all arrangements that may be treated as deferred compensation under Section 409A and to amend them to comply with Section 409A immediately.
- Employers often make representations and warranties regarding Section 409A compliance in acquisition and financing documents.
- Section 409A disproportionately affects key management, as they are more likely to participate in arrangements subject to Section 409A.
- Section 409A defects can “infect” broad-based employee benefit arrangements (e.g., stock plans and severance policies) and, as a result, employers may encounter pressure to “make whole” employees subject to tax under Section 409A.
- If an employer's plans/agreements are subject to Section 409A, internal business administration (e.g., human resources, payroll, and legal departments) will need to monitor various aspects of compliance with Section 409A.

Identify Arrangements Subject to Section 409A

Section 409A defines “deferred compensation” broadly. Compensation that is earned, or to which there is a legally binding right, in one taxable year, but that is payable and includable in income, in a subsequent tax year, is considered deferred compensation subject to section 409A.

Employers should review all compensation-related arrangements to identify those that are subject to Section 409A. In addition, various equity instruments, such as stock options, can have significant and unexpected deferred compensation implications. Common types of arrangements that may be subject to Section 409A are as follows:

- Traditional deferred compensation plans (e.g., top-hat plans and supplemental executive retirement plans for a select group of employees, and director fee deferral programs);
- Stock option plans, restricted stock units, performance share awards, phantom stock, and other equity awards (other than restricted stock, which generally is exempt from Section 409A);
- Employment and retention agreements;
- Separation and severance benefit plans and policies;
- Bonus/performance/incentive pay arrangements;
- Tax "gross-up" arrangements;
- Guaranteed payments under partnership and LLC agreements;
- Leave programs and sick pay plans; and
- Split dollar life insurance arrangements (providing benefits other than death benefits).

If you need assistance identifying, reviewing or amending your non-qualified deferred compensation plans for Section 409A compliance before the December 31, 2008 deadline, please contact the attorney in the firm with whom you are regularly in contact or **Robert Heroux** at **212.554.7844** or **rheroux@mosessinger.com**.

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