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IRS Extends Section 409A Transition Relief

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The Internal Revenue Service (the IRS), in response to pleas from the private sector, granted additional transition relief under Notice 2007-86 to nonqualified deferred compensation plans to comply with Internal Revenue Code Section 409A. Section 409A, enacted by Congress in 2004, drastically altered the creation and operation of affected plans, including, but not limited to, severance, stock option, performance-based, and bonus plans. The penalties for not complying with this Section affect the recipients in that the amounts are subject to inclusion in gross income in the year of deferral along with an additional penalty of 20%. In light of these harsh repercussions, companies offering such plans and participants in them should examine their existing plans now and consider these requirements in drafting new plans.

Recent Guidance

Notice 2007-86 expanded the limited extension issued in September's Notice 2007-78. While the earlier Notice granted additional time for meeting the plan documentation requirements, it did not alter the effective date for the final Section 409A regulations nor did it extend relevant deadlines beyond the end of 2007. However, Notice 2007-86 is a welcome relief in that it:

- Postponed the effective date of the final regulations until January 1, 2009, providing an additional year to satisfy these complex rules.
- Extended the documentary compliance deadline, including adding the required time and form of payment designations until December 31, 2008. Additionally, it establishes a December 31, 2008 deadline for all plan amendments.
- Provide additional time, through the 2008 year, for taxpayers to reschedule payments of such compensation. Note: As with earlier guidance, taxpayers may not modify time and form of payments currently scheduled for 2008 or accelerate payments of amounts into the 2008 year that are otherwise scheduled to be paid after 2008.

Stock Options and Stock Appreciation Rights (SARs)

Notice 2007-86 also extended certain relief for plans issuing stock options and stock appreciation rights (SARs). This extension allows additional time to correct existing eligible discounted stock rights. Correction provisions allow the replacement of discounted stock options or SARS with fixed payment terms through the end of 2008. Alternatively, discounted stock options and SARS may be replaced by their non-discounted equivalent through December 31, 2008 as long as the discount is not exchanged for property or cash during that year.

IRS Extends Section 409A Transition Relief, Continued

Reasonable Good Faith Compliance

This transition rule allows plans to be operated in good faith compliance with earlier guidance issued under Section 409A, as long as the plans are amended on or before December 31, 2008 to satisfy the final regulations.

However, after January 1, 2008, reliance on the proposed regulations will not be considered compliance except with respect to:

- Section 409A as applied to partners and partnerships; and
- The corrections described above concerning discounted stock options and SARS.

Note: These exceptions are available only until the IRS issues further guidance.

Conclusion

Notice 2007-86 provides a needed extension for updating existing nonqualified deferred compensation plans and for creating new compliant plans. However, although the new deadline appears to be a long way off, in reality, altering plans of this complexity, which are subject to such detailed requirements, requires as much lead-time as possible.

Now is the time to begin analyzing your plans, if you have not already done so and to begin making educated and rational decisions regarding necessary changes. These 409A rules are difficult to navigate and interpret if you do not deal with them regularly. This is a very complex area of tax law and you benefit from receiving guidance from professionals who focus on these issues on a daily basis.

Need assistance reviewing existing plans or in drafting new compliant plans?

Contact the Chamberlain Hrdlicka Employee Benefits Group: Call Jerome M. Harris at 713.654.9651; and Stephen M. Mason at 713.654.9646.

