

Final Code Section 409A Regulations Issued at Last!

June 5, 2007

Any arrangements that may provide for a "deferral" of compensation--a right to a payment now that is distributed later--need to be reviewed immediately!

This includes: employment, severance and consulting agreements, offer letters, change in control agreements, director fee deferrals, deferred compensation and bonus plans, stock option, phantom stock and restricted stock plans, reimbursement arrangements, excess and supplemental benefit plans, and 457(f) plans.

On April 10, 2007, the long-awaited Final Regulations to Section 409A of the Internal Revenue Code were issued by the IRS. The Final Regulations--which are nearly 400 pages--include modifications and clarifications to previously issued guidance and confirm that documents are required to be in compliance by January 1, 2008. It is therefore imperative that employers prepare an inventory of all compensation arrangements and plans, including ones that are already operative, to be reviewed for compliance.

Code Section 409A (effective January 1, 2005) was enacted to address concerns involving abuses of nonqualified deferred compensation arrangements, and it also includes restrictions on various items such as deferral and distribution elections, the timing of payments and funding. The penalties for failing to comply with the new law are significant, and affect both service providers (e.g., employees, independent contractors, directors, etc.) as well as employers. Service providers in violation of the law will be immediately taxed on all vested deferred compensation and will be subject to an additional 20% tax, plus interest, while employers may be held liable for failing to report and withhold taxes.

It is important to realize that this law targets the actual deferred compensation arrangement, even though the employer may be a charitable organization or a public company, and regardless of whether the recipient of the payment is an executive, rank-and-file employee or independent contractor.

For more information on the final regulations, please contact author Marianna J. Perakis at 313.496.7558, or another member of the Federal Tax and Employee Benefits Group.