

September 2007

## **IRS Extends Deadline for Documentary Compliance for Code Section 409A**

In Notice 2007-78, the IRS has extended, for one year, from December 31, 2007 to December 31, 2008 for companies to adopt documents that comply with final IRS Regulations under Code Section 409A, the Section regulating the time and form of distributions from nonqualified deferred compensation plans, a broadly defined term covering a variety of arrangements. (There was no deferral of the effective date of the regulations themselves.) The relief is similar to that granted to amendments to tax qualified plans, that is, the plan can be amended on December 31, 2008, retroactive to January 1, 2008, so long as the plan as amended accurately reflects the operation of the plan from January 1, 2008, through the date of amendment. The guidance provides a number of illustrations of the manner in which a plan may retroactively adopt a permissible payment event and how to designate a compliant time and form of payment, which still must occur by December 31, 2007. The guidance also discussed how a plan can be adopted retroactively to reflect the six month delay on payment to specified employees.

One aspect of the Notice 2007-28, however, was troubling; the section dealing with good reason terminations. In order to take advantage of favorable rules under the Code Section 409A regulations such as the short-term deferral rule and the “two time two” rule for severance payments, there must be an involuntary separation from service. Under the regulations, “a good reason termination,” which is a constructive discharge, can be treated as an involuntary separation from service. The Regulations contain a good reason safe harbor, under which, if the conditions are satisfied, terminations pursuant to it will be regarded as involuntary separations from service. In many instances, relatively minor modifications can bring a plan’s existing good reason arrangement into compliance with a good reason safe harbor. However, in Notice 2007-78, the IRS indicated that if a right to payment subject to existing good reason termination is not subject to a substantial risk of forfeiture, e.g., because the conditions giving rise to payment are too easily satisfied, it cannot be modified to cause the amounts subject to the provision to be subject to a substantial risk of forfeiture. The problem, as we see it, is that it is difficult to distinguish between a right to a payment subject to an existing good reason termination which is subject to a substantial risk of forfeiture, from one that is not subject to a substantial risk of forfeiture.

Notice 2007-78 also states that the Treasury Department and IRS anticipate issuing guidance containing a limited voluntary compliance program that will permit taxpayers to correct certain unintentional operations violations of Code Section 409A.

While the delay is beneficial from a logistical perspective, clients will still need to make decisions by December 31, 2007 on plan design issues for nonqualified plans: the delay is simply for formalizing the documents implementing the year end 2007 change.

If your organization sponsors a plan subject to Section 409A and you would like us to assist you in reviewing your plans, please contact us at your earliest convenience:

Manes M. Merrit	212-451-2330
Nina Krauthamer	212-451-2242
Barry L. Salkin	212-451-2212
Annette Messano	212-451-2370

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