

Client Alert

Treasury and IRS Extend Deadline for Written Compliance With Section 409A

The Treasury Department and Internal Revenue Service have extended the deadline for complying with Internal Revenue Code Section 409A to the end of 2007. As you may recall from our prior client alerts, Section 409A imposes strict new rules related to deferred compensation plans. Section 409A was enacted as part of the American Jobs Creation Act of 2004 and became effective January 1, 2005. Over the past two years, Treasury and the IRS issued interim guidance on how to comply with Section 409A and extended the deadline for amending plan documents to comply with Section 409A to December 31, 2006. In new guidance issued yesterday (IRS Notice 2006-79), Treasury and the IRS have further extended the deadline for amending plans to comply with Section 409A until December 31, 2007 and have promised to issue final regulations on Section 409A in the next few months.

Here are some highlights of IRS Notice 2006-79:

- ***Plans Need Not Be Amended to Comply with Section 409A Until December 31, 2007.*** As noted above, this deadline had previously been extended to December 31, 2006. Now, plan sponsors have until the end of 2007 to bring their nonqualified deferred compensation plans into compliance with Section 409A. In the interim, reasonable, good-faith compliance with Section 409A and any guidance issued under Section 409A (most notably to date, Notice 2005-1 and the proposed regulations) is still required.
- ***Final Regulations Not to Be Effective Before 2008.*** The new guidance provides that the final regulations under Section 409A, once issued, are expected to become effective on January 1, 2008.
- ***New Payment Elections Can Generally Be Made Through December 31, 2007.*** The date by which participants can change their existing deferral elections for amounts that are subject to Section 409A has been extended through December 31, 2007, subject to the following rules: (1) with respect to a new election made this year, that new election may not apply to amounts that are otherwise payable in 2006, and may not cause amounts to be paid this year that would not otherwise be payable in 2006; (2) with respect to a new election made in 2007, that new election may not apply to amounts that are otherwise payable in 2007, and may not cause amounts to be paid in 2007 that would not otherwise be payable in that year; and (3) in all cases, the plan must be amended by December 31, 2007 to reflect that changes to deferral elections were permitted.
- ***Options and SARs May Be Amended to Provide for Fixed Exercise Periods Through December 31, 2007.*** Subject to the exclusion for certain back-dated stock grants noted below, stock options and SARs that would otherwise constitute deferred compensation under Section 409A may be amended through December 31, 2007 to provide for fixed exercise periods (to comply with Section 409A).

- ***Non-Exempt Options and SARs May Be Replaced Through December 31, 2007.*** Subject to the exclusion for certain back-dated stock grants noted in the next bullet point, stock options and SARs that are not exempt from Section 409A may be replaced by stock options and SARs that are exempt from Section 409A, as long as the replacement occurs no later than December 31, 2007, and the replacement does not result in the cancellation of a deferral in exchange for cash or other vested property in the year in which the replacement occurs.
- ***No Relief for Back-Dated Stock Options and SARs.*** The transitional relief applicable to stock options and SARs (including those provisions described in the prior two bullet points) is not available with respect to any stock grant that meets all three of the following conditions: (1) the stock grant applies to stock that, as of the date of grant, was required to be registered under Section 12 of the Securities Exchange Act of 1934; (2) the stock grant was made to a person who, as of the date of grant, was subject to the disclosure requirements of Section 16(a) of the Securities Exchange Act of 1934; and (3) such stock grant causes, or is reasonably expected to cause, the issuing company to report a financial expense because the stock grant was issued at lower than fair market value on the date of grant and was not timely reported during the period in which it should have been reported under generally accepted accounting principles.
- ***Payment Terms May Continue to Be Linked to Qualified Plans Through December 31, 2007.*** A nonqualified plan whose payment terms are linked to the time and form of payment elected under a qualified plan (for example, a qualified pension or 401(k) plan) may continue to allow such linked payments through December 31, 2007, as long as such linked payment provisions were permitted under the nonqualified plan as of October 3, 2004.
- ***Relief Provided for Plans That Took Advantage of “March 15, 2005 Deferral Rule.”*** For the 2005 calendar year, Notice 2005-1 allowed deferral elections to be made no later than March 15, 2005 (rather than by December 31, 2004). In order to take advantage of that rule, the plan was required to be amended to provide for such elections by December 31, 2005. To the extent that plans missed that deadline, those plans now have until December 31, 2007 to make the necessary amendment.

For a link to the IRS notice providing this extended transitional relief (Notice 2006-79) and our prior client alerts on 409A, click [here](#) or go to www.chadbourne.com/409A.

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For Additional Information

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