

IRS Offers Limited Code Section 409A Transitional Relief

On September 10, 2007, the IRS issued Notice 2007-78 regarding the application of Section 409A of the Internal Revenue Code (the "Code") to non-qualified deferred compensation plans. Although Notice 2007-78 provides some welcome relief from the Section 409A documentary compliance deadline, such relief is very limited. Accordingly, employers should continue to move forward in their efforts to bring all of their nonqualified deferred compensation plans into compliance by the end of 2007.

2008 Transitional Relief

IRS Notice 2007-78 provides a limited extension with respect to the documentary compliance requirements under Code Section 409A, until December 31, 2008. The relief applies to written plan provisions that do not comply with Code Section 409A on and after January 1, 2008; provided that the plan is operated in strict compliance with Code Section 409A and is amended on or before December 31, 2008, to comply with the final regulations retroactively to January 1, 2008. A plan is treated as being amended to comply with Code Section 409A retroactively to January 1, 2008, only if the written plan, as amended, contains all the provisions required by the final regulations and accurately reflects the operation of the plan on and after January 1, 2008, through the date of the amendment.

Notice 2007-78 does not extend previously issued transitional rules under IRS Notice 2005-1, the preamble to the proposed regulations under Code Section 409A or Notice 2006-79, including the "good faith" compliance period. Nor does Notice 2007-78 extend the effective date of the final regulations. Accordingly, as explained below, many

important decisions regarding the time and form of payment of deferred compensation must be made and documented by December 31, 2007.

Under Notice 2007-78, a plan must designate in writing a compliant time and form of payment of an amount deferred under the plan before January 1, 2008. An amount will be deemed to comply with this guidance only if the written plan terms, disregarding any written plan provisions that do not comply with Code Section 409A, provide a compliant time and form of payment. In order to provide a compliant time and form of payment, a plan must provide for an objectively determinable form of payment payable upon a permissible payment event. Permissible payment events include:

- a separation from service;
- a change in control event;
- an unforeseeable emergency;
- a specified date or fixed schedule of payments;
- death; or
- disability.

The final regulations issued under Code Section 409A require that a permissible payment event be defined in accordance with the regulations. However, under Notice 2007-78, a plan that does not define a payment event will not violate Code Section 409A, provided that the plan is amended by December 31, 2008, to include a compliant definition, and that payments prior to December 31, 2008, are made only on an event which complies with the Code Section 409A definitions. For example, a plan will not be deemed to violate Code Section 409A if a plan

provides for a payment upon a separation from service and the term “separation from service” is not defined in the plan, so long as payments are made only upon a participant’s “separation from service” as that term is defined under the final regulations.

Notice 2007-78 provides additional guidance on how to designate a specified payment date or fixed schedule of payments, and sets forth several changes that may be made during the transitional period that will not be treated as a change in the time and form of payment under Code Section 409A.

Six-Month Delay on Payments to Specified Employees

Code Section 409A and the final regulations provide that a payment of deferred compensation to a “specified employee” triggered by a separation from service may not be made until the date that is six months after the employee’s separation from service and that such requirement must be included in the plan document. However, pursuant to Notice 2007-78, a plan will not be treated as failing to comply with Code Section 409A if the plan does not contain this six-month delay requirement, so long as the payments are delayed and the plan is amended retroactively to January 1, 2008, to contain this delay requirement.

Employment Agreements – Good Reason Provisions

The final regulations under Code Section 409A clarify that a voluntary separation from service for “good reason” that complies with the safe harbor definition under the regulations will be treated as an involuntary separation from service. Such treatment may be important with respect to whether certain payments meet the short-term deferral rule and the separation pay exclusion. Notice 2007-78 provides guidance on how an employment arrangement may be modified to conform an existing “good reason” definition to the safe harbor definition under the final regulations.

Voluntary Compliance Program

Notice 2007-78 states that the IRS anticipates establishing a limited voluntary compliance program that will apply to certain unintentional operational failures to comply with Code Section 409A. The compliance program will provide methods by which certain operational failures may be corrected in the same taxable year in which the operational failure occurred, and other methods by which the amount of tax due as a result of an operational failure may be mitigated.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/employeebenefits.

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