

## Code Section 409A Transition Relief Extended Through December 31, 2007

On October 4, 2006, the IRS issued Notice 2006-79 (the "Notice"), which delays the effective date of the regulations issued under Internal Revenue Code section 409A ("Section 409A") and generally extends the transition relief available under Section 409A until December 31, 2007. Notwithstanding such action, the IRS indicated that it still intends to issue the final Section 409A regulations before the end of 2006. Therefore, although non-qualified deferred compensation arrangements will not have to be amended to comply with the requirements of Section 409A until December 31, 2007, such arrangements must continue to be administered consistent with a good faith, reasonable interpretation of Section 409A.

To satisfy this good faith administrative standard through the end of 2007, an arrangement may comply with previously issued IRS Notice 2005-1, the proposed Section 409A regulations (the "Regulations") or the final regulations once issued. While the Notice extends most of the existing transition relief without change, there are several important issues that should be considered.

### Payment Election Changes

Under the Regulations, nonqualified deferred compensation arrangements subject to Section 409A may be amended to provide for new payment elections with respect to both the time and form of payment. However, if such amendment or election was made during 2006, it could not apply to amounts payable in 2006 and could not accelerate a payment into 2006.

Under the Notice, this rule is retained in substance, but is updated so that elections made in 2007 must not accelerate distributions into 2007 or effect amounts due to be paid in 2007. Importantly, the Notice also provides that participants

may make more than one change under the transition relief. For example, a participant who had elected in 2006 to receive a distribution in 2009 could, prior to December 31, 2007, change such election and receive this distribution in 2008 or any later year. Without this additional transition relief, such an accelerated payment or re-deferral would be prohibited under Section 409A.

### Linked Plans

The Notice continues the relief through December 31, 2007, for nonqualified deferred compensation arrangements under which distribution elections are linked to the elections made under qualified retirement plans. However, in order for the "linked plan" provision to be applicable, the determination of the time and form of the payment must be consistent with the terms of the nonqualified deferred compensation arrangement as in effect on October 3, 2004.

In addition, the "constructive receipt" rules continue to apply to any election as to the time and form of payment under a nonqualified deferred compensation arrangement.

### Stock Options

Finally, grants of stock options or stock appreciation rights, which provide for a deferral of compensation (e.g., issued at a discount) and are thereby subject to Section 409A, may be cancelled and grants that would not be considered to be a deferral of compensation may be reissued by December 31, 2007. However, such cancellation may not result in the deferral of cash or vested property in the year of the cancellation. A vested, but unexercised, stock grant will not be considered to be vested property for these purposes.

This transition relief also continues to provide that the reissued stock options or stock appreciation rights will not be considered to be discounted, provided that the exercise price is equal to or greater than the fair market value of the underlying stock on the date that the original grant was made. Without this relief, the exercise price of the reissued grant would have to equal or exceed the fair market value of the underlying stock on the date of the reissuance; thus, any run up in the value since the date of the original grant would be lost.

However, the relief set forth in the preceding paragraph does not apply with respect to certain “back-

dated” grants of discounted stock options or stock appreciation rights issued by a public company, where the issuance of the discounted grant was not timely reported.

As indicated above, final regulations under Section 409A are expected to be published later this year. Assuming this is the case, the delay provided by the Notice should provide sufficient time for both employers and employees to properly digest any changes made in the final rules, and for administrative practices and plan documents to be timely brought into compliance.

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## 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](http://www.dechert.com/employeebenefits).

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