BUTZEL LONG
ATTORNEYS AND COUNSELORS

Employee Benefits E-news

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SECTION 409A COMPLIANCE DEADLINE FOR DEFERRED AND EXECUTIVE COMPENSATION

Time is running out for employers to comply with Internal Revenue Code Section 409A, a law that regulates nonqualified deferred compensation programs including traditional deferred compensation plans and employment contracts, severance agreements, equity compensation, phantom stock, director compensation and bonus programs. December 31, 2008 is the deadline for bringing all such programs into compliance. Since Section 409A was added to the Code in 2004, the IRS has permitted a good faith transition period for compliance with Section 409A. **This transition period expires December 31, 2008, and no further postponement is anticipated.**

What Programs Does Section 409A Regulate?

Section 409A governs any arrangement that defers taxable compensation payable to an employee or independent contractor (including outside directors) from one tax year to a subsequent tax year. Section 409A imposes rigid restrictions on employee deferral elections, distribution requirements, acceleration events and payments to key employees. The scope of the regulations is broad. There are many exceptions, special rules and complex definitions to navigate to ensure compliance with Section 409A. The following types of arrangements should be reviewed for Section 409A compliance.

- Traditional deferred compensation agreements
- Employment and consulting agreements and offer letters
- Severance agreements and severance pay plans
- Bonus, short and long term performance incentive plans
- Equity and equity-based plans including, stock option, SARS, discounted stock options, restricted stock units, and phantom stock plans
- Supplemental retirement plans (SERPs) and excess 401(k) plans
- Director fee deferrals and director stock compensation
- Post retirement benefits
- Change in control agreements

- Indemnification and reimbursement agreements
- Split-dollar insurance agreements
- 457(f) plans for tax exempt organizations

What Happens if Section 409A is Violated?

Penalties for non-compliance are severe. If a plan fails to comply, either in form or in operation, all current and prior vested deferred compensation is included in the employee's income. Section 409A also imposes a penalty tax equal to 20% of the deferred compensation included in income and interest on the additional income at the underpayment rate plus 1%. Sanctions are imposed on the employee, but the employer is subject to withholding and reporting requirements.

What Steps Are Required Before December 31, 2008?

1. Identify plans subject to Section 409A.
2. Determine whether any exceptions or exemptions are available. Plan benefits that are deferred and vested as of December 31, 2004 are grandfathered and do not have to comply with Section 409A unless the plan is materially modified after October 3, 2004.
3. Identify provisions or conditions that do not comply with Section 409A. For example, eliminate impermissible acceleration provisions and in-service haircut withdrawals, add the six-month postponed benefit commencement date for specified employees of public companies, modify separation from service, disability and change in control definitions and establish deferral election procedures.
4. Adopt all necessary amendments and obtain approval from compensation committees, boards of directors, or appropriate officers. File securities reporting or disclosures, if applicable.
5. Communicate changes to plan participants.
6. Establish administrative procedures to comply with Section 409A withholding and reporting requirements.

Butzel Long attorneys have been actively working with clients to assist in bringing plans into compliance with Section 409A. However, the deadline is fast approaching and immediate action is necessary for employers that have not yet addressed Section 409A. If you need assistance with identifying arrangements subject to Section 409A or in revising the arrangements to comply, please contact your regular Butzel Long attorney, a member of the Butzel Long Employee Benefits Practice Group, or the author of this e-mail news alert.

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