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Nonqualified Plans and Executive Compensation Deadlines Update

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October 13, 2011

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Section 457A Transition Relief Amendment Deadline

Background

- *General.* Under Code Section 457A, deferred compensation under a nonqualified deferred compensation plan maintained by a nonqualified entity is generally included in gross income when there is no longer a substantial risk of forfeiture with respect to such compensation. If, however, such compensation is not determinable at the time it is no longer subject to a substantial risk of forfeiture, it is not included in income until it becomes determinable at which time it is subject to regular income tax as well as (i) an additional income tax equal 20 percent of the amount of the compensation and (ii) “premium interest tax.”
- *A NonQualified Entity* is defined, generally (and subject to a number of additional complex rules), as:
 - a foreign corporation unless substantially all of its income is effectively connected with the conduct of a trade or business in the United States, or is subject to a comprehensive foreign income tax.
 - a partnership unless substantially all of its income is allocated to persons other than foreign persons with respect to whom such income is not subject to a comprehensive foreign income tax and organizations exempt from income tax under Title 26 of the US Code.
- *Effective Date.* Section 457A became effective for amounts deferred that are attributable to services performed after December 31, 2008.
- *Grandfather.* An amount that would otherwise be subject to Section 457A except for the fact that the amount is attributable to services performed prior to January 1, 2009 (“grandfathered amount”) is includible in income (to the extent not includible in income prior to 2018) in the later of (i) the last taxable year beginning before January 1, 2018, or (ii) the first taxable year in which such amount is not subject to a substantial risk of forfeiture.

Section 457A Transition Relief Amendment Deadline *Issue*

- Sections 409A and 457A may both apply to amounts deferred under the same arrangement.
- Accelerating the payment of a Section 457A “grandfathered” amount to a service provider to the later of (i) the last taxable year beginning before January 1, 2018, or (ii) the first taxable year in which such amount is no longer subject to a substantial risk of forfeiture could be a violation of Section 409A’s anti-acceleration rules.

Section 457A Transition Relief Amendment Deadline

Notice 2009-8 Relief

- Notice 2009-8 provides that an amendment to a plan to change the time and form of payment of a Section 457A “grandfathered” amount to conform the date of distribution to the date the amount may be required to be included in income under Section 457A, will not be treated as an impermissible acceleration under Code Section 409A, provided that such change in the time and form is established in writing and is effective on or before December 31, 2011.
- Further, if the affected compensation was earned and vested before December 31, 2004 and is grandfathered from Code Section 409A, such amendment will not be treated as a material modification for purposes of Section 409A, again provided that such change in the time and form is established in writing and is effective on or before December 31, 2011.
- The foregoing is a simplified description of the rules. For more detailed guidance, see Notice 2009-8.

Section 409A Correction of Release Issue

Background

- Background: In general, under Code Section 409A, the distribution of deferred compensation must commence upon a permissible distribution event or at a specified time (or pursuant to a fixed schedule). Treasury Regulation Section 1.409A-3(b) permits a payment (including a payment that is part of a schedule) to be made during a designated period that is nondiscretionary and objectively determinable at the time a distribution event occurs, provided such period begins and ends within one taxable year, or such period is no more than 90 days and the employee does not have the right to designate the taxable year of payment (“permissible designated period”).
- Issue: A plan that conditions payment of deferred compensation on an employment related action by the employee, such as the execution of a release of claims (or other employment related agreements such as noncompetition or nonsolicitation agreements) will violate Section 409A if such agreement either:
 - does not include a permissible designated period during which the release must become effective and payment made (or the compensation is forfeited); or
 - does designate a period of time that is equal to or less than the 90 day period described above during which the release must become effective and payment made (or the compensation forfeited), but does not include restrictions on the timing of payment within such period in the event such period begins in one taxable year and ends in another.

Section 409A Correction of Release Issue (cont'd)

Relief

- Notice 2010-6, as modified by Notice 2010-80 provides that a plan provision in effect on December 31, 2010, will be not be treated as in violation of Section 409A and payments made on or prior to December 31, 2012, pursuant to such section will not be treated as operational violations of Section 409A, provided that any amounts paid after March 31, 2011, that could be paid in a period that begins in one taxable year and ends in a subsequent taxable year are paid in the subsequent taxable year. For amounts that remain deferred after December 31, 2012, such plan must be amended no later than December 31, 2012, as follows:
 - (A) If the applicable plan provision does not provide for payment during a permissible designated period following a permissible payment event, it must be amended as follows:
 - (i) To provide for payment only upon a fixed date either 60 or 90 days following the occurrence of the permissible payment event; or
 - (ii) To provide a designated period of not more than 90 days for payment following a permissible payment event, and if such period begins in one taxable year and ends in a second taxable year, payment will be made in the second taxable year.
 - (B) If the applicable plan provision does contain a designated period for payment of not more than 90 days following a permissible payment event, but the service provider's action could affect the taxable year of payment (e.g., where such payment period begins in one taxable year and ends in a second taxable year), it must be amended as follows:
 - (i) To provide for payment on the last day of the designated period; or
 - (ii) To provide that, if such period begins in one taxable year and ends in a second calendar year, payment will be made in the second taxable year.

Section 409A Correction of Release Issue (cont'd)

Relief

- The foregoing transition relief is subject to certain general eligibility conditions and information and reporting requirements. See Notices 2010-80 and 2010-6.
- Plan provisions not in effect on December 31, 2010 are generally not eligible for the transition relief and are limited to much more stringent corrective provisions, deadlines and potential penalties. See Notices 2010-80 and 2010-6.
- The foregoing is a very simplified description of the rules. For detailed guidance, see Notices 2010-80 and 2010-6.

Section 162(m) Per-employee Limit on Options and SARs

- Section 162(m) regulations provide that options and SARs granted under a plan that “states the maximum number of shares with respect to which options or rights may be granted during a specific period to any employee,” and that meets certain other requirements (e.g., shareholder approval) constitute “performance – based” compensation.
- Many public companies have interpreted the regulation to require an overall share limit for the plan (for securities purposes) and a specific per-employee limit on the number of shares with respect to which stock options and SARs may be granted. Others have treated one overall share limit as also satisfying the per-employee limit.
- Proposed regulations issued June 24, 2011 clarify that the shareholder-approved plan must include a specific per employee limit, in addition to any overall maximum limit on aggregate number of shares that maybe issued under the plan to all employees. Prop. Reg. Section 1.162-27(j)(2)(vi) provides that the clarification to the per-employee limit would apply on or after June 24, 2011. (The preamble, however, provides that the regulations would apply to taxable years ending on or after the date of publication of final regulations.)
- If a plan does not currently have a per-employee limit with respect to a specific period of time, such a limit must be added and approved by shareholders.

Status of Compensation Related Provisions in Dodd Frank Act (DFA)

- Non-binding advisory vote on executive compensation (“Say on Pay”): SEC released final regulations for say on pay voting requirements on January 25, 2011. The requirements are effective for a public company’s first annual meeting taking place on or after January 21, 2011. Smaller reporting companies are exempt from this requirement for two years.
- In 2011, approximately, forty companies failed to receive a majority vote on their say on pay votes and approximately nine companies have been sued by shareholders as a result of such failure. To date, there appear to have been two initial decisions on such cases with one case surviving a motion to dismiss and one case being dismissed on a motion to dismiss.
- Non-binding advisory vote on golden parachutes: SEC released final regulations for golden parachute voting requirements on January 25, 2011. The requirements are effective for proxy statements regarding the approval of an acquisition, merger consolidation or proposed sale filed on or after April 25, 2011. Smaller reporting companies are not exempt from this requirement.
- Independent Compensation Committees and Advisors: DFA requires national security exchanges to require listed companies to meet certain independence requirements for members of the compensation committee and certain advisers to the compensation committee. SEC released proposed regulations regarding such requirements on March 30, 2011 and final regulations are expected later this year. The provisions will not become effective until after final regulations are issued and the national securities exchanges issue rules for listed companies.

Additionally, companies are required to meet disclosure requirements regarding compensation consultants for proxy filings following the issuance of final regulations, which are expected later this year.

- Executive Pay for Performance: DFA requires disclosure regarding relationship between compensation actually paid and financial performance of the company and disclosure regarding the ratio of CEO pay to the median pay of all employees of the company. SEC has not yet issued regulations. No effective date has been specified but proposed regulations are expected later in 2011 and final regulations are expected in 2012.
- Clawbacks: DFA requires national security exchanges to require listed companies to adopt a policy requiring clawback of incentive compensation paid or granted to executives and former executives in certain circumstances where a company is required to prepare an accounting restatement. SEC has not yet issued regulations. No effective date has been specified but proposed regulations are expected later in 2011 and final regulations are expected in 2012.

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