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Executive Compensation & Employee Benefits Practice  
Tax Transactions Practice

## **Year-End Deadline for Amending Deferred Compensation Plans and Legislation Limiting Deferrals by Non-US Funds**

### **Required Amendment by Year-End and Limits on Deferrals--Amounts Attributable to Services Performed before January 1, 2009**

Many non-US investment funds (e.g., hedge funds and private equity funds) permit their investment managers to defer their management fees and other compensation (with a corresponding deferred recognition of taxable income). Often, the deferrals are made under what are known as "nonqualified deferred compensation plans" that are subject to Section 409A of the Internal Revenue Code of 1986. Not later than December 31, 2008, such plans (i.e., the deferral arrangements) must be amended to satisfy the complex requirements imposed by Section 409A, which primarily affect the deadlines for making deferral elections and the timing and form of payment of deferred amounts.

The requirements generally apply to nonqualified deferred compensation plans providing for payments that are to be made after December 31, 2008.

Failing either to have such plan amendments adopted by the end of 2008, or to operate a plan in accordance with the requirements of Section 409A and the plan documents, can result in the imposition of significant penalties, including accelerated recognition of taxable income, a 20 percent tax (in addition to regular income taxes) and interest penalties. Accordingly, investment funds (and other employers) should review their deferred compensation plans and arrangements to ensure that they comply, or become compliant, with these requirements by the end of 2008.

For further discussion of the requirements of Section 409A, see Mayer Brown's Client Update: "[How the Final Section 409A Deferred Compensation Rules Affect Employer Plans.](#)"

Even if the above described amendments are adopted in a timely manner, restrictions included in recently enacted legislation (the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, enacted October 3, 2008 (the "2008 Tax Act")), provide that amounts attributable to services performed before January 1, 2009, will be subject to tax not later than the individual's last taxable year before 2018, or, if later, the year in which vesting occurs.

### **Legislation Eliminating Deferrals by Non-US Funds--Amounts Attributable to Services Performed after December 31, 2008**

The 2008 Tax Act eliminates the ability to defer compensation attributable to services performed after December 31, 2008. Such deferred fees and other compensation will be includible in a US taxpayer's income at the time the amounts become vested (rather than being deferred until distribution). The

restrictions apply to nonqualified deferred compensation plans maintained by entities that do not benefit from a US or foreign income tax deduction. Generally, such entities include investment funds maintained in a jurisdiction that does not impose a tax on the earnings or gains on the fund's assets. The restrictions also apply to nonqualified deferred compensation plans maintained by certain partnerships that have tax exempt and foreign investors.

In view of the new limitations, investment funds may find it beneficial to establish a structure before January 1, 2009, that permits investment managers to receive allocation of fund income or gain, rather than deferred management fees.

The legislation provides no relief from the December 31, 2008, deadline for the adoption of the above-described plan amendments to satisfy the requirements of Section 409A.

For further discussion of the proposed legislation, see our Client Update: "[Proposed Deferred Compensation Restrictions for Offshore Entities](#)."

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