

## BENEFITS UPDATE

### Section 409A Deadline Ahead: Current Action Required

*January 24, 2008*

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Section 409A of the Internal Revenue Code imposes significant requirements with respect to nonqualified deferred compensation plans. It applies to amounts deferred on or after January 1, 2005. The IRS provided a lengthy transition period and issued final regulations under section 409A in 2007. The transition period, which was originally set to expire at the end of 2007, was extended through 2008. Beginning on January 1, 2009, however, all nonqualified deferred compensation plans must be in full compliance with section 409A, the final regulations and other applicable guidance. For a more complete review of the final regulations, see [“How the Final Section 409A Deferred Compensation Rules Affect Employer Plans,”](#) published by Mayer Brown on May 30, 2007.

Section 409A applies not only to traditional nonqualified deferred compensation plans but also to many types of arrangements (or aspects of arrangements) that have not typically been considered to be deferred compensation plans. For example, section 409A may apply to bonus arrangements, fringe benefit arrangements, expense reimbursement arrangements, indemnification

agreements, employment agreements, change in control agreements, tax gross up arrangements, equity-based arrangements, and severance arrangements. Section 409A can also apply to arrangements covering just one person.

In addition to requiring operational compliance, section 409A requires nonqualified deferred compensation plans to be in writing and requires that the written plan comply with requirements. Although there are exceptions to the application of section 409A, the exceptions are very complicated and, in many cases, plans need to contain specific provisions to ensure that the exceptions will apply. If either the plan document or plan operation fails to satisfy the requirements, the penalties (discussed further below) are imposed on employees, directors, consultants and other service providers; the penalties are not limited to executives.

The penalties for failure to comply with the applicable requirements of section 409A are very serious and include accelerated recognition of income, a 20 percent excise tax (in addition to regular income taxes) and

interest penalties. Although the penalties are imposed on individuals, the employer has withholding and reporting obligations. Individuals will likely seek to recover from employers in the event penalties are imposed and, even if such claims are not successful, they will be expensive to resolve.

Because the scope of section 409A is so broad and the penalties so serious, employers must review their benefit plans and arrangements to ensure that plans and arrangements are compliant with the applicable requirements, or can become compliant, by the end of 2008.

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*If you have any questions regarding the information in this Update or its applicability to your circumstances, or if we can assist you with bringing your benefit plans and arrangements in compliance with section 409A, please telephone the member of our Compensation Department who regularly advises you or one of the lawyers listed here. For information on additional publications of interest, visit our home page at <http://www.mayerbrown.com/employeebenefits>.*

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