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IRS EXTENDS PLAN AMENDMENT DEADLINE AND TRANSITION RELIEF PERIOD FOR NONQUALIFIED DEFERRED COMPENSATION PLANS

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As expected, in Notice 2006-79, the IRS announced that employers will have until December 31, 2007 to update nonqualified deferred compensation plan documents to comply with the final regulations under Internal Revenue Code § 409A. While the IRS still plans to publish final regulations during 2006, the IRS recognizes that employers need more time to analyze the final regulations and deal with compliance issues.

The transition relief period that has been in place since § 409A first became effective on January 1, 2005 will continue during 2007. During this transition period, plans will be treated as complying with § 409A if they are operated “in reasonable, good faith compliance with the provisions of § 409A and applicable provisions of Notice 2005-1 and any other generally applicable guidance published with an effective date prior to January 1, 2008.” While compliance with the proposed or final regulations during this period is not required, compliance with either set of regulations will be considered reasonable, good faith compliance with § 409A.

During the extended transition period, employers will continue to have the option of amending plans to give participants the ability to make new payment elections that comply with § 409A. These elections may relate to both the time and form of payment. However, participants may not elect to postpone a payment otherwise due during the year in which the new election is made, nor may they elect to accelerate into the current year a payment due in a future year. For example, if a plan participant is scheduled to receive a deferred compensation payment upon termination of employment, an election in 2007 cannot postpone the payment due in 2007 if the participant terminates employment in 2007.

The notice also clarifies that employers and plan participants may make more than one payment election change during the transition period. For example, assume a participant was

originally scheduled to receive five substantially equal annual installment payments beginning in 2010, but in 2005 made a new payment election for a lump sum payment in 2010. The participant may make yet another payment election in 2006 or 2007, for example, to change the payment form back to installment payments beginning in 2010.

Other plan structures and procedures that continue to be allowed during the transition period include:

- (i) Linking certain nonqualified deferred compensation plan payments to payment elections under qualified plans; and
- (ii) Substituting non-discounted stock options and SARs that are exempt from the requirements of § 409A for discounted stock options and SARs that provide for the deferral of compensation (excluding certain discounted stock rights of public companies granted to directors, executive officers or ten percent or more shareholders).

Although the extensions are welcome news, employers still need to make sure their plans are satisfying the reasonable, good faith compliance standard during the transition period. Both the IRS and practitioners have expressed concern that many employers have not yet fully recognized the impact that § 409A has on traditional nonqualified deferred compensation plans, or on arrangements that have not traditionally been viewed as providing for deferred compensation, such as equity compensation plans and employment or change in control agreements.

If you have questions, please contact Richard Gibson (rgibson@rbh.com) or Laura Smith (lsmith@rbh.com).

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