

# One Minute Memo<sup>®</sup>



## IRS Grants *Real* One Year Extension For §409A Compliance, Including W-2 Reporting

The IRS has announced that the deadline for bringing deferred compensation arrangements into compliance with §409A of the Internal Revenue Code has been extended to December 31, 2008. The new announcement supersedes the more limited §409A relief previously granted by the IRS in September. The IRS has also announced that deferred compensation that does not violate §409A will not need to be reported on 2007 Forms W-2 or 1099.

Code §409A was enacted in 2004 to provide comprehensive rules for the taxation of deferred compensation plans, including certain types of severance and equity compensation arrangements. The IRS issued final regulations implementing §409A on April 10, 2007, with an effective date of January 1, 2008. On September 10, the IRS issued Notice 2007-78, which allowed employers an additional year to adopt most formal amendments to their deferred compensation plans but still required full operational compliance with the final regulations by December 31, 2007. Notice 2007-78 was widely criticized as not providing employers with enough time to digest and implement the final regulations. On October 22, the IRS caved in by issuing Notice 2007-86, which revokes most of 2007-78 and grants a full one-year extension of the §409A compliance deadline.

In brief, Notice 2007-86 provides that:

- No amendments to deferred compensation plans are required until December 31, 2008. However, any amendment that will change the time or form of payment of a benefit that would otherwise be payable in 2008 (or that would accelerate a payment into 2008) still needs to be adopted by December 31, 2007.
- The period during which plans can be administered on the basis of a good faith interpretation of §409A, rather than in strict compliance with the regulations, is generally extended until December 31, 2008. However, the IRS will not treat an arrangement as in compliance if it violates Notice 2005-1. The IRS also noted that the proposed regulations cannot be relied on as evidence of good faith compliance after December 31, 2007. A plan must also be operated in accordance with its terms, to the extent not inconsistent with Section 409A, during the extended relief period. These reliance provisions mean that there may be some limited circumstances where adopting amendments by the end of 2007 will still be appropriate.
- Plans may be amended to provide for changes in the time and form of payment, or to permit participants to make new payment elections, until December 31, 2008, subject to the same limits that applied to the previous extensions – that is, an amendment or election made in 2008 cannot accelerate the payment of deferred compensation into 2008 or affect amounts that are otherwise payable in 2008.
- A SERP or other type of supplemental or restoration plan that wraps a qualified pension plan can continue to link its benefit payments to the time and form of payment elected under the qualified plan until December 31, 2008. Employers that have already made decisions on how to “de-link” their plans will need to decide whether to defer implementation of that decision until 2009, and may need to adopt amendments by the end of 2007.

- Discounted stock options and SARs can be retroactively amended to increase the exercise price to the market value on the date of original exercise until December 31, 2008, except for public companies that are required to restate their earnings because of option backdating.

Section 409A allows employees to make deferral elections for incentive compensation up until six months prior to the end of the performance period. Notice 2007-86 specifically notes that the transition relief that allows employers to utilize a good faith definition of what constitutes incentive compensation is not being extended for 2008 bonuses. Accordingly, if an employer has any doubt as to whether its bonus plan constitutes qualified incentive compensation, employees should make their deferral elections for 2008 bonuses prior to the beginning of the 2008 performance period.

The day after it issued Notice 2007-86, the IRS also issued Notice 2007-89, in which it announced that deferred compensation that meets the requirements of §409A (i.e., “Code Y” reporting) will not need to be reported on Forms W-2 or 1099 for 2007, which are due on January 31, 2008. Deferred compensation that is taxable under §409A (“Code Z” amounts) is subject to reporting and withholding for 2007.

If you have any questions about the application of Notice 2007-86 or 2007-89 to your company’s deferred compensation arrangements, please contact the Seyfarth Shaw LLP employee benefits attorney with whom you regularly work or any employee benefits attorney on our website at [www.seyfarth.com](http://www.seyfarth.com).

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