

FORD & HARRISON^{LLP}
THE RIGHT RESPONSE AT THE RIGHT TIME

LEGAL ALERT



Legal Alert: Making Tax Code §409A Corrections Before Time Runs Out

7/8/2008

Problem: In less than six months, your company's executives may become liable for income tax, plus a 20% additional tax, as well as penalties and interest, on income they have earned, even if payment is not due until a later year, or is conditioned on an event, such as a termination without cause that is uncertain to occur. This applies to both public and private companies.

December 31, 2008 is the deadline to bring your company's non-qualified deferred compensation plans and arrangements, including employment and separation agreements into full compliance with §409A of the Internal Revenue Code. **Issue:** What changes must you make to correct your company's compensation and benefit arrangements to comply with §409A?

Solution: Among other measures that may be applicable to your specific arrangements, each of the following must be addressed before December 31, 2008: Identify, and document in a written plan, all deferred compensation arrangements – including those in employment contracts, in separation agreements, and in any type of short or long term incentive or non-qualified retirement arrangements; Amend, to comply with §409A, all deferred compensation arrangements that do not fall within the "short term deferral" rule, the "2 year/24 month" rules for severance plans or for involuntary separations from service, or any other exception to §409A; Revise non-compliant §409A definitions of "Disability," "Change in Control," and "Good Reason," where those events trigger payment of a deferred compensation benefit; Require express or implied compensation deferral elections to occur before the year in which the compensation is earned, unless the compensation affected qualifies as performance based; State a fixed payment date(s) for any compensation deferred or define the time of payment in terms of one of the other allowed distribution events; Require any changes in time or form of distribution payment to comply with the subsequent election (the "12 month/5 year" rule) and no-acceleration rules; and If possible, replace discounted nonqualified stock options or stock appreciation rights with exempt stock options or make them §409A compliant by including fixed payment terms. For some deferred compensation arrangements, all that will be needed in order to comply with §409A is changing the language of the applicable agreements. For others, the arrangement must be reconstructed or dissolved and reformed. For assistance, please call the Ford & Harrison attorney with whom you work or any one of the following attorneys in the firm's Employee Benefits Group: Stephen Zweig, 212-453-5906; Jeffrey Ashendorf, 212-453-5926; or Victoria Chemerys 305-808-2107.