PRYOR CASHMAN LLP

LEGAL UPDATE

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INTERNAL REVENUE CODE SECTION 409A - DOCUMENT REVISIONS NEEDED

Congress implemented Code Section 409A on October 22, 2004, as part of the American Jobs Creation Act of 2004. The Internal Revenue Service ("IRS") published final regulations for Code Section 409A on April 17, 2007. The effective date of the regulations is January 1, 2009. We do not expect a deferral of the effective date.

Essentially, Section 409A limits the flexibility employers have as to timing in designing and paying deferred compensation by tightening the rules and imposing penalties for failure to follow those rules. The penalties for failing to comply with Code Section 409A are substantial, including immediate taxation of the deferred income, an additional tax of twenty (20%) percent imposed on the individual recipient, not the payor, plus interest and penalties (not to mention possible state level taxation).

Clients only have until December 31, 2008 to review and implement required changes to their plans, arrangements, and agreements that provide deferred compensation and may be impacted by Code Section 409A. Not only must traditional deferred compensation plans be reviewed, but also employment agreements, severance arrangements, equity plans, and fringe benefit programs. The only major class of arrangements exempt from Code Section 409A are qualified plans (e.g. 401(k) plans, pensions plans, and the like).

The regulations specifically state that "savings clauses" are disregarded (a savings clause is a clause in a document that states that the document will be interpreted in a manner that complies with Code Section 409A). Consequently, the actual provisions of any written document must comply with Code Section 409A to avoid the risk of tax, penalties, and interest imposed for violations. As an indication of the importance of this review, the Firm's executive compensation department has yet to see a single arrangement to date that is fully compliant with Code Section 409A; most arrangements do not even attempt to address the new law.

Code Section 409A is too complex to summarize here. However, major features include:

- Limitations on elections regarding form and timing of payments;
- Distributions must be made on specified dates or on the occurrence of specific events;
- Acceleration of distributions is prohibited in most situations;
- Key employees of public companies may not receive distributions for 6 months after termination, unless they qualify for specific (and narrow) exemptions;
- Subsequent elections to change timing and form of payments cannot be effective for one (1) year and an election must delay the payment by at least five (5) years;
- Arrangements must be formalized in a written plan document or agreement;
- Payments on account of termination of employment may not be made unless an employee has truly stopped working for an employer;
- Certain terms such as "change in control", "disability" and "good reason" terminations are all defined in Section 409A and arrangements must comply with those definitions.

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The foregoing is merely a discussion of Internal Revenue Code Section 409A and is not intended to provide legal advice. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact one of these members of the Employee Benefits, Executive Compensation and ERISA Group: Christopher J. Sues at csues@pryorcashman.com or 212-326-0428; or Matthew O. Young at myoung@pryorcashman.com or 212-326-0179.

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Christopher J. Sues joined Pryor Cashman in 1995 and is the Chairman of the firm's Employee Benefits, Executive Compensation and ERISA Group. He regularly counsels clients regarding employment agreements and executive compensation plans and programs and is also heavily involved in the employee benefit aspects of mergers and acquisitions.

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