



Practical Insights - Year-End Deadline Looms for Tax Code §409A Compliance

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Problem: In less than two months, on January 1, 2009, 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 executives in both public and private companies.

Issue: What changes must you make to correct your company's compensation and benefit arrangements and plans to comply with §409A of the Internal Revenue Code?

Solution: Each of the following must be addressed by December 31, 2008:

- All deferred compensation arrangements — must be documented in writing, whether they are in employment contracts, in separation agreements, or in any type of short or long term incentive or non-qualified retirement arrangement..
- All deferred compensation payouts – must be amended, in writing, unless they fall within the "short term deferral" rule, or the " 2 year/ 24 month" rule for severance plans or involuntary or "good reason" separations from service, or another exception to §409A.
- Non-compliant definitions of "Disability," "Change in Control," and "Good Reason" – must be amended, in writing, where those events, alone, can trigger payment of a deferred compensation benefit.
- Express or implied compensation deferral elections – must be amended, in writing, to require the election be made before the year the compensation is earned (unless the affected compensation qualifies as "performance based").
- Deferred compensation distribution events – must be amended, in writing, unless compliant with one of the six distribution events allowed under §409A.
- Change in time or form of payment of deferred compensation – must be amended, in writing, unless compliant with the subsequent election ("12 month/5 year" rule) and no-acceleration rules.

For some deferred compensation arrangements, all that will be needed in order to comply with §409A is changing the language of the applicable agreements or plans. For others, the arrangement must first be put in writing, or reconstructed, or dissolved and reformed.