PRYOR CASHMAN LLP

LEGAL UPDATE

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LAST CHANCE FOR COMPANIES TO CORRECT SECTION 409A DOCUMENT FAILURES WITHOUT PENALTIES

SUMMARY

Companies have a last chance to correct their nonqualified deferred compensation plans and arrangements (collectively "Plans") to bring them into compliance with Section 409A of the Internal Revenue Code ("Section 409A") without triggering additional taxes and penalties. IRS Notice 2010-6 (the "Notice") allows companies to amend their Plans and correct various document failures[1] which violate Section 409A. To qualify for the broadest coverage under the Notice, though, **the Plans must be amended by December 31, 2010!**

BACKGROUND

The American Jobs Creation Act of 2004 added Section 409A to the Internal Revenue Code and the Internal Revenue Service (the "IRS") issued final regulations under Section 409A on April 17, 2007, which, as a result of an extension, became effective on January 1, 2009. The final regulations and other authority issued by the IRS provided a grace period requiring companies to comply with the documentary requirements of the final regulations by January 1, 2009. Many companies took advantage of the grace period and amended their Plans to comply with the final regulations prior to January 1, 2009.

Section 409A generally requires that all deferred compensation be included in an employee's gross income unless it is subject to a substantial risk of forfeiture, the employee has already included it in gross income for a prior year, or the deferred compensation qualifies for certain exceptions under Section 409A. The penalties for failing to comply with Section 409A are substantial, including immediate taxation of the full amount of the deferred compensation, an **additional 20% tax**, and an underpayment penalty. State level taxes and penalties may also apply.

THE NOTICE

The Notice introduces a correction program that allows employers to amend their Plans in order to bring them into documentary compliance with Section 409A. Under the Notice, Plan corrections may be made at any time, but Section 409A taxes and penalties will still apply in many cases. However, **the Notice gives employers a special opportunity to correct any documentary failures in Plans by December 31, 2010** without triggering additional taxes and penalties associated with Section 409A violations; provided no payments have yet been made under the provisions triggering the documentary failure. In the event payments have been made under those provisions, amending the Plan will satisfy the documentary requirements of Section 409A, but payments made under the offending provisions would be treated as operational failures[2] and could be corrected under another notice issued by the IRS, although Section 409A taxes and penalties may apply with respect to those payments.

FINAL OPPORTUNITY

The special opportunity under the Notice for companies to correct their Plans will expire on December 31, 2010. If a company has not had their Plans reviewed for compliance with Section 409A, doing such a review and any necessary amendments prior to December 31, 2010 may allow significant taxes and penalties to be avoided. **Section 409A applies not only to traditional deferred compensation arrangements, but to any arrangement pursuant to which compensation can be deferred, such as employment agreements (where if a good reason event has occurred severance can be deferred), gross-up arrangements, tax equalization**

[1] A document failure occurs when the terms of the Plan itself are not consistent with Section 409A, such as providing payment upon an impermissible payment event. In contrast, an operational failure occurs when the Plan has the required provisions, but those provisions are not honored.

[2] An operational failure occurs when the Plan has the required provisions, but those provisions are not honored.

programs, expense reimbursement programs, and executive perquisites. Companies should review all of their Plans and amend the Plans that need to be amended to comply with Section 409A prior December 31, 2010 if they wish to take advantage of the relief under the Notice.

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The foregoing is merely a discussion of certain relief available under the Notice for Plan corrections under 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 Edward J. Rayner: 212-326-0110 • erayner@pryorcashman.com, Christopher J. Sues: 212-326-0428 • csues@pryorcashman.com, or Matthew Young: 212-326-0179 • myoung@pryorcashman.com

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Edward J. Rayner is a Partner and is Chairman of the Executive Compensation, ERISA and Employee Benefits Group. Ed's practice encompasses all aspects of executive compensation, employment and severance arrangements, pension plan investments and employee benefits.

Ed has extensive experience negotiating, designing and implementing employment agreements and severance agreements for CEOs, chairpersons and senior executives of public and private corporations, both domestic and foreign. Ed has represented a large number of clients in leveraged and management buyouts, including many of the most prominent buyout firms, as well as management teams and individual senior executives. As a result of these transactions, Ed has acquired exceptional expertise dealing with the issues arising from using stock in privately-held companies in connection with compensation arrangements.

In addition, Ed also regularly represents financial professionals, such as bankers, asset managers, hedge funds and various other professionals in connection with employment, severance, partnership and other compensation arrangements.

Ed is a nationally recognized expert on the issues relating to managing pension plan assets and dealing with counterparties that are subject to ERISA. He has regularly advised clients on all aspects of ERISA's fiduciary responsibility rules and has a great deal of experience advising both financial institutions, such as banks and insurance companies, as well as various hedge and private equity funds on these rules. Ed's experience in this area includes the following matters:

- Advising financial institutions on ISDA transactions and various other transactions with pension plans and other entities subject to ERISA
- Setting up "plan asset" funds and establishing investment procedures for such funds to comply with ERISA's fiduciary obligations
- Structuring funds and other vehicles to avoid plan asset status by remaining below the 25% threshold
- Using the Venture Capital Operating Company/Real Estate Operating Company exemptions under the plan asset regulation and structuring the prospective investments by funds to comply with those exemptions
- Structuring certain corporate and structured finance vehicles to comply with ERISA's requirements
- Representing both borrowers and lenders, including banks and insurance companies, with respect to ERISA provisions in credit and other lending arrangements

Ed has also represented clients in all kinds of acquisitions and divestitures in connection with ERISA and executive compensation, including mergers, sales of assets, tender offers, spinoffs, split-offs, reorganizations and other transactions. Many of these transactions were large multi-billion dollar transactions.

Ed has been named by *The Best Lawyers in America* as one of the leading lawyers in Employee Benefits Law (2008, 2009, 2010 and 2011 editions) . He has also been named as a "Super Lawyer" in Employee Benefits Law by *New York Super Lawyers* (2007, 2008, 2009 and 2010 editions).

Ed is a frequent ERISA speaker at prominent conferences, including PLI, NYSBA, Institutional Investor and West Legalworks.

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Christopher J. Sues joined Pryor Cashman in 1995 and is a partner in the firm's Executive Compensation, ERISA and Employee Benefits 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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