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Executive Compensation Law ALERT

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IRS Expands Extension of Deadline for Internal Revenue Code Section 409A Compliance

On October 22, 2007, the Internal Revenue Service ("IRS") issued Notice 2007-86 (the "October 2007 Notice"), which extends the effective date of the final regulations issued under Internal Revenue Code section 409A ("Section 409A") by one year, to January 1, 2009. The deadline for employers to begin reporting contributions to and earnings under nonqualified plans, as required by Section 409A, has also been extended.

As described in previous Alerts, Section 409A applies to virtually any nonqualified deferred compensation plan, agreement or arrangement that provides for the payment of compensation in a year after it is earned, potentially including not only nonqualified deferred compensation and retirement plans but also employment and consulting agreements, bonus plans, stock option plans, reimbursement arrangements, split dollar arrangements and royalty arrangements (collectively, "nonqualified plans"). If a nonqualified plan does not conform to Section 409A, participants in the plan are required to immediately include in income any amounts vested under the plan and to pay additional interest, penalties and a 20% excise tax.

The October 2007 Notice effectively revokes and supersedes most of the substantive provisions contained in IRS Notice 2007-78, issued just the previous month, which had extended by one year the deadline for bringing a nonqualified plan into full *written* compliance with Section 409A, but left unchanged the original January 1, 2008 deadline for specifying in writing any provisions relating to the time and form of payment of benefits under the plan, and for operating the plan in full compliance with Section 409A. The October 2007 Notice, by contrast, does not require operational compliance with the final Section 409A regulations during 2008 and essentially extends the transition rules allowing for the revision of documents and payment terms in almost all respects to January 1, 2009.

Although the relief provided by the October 2007 Notice is quite comprehensive, it is not absolute. During the period prior to the new January 1, 2009 effective date, companies must continue to operate their nonqualified plans based on a "reasonable good faith" interpretation of Section 409A. Moreover, although changes to distribution elections may now be made in 2008 without application of the final Section 409A regulations, in order to apply to distributions in 2008, such changes need to be in place by January 1, 2008. Thus, it is still the case that the opportunity to change the timing of 2008 payouts will expire on December 31, 2007.

That the IRS felt the need to issue a second notice providing more comprehensive relief from the original effective date contained in the final Section 409A regulations further underscores just how much time and effort will be required of many taxpayers to ensure that their nonqualified plans fully comply with Section 409A. In many cases, this effort will involve careful consideration of the changes required, as well as obtaining various consents to implement the changes. Moreover, the IRS has indicated it will not support any additional delays for compliance with Section 409A. Accordingly, taxpayers should begin the process of bringing their nonqualified plans into compliance with Section 409A as soon as possible.

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