



### Review Compensation Arrangements Now!

The deadline for compliance with new Section 409A of the Internal Revenue Code is December 31, 2007. Virtually every nonqualified compensation arrangement providing for payments in cash or property in the future should be reviewed as soon as possible for compliance with the new rules. Failure to comply with the new rules may subject your client to back taxes, interest, penalties and 20% excise taxes!

#### Arrangements to Which Section 409A Could Apply:

- Employment, Consulting, Severance and Change in Control Agreements
- Nonqualified Deferred Compensation, Retirement and Pension Makeup Plans
- Performance and Incentive Bonus Plans
- Stock Option, Stock Appreciation and Phantom Stock Plans
- Reimbursement Arrangements
- Performance and Royalty Arrangements
- Any other arrangement having the effect of deferring compensation of employees, directors or independent contractors, other than ERISA-qualified plans

#### Highlights of New Provisions:

**a) Effect of Section 409A.** Section 409A imposes limitations on the timing of payments of deferred compensation and elections relating thereto. Failure to comply with these requirements results in an acceleration of the income tax on the service provider (the “employee”) with respect

to such income, and the imposition of a 20% additional penalty tax on the employee.

**b) Equity Arrangements Covered.** Deferred compensation is defined broadly to include below market options or SARs, options or SARs on other than common stock of the employer or its parent, options or restricted stock with any kind of deferral feature, and phantom equity arrangements.

**c) Timing of Deferrals.** Deferral of payments must be agreed upon before right is granted or before the year in which the services are performed with limited exceptions, such as for “performance-based compensation.”

**d) Timing of Payments Must be Specified.** The timing of all payments must be specified in writing in sufficient detail to meet or avoid the requirements of Section 409A. The new rules seek to avoid any discretion on the part of either the employee or the employer regarding the timing of distributions after the services have been performed.

**e) Distribution Options Limited.** Distributions may only be made upon the employee’s termination of service, death, or disability, or a change in control, unforeseeable financial hardship, vesting or scheduled date. The timing of distributions may not be accelerated or changed by either the employee or the employer except under very limited circumstances.

**f) Public Company Severance Payments Subject to 6 Month Delay.** Severance or termination payments to

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specified executives of public companies must be delayed until 6 months after termination with specified limitations for short term payments and involuntary and window severance payments.

### Excluded Plans

The following types of plans generally should not be covered or should comply with Section 409A:

- ERISA-qualified plans and Section 403(b), 457(b) and 423 plans
- Independent contractor arrangements with contractors who perform substantial services (other than management services) to more than one unrelated employer (no more than 70% to one employer group)
- Agreements in which all benefits were fully vested before October 3, 2004 and to which there have been no material modifications or further contributions other than market rate earnings
- Reimbursement plans if no payment is includable in income by the employee
- Agreement that require all payments to be made within 2½ months after the end of the year in which the right vests (i.e., is no longer subject to a substantial risk of forfeiture)
- Stock option plans for common stock that cover only employees of the issuer and its subsidiaries (not parents or affiliates), do not permit grants below fair market value and do not have any other deferral feature

- Settlement agreements resulting from negotiated settlement of bona fide dispute

Even with some of these arrangements, it may not be readily apparent whether the new rules apply, and the arrangement should be reviewed. Even if Section 409A does not apply, it may be prudent to modify certain language to make it even clearer such as by adding protective 409A language.

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