Paul|Weiss

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Final Warning!
December 31, 2008 Deadline for Section 409A Compliance

Compensation arrangements subject to Section 409A of the Internal Revenue Code must be amended by December 31, 2008 to meet regulatory requirements. The deadline cannot be extended.

Please let us know ASAP if you need help preparing appropriate amendments or forms for Section 409A, or if you need help in determining whether specific arrangements are subject to Section 409A.

Employers should be checking arrangements with employees, directors, consultants and other independent contractors. Private equity firms may want to make sure that portfolio companies have addressed Section 409A compliance. Hedge funds should be checking their own deferred compensation arrangements.

For the last three years, employers have generally not been required to fully document affected arrangements. This relaxed IRS policy is ending and all forms and documents must comply with Section 409A regulatory requirements by December 31, 2008.

Background

Section 409A regulates the timing of elections and payouts under nonqualified deferred compensation plans. Section 409A applies to both elective and non-elective plans, and also applies to many arrangements not traditionally regarded as deferred compensation. In a public company, deferred compensation otherwise payable upon separation from service must be delayed by 6 months for the 50 highest-paid officers. Noncompliance can result in employees or independent contractors having to pay tax on income before it is paid to them, and also in the imposition of substantial penalty taxes. A review is appropriate now even for forms and documents that were prepared with Section 409A in mind, to take into account the final regulations adopted in April 2007 and subsequent developments.

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Example Arrangements

Here are some of the compensatory arrangements that can be subject to Section 409A and that may need to be fixed by the end of 2008:

- Discount stock options or discount equity appreciation rights
- Options and equity appreciation rights on the "wrong" kind of employer equity (for example, typical options on parent company stock are generally exempt from Section 409A if given to either parent or subsidiary employees, but there is no Section 409A exemption for options on subsidiary stock awarded to parent company employees)
- Phantom stock, RSU and bonus plans, unless payments are fixed to a date within 2-1/2 months after the vesting year
- Equity incentives that may be repurchased for more than fair value
- Some change in control, deal bonus and earn-out plans
- Severance arrangements, including in employment contracts, offer letters and retention agreements (a sleeper potential issue – requiring a release to collect severance, without imposing a deadline for signing the release)
- Split-dollar life insurance
- SERPs, excess and wrap-around plans, and nonqualified salary reduction plans
- Disguised security devices, like some offshore trusts, and "springing" security interests that trigger if the employer is financially downgraded.
- Reimbursements, in-kind benefits, golden parachute and other tax gross-ups -- all may need to satisfy special timing rules

As you can see, many covered arrangements will be part of bilateral contracts and employers will not necessarily be able to quickly identify affected employees and independent contractors and/or obtain timely consent to any needed amendments.

Rethinking Old Choices

Under an expiring transition rule, December 31, 2008 is also a deadline for restructuring old deferred compensation deals without having to comply with Section 409A's stringent rules on advance elections and minimum deferral periods. This flexible opportunity requires that payments not be brought into or pushed out of 2008.

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning the initiatives addressed in this memorandum can be directed to:

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