

Client Alert

A report
for clients
and friends
of the Firm **October 2007**

IRS Extends Section 409A Transition Relief To December 31, 2008

On October 22, 2007, the IRS and the Treasury Department issued Notice 2007-86 (the "Notice") extending to December 31, 2008 certain transition relief regarding the application of Section 409A of the Internal Revenue Code of 1986, as amended ("Section 409A") to nonqualified deferred compensation plans. The Notice is a welcome expansion of the more limited relief provided by Notice 2007-78, published only six weeks ago, which extended the time for plan sponsors to adopt formal plan amendments to comply with Section 409A, but had required full operational compliance with the final regulations by January 1, 2008.

Extension of Transition Relief

Plans subject to Section 409A are not required to fully comply with the final Section 409A regulations during 2008. Instead, plans or other covered arrangements (referred to herein as "plans") must be operated in accordance with their terms, to the extent consistent with, and in good faith compliance with Section 409A, and the "applicable guidance" which includes Notice 2005-1 (but not the proposed regulations).

Although plans, employment agreements and other arrangements must continue to be operated in accordance with Section 409A, Section 409A covered arrangements do not need to be amended to comply with Section 409A until the end of 2008. Notwithstanding the additional time to make written modifications, employers may conclude that it is prudent to continue or commence the modification process without delay to finalize in writing the manner covered arrangements will be operated.

Reasonable Good Faith Compliance

For periods before January 1, 2008, if a plan is operated in compliance with Notice 2005-1, the proposed regulations or the final regulations, it will be considered to be in

"reasonable, good faith" compliance with Section 409A. For periods after December 31, 2007 and before January 1, 2009, compliance with Notice 2005-1 or the final regulations (but not the proposed regulations) will constitute "reasonable, good faith" compliance. To the extent that a provision of the final regulations is inconsistent with Notice 2005-1 for periods after December 31, 2007 and before January 1, 2009, the plan may comply with the provisions of either the final regulations or Notice 2005-1.

After 2007, plan sponsors generally may not rely on the proposed regulations, with limited exceptions relating to the application of Section 409A to partners and partnerships, changes in payment elections or conditions, and the substitution of non-discounted stock options and stock appreciation rights (SARs) for discounted stock options and stock appreciation rights.

Changes to Payment Elections on or before December 31, 2008

Participants or plan sponsors may elect to change the time and form of payments made from plans subject to Section 409A through December 31, 2008 without violating the strict Section 409A rules on acceleration of payments and subsequent deferrals, provided an election or plan amendment that occurs in 2007 does not apply to any amount that would otherwise be payable in 2007 and does not cause an amount to be paid in 2007 that would not otherwise be payable in 2007. Similarly, an election or plan amendment made in 2008 may not apply to any amount that would otherwise be payable in 2008 or cause an amount to be paid in 2008 that would not otherwise be payable in 2008. Accordingly, an election to defer an amount due in 2008 or to accelerate an amount into 2008 must be made in 2007.

Payments from "Linked Plans"

The ability to link the time and form of payment under nonqualified deferred compensation plans to an election under a qualified plan is also extended through December 31, 2008. In addition, this relief extends to Section 403(b) plans, Section 457 plans and certain broad-based foreign

plans. This relief essentially gives plan sponsors an additional year to de-link such plans.

Discounted Stock Options and SARs

The Notice extends to December 31, 2008 the time wherein discounted stock options and stock appreciation rights (SARs) (which are subject to Section 409A) may be cancelled and replaced with stock options and SARs that would not be considered discounted if issued on the original grant date, so long as the cancellation or replacement of an option in 2008 is not in exchange for cash or vested property in 2008. The Notice also extends to December 31, 2008 the time that a stock right, providing for the deferral of compensation subject to Section 409A can be amended to provide for fixed payment terms consistent with Section 409A or to provide for elections of fixed payment terms by holders, so long as the option or right is amended or elections are made before December 31, 2008. This relief does not apply to discounted options granted to officers and directors of certain public companies.

Voluntary Correction Program

The Treasury Department and the IRS have again stated that they anticipate issuing guidance as soon as possible with respect to initiating a voluntary correction program for Section 409A failures.

Notice 2007-78

The limited transition relief provided in Notice 2007-78 has been superseded by the Notice. However, the guidance provided in Notice 2007-78 is still effective with respect to good reason provisions in employment contracts which now may be amended to conform certain good reason definitions to the Section 409A final regulations good reason conditions on or before December 31, 2008. Guidance provided in Notice 2007-78 with respect to predetermined cashouts is also still effective.

For a more detailed explanation of the guidance on these topics in Notice 2007-78, please see our recent Client Alert available on our website at http://www.proskauer.com/news_publications/client_alerts/content/2007_09_17/.

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Client Alert

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