



JONES DAY  
**COMMENTARY**

## IRS ISSUES LIMITED “RELIEF” TO BRING DOCUMENTS INTO COMPLIANCE WITH SECTION 409A REGULATIONS

Internal Revenue Code Section 409A is the latest effort to use the tax laws to regulate executive compensation. Enacted in 2004, Section 409A imposes substantial penalties on nonqualified deferred compensation arrangements that fail to meet its many requirements. Because of the scope and complexity of Section 409A, the Internal Revenue Service (“IRS”) and the Treasury Department have previously provided generous transition relief for taxpayers to comply with Section 409A. Earlier this year, final regulations were released. The IRS and Treasury stated at that time that deferred compensation arrangements must be in full compliance, both in written form and operation, by January 1, 2008, in order to avoid Section 409A penalties.

Achieving full compliance by the end of 2007 has proven to be a daunting task. Many requests for further delays in the compliance deadline were submitted, including a letter dated August 21, 2007, signed by 92 major law firms.

On September 10, the IRS and Treasury responded by issuing Notice 2007-78 (the “Notice”), which extends the Section 409A documentary compliance deadline from December 31, 2007, to December 31, 2008, for *certain* provisions required to be in writing. For example, the six-month delay provision for payments to certain senior executives of public companies following separation from service may now be documented at any time prior to December 31, 2008.

The relief provided by the Notice, however, is limited in scope and practical effect. Certain aspects of documentary compliance must be in place by the original deadline of December 31, 2007, including designation of time and form of payment. Since these provisions are fundamental to the design and operation of most deferred compensation plans, the benefits of the Notice may be modest. Moreover, the Notice does not extend most of the transition relief scheduled to

expire on December 31, 2007. Thus, for example, the ability to change the time and form of certain payments due after 2007, which allows new payment elections by plan participants, terminates on December 31, 2007.

The Notice does provide some relief that may be useful to compensation committees that may be required to comply with corporate governance procedures before amending existing management agreements. The Notice confirms that companies have the ability to conform existing good reason conditions with some or all of the conditions of the safe-harbor good reason definition provided in the Section 409A regulations, so long as such changes are made on or prior to December 31, 2007. The Notice also provides that companies have the ability to remove certain noncompliant plan provisions (e.g., hair-cut provisions) at any time prior to December 31, 2008, provided that the plan complies in operation before that date.

In addition, the Notice indicates that the IRS and Treasury anticipate establishing a limited voluntary compliance program intended to provide a means for taxpayers to correct certain unintentional operational violations of Section 409A.

We believe that for most companies, the Notice should *not* be viewed as general relief from the need to continue the scope of review currently planned (or underway) or as a meaningful reduction in the amount of work necessary to comply with Section 409A by the end of 2007. While documentary compliance in certain areas may be postponed until December 31, 2008, documentary compliance in a number of critical areas is still required by December 31, 2007, as is continuing operational compliance.

## LAWYER CONTACTS

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