

Federal Tax Course Letter

RETIREMENT BENEFITS

IRS Extends Deadline for 409A Compliance

The IRS has announced that taxpayers will have until December 31, 2008, to bring documents into compliance with the final nonqualified deferred compensation (NQDC) regulations under Code Sec. 409A [IR-2007-157; Notice 2007-78]. Code Sec. 409A and the accompanying regulations provide rules for the tax treatment of NQDC plans in response to concerns involving reported abuses of these plans that typically provide benefits to executives and key employees.

Background

Under Code Sec. 409A, all amounts deferred under a NQDC plan for all tax years are currently includible in income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless the plan (1) meets the distribution, acceleration of benefit and election requirements under Code Sec. 409A, and (2) is operated in

accordance with these requirements. If a NQDC plan fails to satisfy the statutory and regulatory requirements, plan participants must immediately include amounts deferred under the plan in income and pay interest at the underpayment rate plus one percentage point and a 20-percent penalty [Code Sec. 409A(a)(1)(B)]. The regulations provide guidance regarding the requirements for deferral elections and payment timing under Code Sec. 409A. Affected plans and arrangements were required to comply with the final regulations by December 31, 2007.

In Notice 2007-78, the IRS extends the document compliance deadline for one year but does not extend the January 1, 2008, effective date of the final regulations. The IRS also plans to issue guidance containing a limited voluntary compliance program that will permit corrections of certain unintentional operational violations of Code Sec. 409A.

Retroactive Amendment Period

Notice 2007-78 provides that a NQDC plan will not violate Code Sec. 409A merely because the written provisions of the plan fail to meet the requirements of the final Code Sec. 409A regulations if:

- the plan is amended on or before December 31, 2008, retroactively to January 1, 2008, to contain the requirement; and
- the written plan provision accurately reflects the operation of the plan through the date of the amendment. Taxpayers must demonstrate that the required delay was applied to affected payments.

Transition Relief— Designation of a Compliant Time and Form of Payment

Notice 2007-78 provides that deferrals of compensation deferred after December 31, 2007, and before January 1,

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2009, will not comply with Code Sec. 409A unless the plan designates in writing before January 1, 2008, a compliant time and form of payment of the deferred compensation.

A plan will satisfy this requirement if it provides an objectively determinable form of payment payable upon (1) a separation from service; (2) a change in control event; (3) an unforeseeable emergency; (4) a specified date or fixed schedule of payments; (5) death; or (6) disability.

For example, a plan may provide that an amount deferred under the plan will be paid in the form of a life annuity commencing on the later of the service provider's separation from service or attaining age 65. However, a plan may not provide that an amount deferred under the plan will be paid during the three years following the service provider's separation from service (with the exact timing of the payment during the three-year period determined at the discretion of the service recipient), because that plan term would not provide a compliant time and form of payment. The plan may specify any combination of payment events that is permissible under the final regulations, including that a deferred amount is to be paid upon the earliest of

the events listed above or the latest of these events.

Anticipated Limited Voluntary Compliance Program

The IRS announced that it anticipates issuing guidance in the near future establishing a limited voluntary compliance program that will apply to certain unintentional operational failures to be corrected in the same year in which the operational failure occurred to avoid application of Code Sec. 409A taxes and penalties. It also anticipates that the program will permit other correction methods that will result in only limited amounts becoming included in income and subject to penalties.

No Offshore Trust Relief

Code Sec. 409A(b)(1) generally prohibits the use of offshore trusts in connection with amounts payable under a NQDC plan. In Notice 2007-78, the IRS provides that the grace period provided to offshore trusts in Notice 2006-33 is not being extended beyond its December 31, 2007, deadline. Thus, for such grace period assets, a NQDC plan must be in conformity with a reasonable, good-faith interpretation of Code Sec. 409A on or after December 31, 2007. ■