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TREASURY DEPARTMENT AND IRS EXTEND TRANSITION RELIEF FOR NONQUALIFIED DEFERRED COMPENSATION ARRANGEMENTS SUBJECT TO CODE SECTION 409A

By: Kelly C. Simoneaux

On October 4, 2006, the Treasury Department and the Internal Revenue Service issued Notice 2006-79 (the "Notice"), which extends most of the existing transition relief for nonqualified deferred compensation arrangements that are subject to the requirements of Section 409A of the Internal Revenue Code ("Section 409A"). ([Click here](#) to link to the Treasury's release.)

As we have previously reported, Section 409A imposes strict requirements on nonqualified deferred compensation arrangements, particularly focusing on the distribution rules and election procedures, and imposes significant penalties for failure to comply. Employers are currently operating under guidance giving certain transition relief through the end of 2006. In light of the fact that the final regulations have not yet been issued under Section 409A (they are expected to be issued later this year), and recognizing the difficulty some employers may face trying to make the required changes to their plans and arrangements prior to the end of 2006, the Treasury Department and the IRS have extended most of the transition relief and the documentary compliance deadlines under Section 409A. In particular, the Notice:

- Extends the deadline for amending nonqualified deferred compensation plans to comply with Section 409A until December 31, 2007.
- Extends the transition relief regarding distribution elections, now permitting new payment elections to be made through December 31, 2007, with respect to both the time and form of payment. Similar to prior guidance, the extended guidance does not permit an election made during 2007 to apply to amounts that are otherwise payable in 2007 or to cause an amount to be paid in 2007.
- Extends through 2007 the transition relief for distributions under a nonqualified plan that is linked to a qualified plan.

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Note that in response to the recent concerns regarding inappropriate option grant practices by some companies, this extended transition relief does not apply to cancellations or amendments of discounted stock options or stock appreciation rights granted to insiders of public companies where the company has reported or reasonably expects to report a financial expense that should have been reported in a prior period due to the issuance of a discounted stock right. Thus, to the extent such rights must be cancelled or amended to comply with Section 409A, the company must take action prior to December 31, 2006.

What Should Companies Do Now?

Companies have been required to operate in “reasonable, good faith compliance” with the requirements of Section 409A since January 1, 2005, and this continues to be the case. Therefore, during this extended transition period it is important that companies continue to (1) review their nonqualified plans and arrangements to assure that they are being operated in compliance with Section 409A, which may require revisions to procedures and related forms (such as employee deferral election forms), (2) ensure compliance with Section 409A prior to making any payments from such plans and arrangements, and (3) prepare to bring plan documents and arrangements into documentary compliance once the final regulations are issued

Keep in mind that Section 409A has a broad reach, applying to a variety of deferred compensation plans, supplemental plans, and employment and severance agreements.

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Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues you may contact any of the following attorneys.

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