

## Final 409A Deferred Compensation Regulations: Not the Hoped for Relief

On April 10, 2007, the IRS issued the long-awaited, and oft-delayed, final regulations under Section 409A of the Internal Revenue Code of 1986 (the "Code"). Their length (397 pages) and overall complexity requires more study before we can offer definitive guidance with respect to them. It is clear, however, that, while the final regulations offer some relief from the difficulties presented by the breadth of Section 409A, in some areas they actually create new compliance problems. Some highlights of the final regulations are set forth below:

### **Effective Date**

The final regulations are effective January 1, 2008. Any non-complying plan therefore must be amended or terminated by that date to avoid the excise tax imposed for non-compliance.

### **Good Reason Termination**

The IRS had taken the position that a termination for "good reason" under an employment agreement was not necessarily involuntary and thus could be subject to Section 409A. The final regulations modify this position somewhat by providing that good reason may constitute an involuntary termination, while still requiring that the parties must be able to demonstrate that the termination was the result of a "material adverse change" in the employment relationship, (*e.g.* a change in an executive's duties, working conditions, or compensation). The final regulations also provide a safe harbor definition of good reason, adding that the executive must quit within one year of the good reason breach and must give timely notice of the breach. Many executives, however, are likely to conclude that they need more protection than the safe harbor provides, making its value problematic.

### **Severance Payments**

The proposed regulations provided an exemption for severance payments of up to two times the limit on compensation under qualified retirement plans (capped at \$450,000 in 2007) if the payments are completed by December 31 of the second calendar year following the termination date. The final regulations expand this rule by providing that only amounts in excess of the capped limit will be subject to Section 409A.

### **Partnership**

Like the prior guidance, the final regulations do not address partnerships in any meaningful way, leaving unanswered a number of significant questions about the application of Section 409A to partnerships.

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**Definition of Service Recipient Stock**

The final regulations expand the definition of service recipient stock to include any class of the service recipient's common stock (the proposed regulations limited it to the highest class of common).

You may call anyone in the tax department if you have questions about Section 409A or would like additional information.