IRS Announces Limited Section 409A Transition Relief for 2008

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On September 10, 2007 the IRS issued Notice 2007-78, which extends until December 31, 2008 the deadline for amending deferred compensation plans to comply with Section 409A. Unfortunately, the relief provided by the extension is substantially undercut by the requirement in the Notice that a Section 409A-compliant time and form of payment of deferred amounts be designated in writing by December 31, 2007. In the Notice, the IRS also (a) states its intention to adopt a limited voluntary compliance program, (b) explains how existing Section 409A transition rules (which expire on December 31, 2007) apply to certain aspects of employment and severance arrangements, and (c) announces that the good faith compliance standard for complying with Section 409A's rules relating to offshore trusts and funding will remain in effect until further notice.

Following are key highlights of the Notice:

- **Limited 2008 Transition Relief.** The Notice provides transition relief until December 31, 2008 to comply with the plan documentation requirements of the final regulations issued under Section 409A (the "Final Regulations"). Undercutting this relief, however, the Notice requires that a Section 409A-compliant time and form of payment (e.g., payment upon a fixed time or schedule, separation from service, change in control, death, disability) be designated in writing by December 31, 2007. Unfortunately, complying with this requirement will, in many cases, necessitate much of the work that would be required to amend a deferred compensation arrangement to comply with Section 409A. Under the Notice, operation of the plan during 2008 also must be in full compliance with the Final Regulations, and the plan must be amended by December 31, 2008, retroactively to January 1, 2008, to reflect the operation of the plan during 2008.
- **What the Notice Does Not Do.** The Notice does not delay (a) the January 1, 2008, effective date of the Final Regulations, (b) the December 31, 2007 expiration of the Section 409A good faith compliance period (except for the offshore trust and funding rules), or (c) the December 31, 2007 expiration of the existing Section 409A transition rules, which have allowed substantial flexibility with respect to amending deferred compensation arrangements to comply with Section 409A or an exemption thereto.

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- **Employment Agreements.** The Notice provides guidance as to the IRS's position with respect to the application of the existing Section 409A transition rules to the amendment of "good reason" termination provisions in existing employment and severance arrangements. Unfortunately, the IRS appears to adopt a restrictive interpretation that would limit the ability to amend good reason termination provisions so as to conform with the Final Regulation's good reason standards (which, in many cases, can allow severance benefits to qualify under the short-term deferral rule or other exemption from Section 409A).
- **Voluntary Compliance Program.** Because of the severe consequences of failing to comply with Section 409A, employers and practitioners have called upon the IRS to develop a voluntary compliance program under which noncompliance may be corrected. The Notice announces that the IRS anticipates that it will issue guidance establishing a limited voluntary compliance program. Due to the stated limited scope of program—it would apply only to unintentional operational (and not documentation) failures and require correction in the same tax year as the failure—it appears that the program will be of limited usefulness.

Because of the limited scope of the relief provided by the Notice and the time demands of amending plans to comply with the complex regulatory scheme established by Section 409A, there likely will be substantial pressure on the IRS to issue broader relief. In the absence of any certainty as to future relief, however, employers should continue to press forward with their compliance efforts.

We hope that you find this brief summary helpful. If you would like more information, or assistance in addressing or commenting on the issues raised in this advisory, please feel free to contact:

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