

Legal Updates & News

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California clones IRS Pilot Program on Section 409A Corrections, Year-End Deadline to Amend for Section 409A

June 2008

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California's Franchise Tax Board (the "FTB") has issued a [statement](#) in its May 2008 edition of *Tax News*, essentially following Internal Revenue Service [Notice 2007-100](#) (pdf), which established a pilot correction program to enable employers to correct certain minor administrative errors in deferred compensation arrangements subject to Internal Revenue Code Section 409A. California's reporting requirements under this correction program are less onerous than those of the IRS – taxpayers will not be required to submit additional statements to the FTB as attachments to their income tax returns – but the substantive requirements of California's transitional relief follow the IRS pilot program.

While these correction programs are available for administrative problems, employers are to be reminded of the December 31, 2008 deadline to bring the documentation of their programs into compliance with Section 409A. As noted in a previous Morrison & Foerster [alert](#), compensation arrangements potentially subject to Section 409A include not only traditional deferred compensation plans, but also payments under severance agreements, employment agreements, change in control and retention agreements, discounted stock options, and other forms of equity compensation such as restricted stock units or "phantom" stock.

Any such arrangement that is not brought into compliance with Section 409A by the final deadline of December 31, 2008 may cause the compensation to be taxed before it is paid and cause the employee to incur an additional 20% federal tax (plus an additional 20% in California). Interest may also apply. Although the IRS granted companies a final twelve months to bring their compensation arrangements into documentary compliance by extending the transition period for amendments to December 31, 2008 (as noted in our November 2007 [alert](#)), every indication is that this deadline will not be extended again.

Critical action items to address now include:

- **Inventory** all plans and arrangements subject to Section 409A.
- **Determine** whether modifications or amendments are needed to bring the documents into compliance.
- **Adopt** needed changes by December 31, 2008. (Please note that some corrections require actions such as a "tender offer" – a formal process that takes approximately a month to complete.)

Many of the amendments to bring compensation arrangements into compliance with Section 409A require board or compensation committee action, formal filings and/or obtaining consent from the service provider. We encourage companies to address these issues well before December to ensure that their employees will not be unnecessarily subjected to harsh Section 409A penalties.

Companies still needing to amend their compensation programs to comply with Section 409A prior to the December 31, 2008 deadline, or to learn more about the federal and California correction programs, should contact us for assistance.

