
Legal Updates & News

Legal Updates

Action Required by December 31, 2007, to Comply with Final Section 409A Requirements

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This is a reminder that employers have until December 31, 2007, to comply with the final regulations under Internal Revenue Code Section 409A. We described the main features of Section 409A, which governs various types of deferred compensation, in previous Morrison & Foerster alerts, the most recent of which is available [here](#).

Background

Section 409A has generally been in effect since 2005. Employers have been required to administer deferred compensation arrangements in accordance with Section 409A during a transition period that began at that time. That transition period ends December 31, 2007, and arrangements subject to Section 409A must be amended by year end to comply with the final rules. Noncompliant arrangements that are not amended may subject an employee or other service provider to income tax before any compensation is actually received, and they may result in an additional 20% penalty tax (40% in California).

Plans Needing Attention

In addition to traditional deferred compensation plans, Section 409A may apply to severance arrangements; payments under employment, change in control, and retention agreements; stock options granted at a discount; and certain other forms of equity-based compensation.

Action Items

To ensure documentary compliance with the Section 409A rules, employers should:

- **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, 2007. Note that some changes may require lead time. Discounted stock options, for example, may need to be fixed using a "tender offer," which requires a formal filing and takes about a month to complete. Similarly, many agreements will require board or compensation committee action or the service provider's consent to be amended. Accordingly, we recommend that employers start planning early for final compliance.