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ALERT

APRIL 12, 2007

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Treasury and IRS Issue Final 409A Regulations

The U.S. Department of the Treasury and the IRS released long-awaited final regulations under Internal Revenue Code § 409A on Tuesday (April 10, 2007). Code § 409A was enacted as part of the American Jobs Creation Act of 2004 and it regulates a broad range of compensatory plans and arrangements that are lumped together under the heading of "non-qualified deferred compensation plans." Spanning some 398 pages, the final rule preserves much of the approach taken in prior guidance, but it also makes some important changes and enhancements. Key features of the new regulations include:

- **Plan Aggregation Rules.** There are now nine categories or types of plans (up from four in the proposed regulation). This is important for determining which plans and arrangements of a particular participant are treated as violating Code § 409A as a result of a violation in another plan of the same type covering the same person.

- **Definition of "Service Recipient Stock."** The proposed regulations contained a restrictive rule governing what stock could qualify as "service recipient stock" that would allow a stock option or stock appreciation right to escape regulation under Code § 409A. The final regulations liberalize the classes of stock and issuers that qualify.

- **Good Reason Termination Events.** The proposed rule treated benefits payable in the case of termination for "good reason" as vested when the promise was originally made. The final rule changes this result in a few important respects. This change will afford employers with a greater range of options in designing severance arrangements.

- **Separation from Service.** "Separation from service" is one of the permissible Code § 409A distribution events. The final regulation vastly simplifies the standard for determining

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whether an employee has separated from service by establishing a handful of easy-to-apply presumptions. The treatment of severance arrangements, and the ways in which they might either avoid classification as deferred compensation, are also addressed at length.

- **Reimbursements.** The final rule makes clear that certain post-employment reimbursement arrangements are subject to Section 409A to the extent they furnish taxable benefits.

- **Documentary Compliance.** The final rule established clear standards for what must be in a compliant plan document. Additionally, "savings clauses" will not be given effect in a plan that otherwise violates the substantive provisions of Code § 409A.

- **"Linked" Plans.** One of the more daunting issues raised by Code § 409A is the treatment of non-qualified plans, the benefits or elections under which are coordinated with (or "linked" to) qualified plans. While the final regulations do not provide general relief for linked plans, they do provide rules that allow for linked plan structures.

Concurrent with the release of the final Code § 409A regulations, Treasury and the IRS also issued Notice 2007-34, which provides guidance on the impact of Code § 409A on split-dollar life insurance arrangements.

The final Code § 409A regulations take effect January 1, 2008, but they can be relied upon immediately. Plans must by brought into documentary compliance by December 31, 2007.

While extensive, the final Code § 409A regulations do not cover all of the Code § 409A requirements. It does not, for example, deal with timing and inclusion of income, nor does it deal with certain benefit security features (*e.g.*, offshore trusts and financial health triggers). These and other issues will be dealt with in separate guidance.

Over the next few weeks and months, we will be issuing client advisories that focus on important provisions of this new and important rule. ***Stay tuned!***

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If you have any questions concerning the information discussed in this advisory or any other employee benefits topic, please contact one of the attorneys listed below or your primary contact with the firm who can direct you to the right person. We would be delighted to work with you.

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