Allen Matkins Tax and Benefits Alert





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Recent tax law requires deferred compensation plans to be amended by December 31, 2008

Employers have until December 31, 2008 to amend deferred compensation arrangements to comply with Section 409A of the Internal Revenue Code ("Section 409A"). Failure to do so can cause significant adverse tax consequences for employers, employees and other service providers who are parties to such deferred compensation arrangements.

Please note that this Alert is only a brief summary of Section 409A's requirements and is not intended as legal advice. Due to the complexity of Section 409A and the related IRS regulations, we encourage you to contact your Allen Matkins attorney or one of the following Allen Matkins employee benefits attorneys if you have questions or need assistance in addressing the Section 409A requirements.

In addition to traditional non-qualified deferred compensation plans, many arrangements that employers would not generally consider to be deferred compensation are treated as deferred compensation under Section 409A, including, but not limited to, employment contracts, severance contracts, severance pay plans, bonus plans, incentive plans, stock options, stock appreciation rights, restricted stock units, phantom stock awards, change in control agreements, change in control plans and Section 457(f) plans. Any arrangement that is subject to Section 409A is referred to in this Alert as a "plan."



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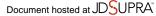
About Section 409A

Section 409A was enacted in October 2004. Under Section 409A unless certain requirements are satisfied, amounts deferred under a plan are currently taxable to employees and certain other service providers for income tax purposes unless the amounts are subject to a substantial risk of forfeiture or were previously included in the employee's gross income.

In addition, the employee's tax liability under Section 409A is subject to an interest charge and the employee is subject to a 20% penalty tax in addition to the employee's regular income tax on such amounts included in gross income under Section 409A. In some cases, the IRS may seek tax deficiencies and penalties from employers. In addition, employers will have withholding obligations if amounts are taxable to employees under Section 409A.

Your plan may need to be amended

All plans must be operated in compliance with Section 409A and related IRS regulations and other guidance published by the IRS. If a plan is operated in compliance with Section 409A but is not amended to comply with Section 409A on or before



http://www.jdsupra.com/post/documentViewer.aspx?fid=8ccff544-ef5f-4201-af33-d6df07e317a0 December 31, 2008, **the plan will be treated as failing to**

comply with Section 409A as of January 1, 2009. This would not result in penalties under Section 409A for tax years ending prior to January 1, 2009. However, it would result in taxes and penalties on employees and certain other service providers with respect to amounts which are vested as of January 1, 2009 but which remain unpaid as of such date and with respect to amounts that vest after January 1, 2009.

Employers should immediately review all plans and compensation arrangements to determine whether they may be subject to Section 409A or whether they qualify for an exemption from Section 409A. If they are subject to Section 409A, such plans must be amended by December 31, 2008 if they do not currently comply with Section 409A.

In addition, taxpayers generally have until December 31, 2008 to amend a discounted stock option or stock appreciation right ("SAR") that is subject to Section 409A and replace it with a non-discounted stock option or SAR in order to avoid adverse tax consequences under Section 409A. This is accomplished by amending or replacing the discounted stock option or SAR by December 31, 2008 to increase the exercise price to at least 100% of the fair market value of the underlying stock on the original grant date of the option or SAR. However, discounted stock options and SARs granted to Section 16 officers and directors of public companies can no longer be repriced in order to avoid tax consequences under Section 409A. The Section 409A deadline for repricing such options and SARs expired on December 31, 2006.

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