BRIEF SUMMARY OF BASIC 409A RULES AND CONCEPTS

I. **Introduction**. Added to the tax code in October of 2004, Section 409A has created a new body of law governing deferred compensation.

A. On the positive side, Section 409A resolves decades of uncertainty created by conflicts between IRS positions and federal court authority. On the negative side, it eliminates many common plan designs, magnifies the risks of being wrong, and creates new issues and restrictions for many types of arrangements not commonly thought of as "deferred compensation."

B. Section 409A, in essence, creates a new category of "semi-qualified" deferred compensation plans. The statute calls them by their traditional name - "nonqualified deferred compensation plans" - to distinguish them from "qualified employer plans" (fully tax-advantaged pension plans and 401(k) plans, for example), but at the same time, Section 409A imposes statutory standards that these plans must now meet to preserve their traditional, limited tax-deferral.

C. Qualified employer plans offer three principal tax advantages: (1) the employee postpones taxation until benefits are received; (2) the employer receives a tax deduction as plan contributions are made; and (3) the plan pays no income tax on its earnings. Those plans, however, have a major catch. They come with severe restrictions under the Internal Revenue Code and ERISA, including contribution and benefit limitations, nondiscrimination rules, funding and vesting requirements, and many other design constraints.

D. For a variety of reasons, employers have often added nonqualified deferred compensation plans to their benefits array, to accomplish several things that their qualified employer plans cannot do - such as:

1. providing greater retirement benefits,

2. limiting benefits to key people only, and

3. encouraging retention through longer vesting periods.

The nonqualified plans offer relatively modest tax benefits - allowing the employee to postpone taxation until the money is received, but requiring the employer to postpone its deduction until the employee is taxed, and taxing currently any earnings on amounts the employer reserves to pay future benefits.

E. With Section 409A, nonqualified plans now have their own statutory standards to meet before they can provide traditional tax deferral for the employee. **And if they try but fail to meet those standards, each affected employee will face substantially more tax liability than if all the benefits had been paid as current compensation.**

F. In April of 2007, the IRS issued final regulations interpreting Section 409A. The new regulations are effective as of January 1, 2008, but they can be relied upon to meet the "good faith compliance" standard that continues to apply in the interim. Transition rules, including a remedial amendment period for plan documents, continue in effect through 2007 (with a number of special twists). The final regulations required plan documents to be compliant by December 31, 2007, but IRS Notice 2007-78 provides some additional time (until December 31, 2008) to finalize plan documents if certain conditions are satisfied.

II. **Plans That Are Covered**. The IRS uses an expansive definition of "nonqualified deferred compensation plan" in interpreting Section 409A. In general, it includes virtually any arrangement that defers payment of compensation later than 2½ months past the end of the tax year in which the services giving rise to the compensation were performed.

A. The form or formality of the "plan" does not make a difference. Section 409A covers deferred compensation arrangements, whether they appear in formal plan documents, board resolutions, individual employment agreements, or unwritten practices. But compliance will require a document, or combination of documents, that contain certain provisions required by the final regulations.

B. In defining what constitutes "deferred compensation," the IRS has adopted the key concept of "legally binding right." If an individual attains a legally binding right to compensation during one tax year, but does not receive payment until a later tax year, the compensation is "deferred compensation."

1. A service provider (e.g. employee) lacks a legally binding right if the service recipient (e.g. employer) may unilaterally, in its sole discretion, eliminate or reduce the future compensation after the services are performed.

2. But if payment is conditioned only on objective criteria, the IRS says that the service provider has a legally binding right to the compensation, and, unless a specific exemption applies, the possible future payment is considered "deferred compensation," even if the conditions create a substantial risk of forfeiture.

C. Section 409A covers not only deferred compensation that the employee has chosen to postpone to a later time, but also compensation that the employer has unilaterally chosen to pay later. Section 409A also covers many types of arrangements not commonly thought about as deferred compensation, including, for example, many types of equity-based compensation.

D. Section 409A covers not only employee compensation; it also covers compensation arrangements with directors, other independent contractors, and even some business entities that are paid for performing services. (That's why the regulations use the terms "service provider" and "service recipient" instead of employee and employer.)

III. **Exempt Compensation Arrangements**. Some types of compensation programs are specifically exempt from Section 409A, even if they might otherwise satisfy the general definition of deferred compensation plan.

A. Qualified employer retirement plans, which are already subject to strict tax-based regulation, are excluded from the reach of the new rules. For these purposes, qualified plans include:

1. defined benefit and defined contribution plans subject to Code section 401(a), and such as 401(k) plans;

2. tax-sheltered annuity plans under Code sections 403(a) and 403(b);

3. tax-exempt employer programs that satisfy Code section 457(b); and

4. SEPS and SIMPLEs under Code sections 408(k) and (p).

B. Most traditional welfare plans are also exempt:

1. vacation pay;

2. sick pay;

3. compensatory time off;

4. disability plans; and

5. death benefit plans.

C. Many (but not all) stock-based programs are excluded:

1. incentive stock option plans and Code section 423 employee stock purchase plans;

2. other stock option plans for stock of the service recipient, if the exercise price can never be lower than the stock's fair market value at the grant date and the option plan does not include any other deferral features;

3. restricted stock and other types of payment in the form of property taxed under Code section 83;

4. "stock appreciation rights" based on stock of the service recipient, if the base value can never be lower than the stock's fair market value on the date of grant and the right contains no other deferral features.

D. Tax-free benefits or amounts (unless paid in lieu of Section 409A deferred compensation). This means that health plans will be exempt if they are fully insured or if they are self-insured and satisfy the nondiscrimination rules of Code Section 105(h).

E. "Short-term deferral" arrangements under which the compensation must be paid within 2 1/2 months after the close of the service provider's taxable year or the service recipient's taxable year (whichever ends later) in which the compensation ceases to be subject to a substantial risk of forfeiture.

F. Employer-paid COBRA premiums or employer-paid reimbursement for COBRA premiums the employee pays (even if these amounts are taxable).

G. The following types of severance arrangements:

1. collectively bargained arrangements covering involuntary terminations or a window program.

2. arrangements covering involuntary terminations or a window program and providing limited amounts of severance pay (no more than 2 times the lesser of the service provider's annual compensation or the qualified plan annual compensation limit), all of which is paid by no later than the end of the service provider's second taxable year following the taxable year in which separation occurs.

3. certain types of severance payments required by foreign law.

4. non-taxable expense reimbursements, if (a) reimbursement is limited to expenses actually incurred no later than the end of the second year following the year in which separation occurs, and (b) reimbursement is made by the end of the third year following the year in which separation occurs.

5. arrangements providing in-kind benefits (for example, outplacement assistance) over a limited period ending no later than the end of the second year following the year in which separation occurred.

6. small amounts of severance pay (no more than the regular 401(k) elective deferral limit for the year in which separation occurred).

H. Grandfathered amounts (earned and vested by December 31, 2004), and earnings on those amounts, are exempt unless and until the plan providing them is materially modified after October 3, 2004.

IV. **<u>Aggregation Rules</u>.** All plans of the same type are aggregated and treated as a single plan. (For this purpose, a "plan" is a deferred compensation arrangement between a service provider and a service recipient.) The primary result of this aggregation is that a failure to satisfy one or more of the Section 409A requirements with respect to one plan will taint all plans of the same type covering the same service provider and cause them to violate Section 409A with respect to that service provider as well. The final regulations divide plans into the following types or categories:

A. Elective deferral plans.

B. Account balance plans without elective deferrals.

C. Non-account plan (i.e. defined benefit) plans.

D. Separation pay plans (benefits are payable only upon involuntary termination of employment).

E. Plans providing in-kind benefits or expense reimbursements.

F. Split-dollar life insurance arrangements.

G. Certain plans covering primarily non-resident aliens.

H. Stock rights plans (other than those that are exempt).

I. All other plans subject to Section 409A.

V. **<u>Permissible Payout Events</u>**. Section 409A establishes a "Safe Six" list of distribution events, allowing plans to pay out deferred compensation in any combination of those six events, but no others. If a plan allows for payout under any other circumstances than the Safe Six, the plan fails and produces punitive taxation for all affected service providers under all arrangements of the same type.

A. The following are the Safe Six distribution events:

1. separation from service (with a special 6-month delay for key employees of public companies)

2. disability - a period of disability caused by a condition expected to last at least 12 months, based on either of two standards of disability -

a. an inability to engage in "any substantial gainful activity" or

b. the disability standard set by the service recipient's long-term disability plan (one that pays benefits for at least 3 months)

3. death

4. a time certain or fixed schedule specified under the plan before the deferral occurs (this doesn't include an event or occurrence the date of which is unknown)

5. change in control of the service recipient - defined by the regulations as one of three separate categories of changes to a relevant business entity (one that employs the individual, is responsible for paying the compensation, or is a majority owner, directly or through an ownership chain, of one of the other two). The three types of changes are:

   a. a change in corporate ownership (acquiring stock with at least 50 percent of the market value or voting power);

   b. a change in effective control (during a 12-month period, either acquisition of 30 percent of the voting power or replacement of a board majority); or

   c. a change in ownership of a substantial portion (at least 40 percent of the market value) of the corporation's assets.

6. unforeseeable emergency - to meet a "severe financial hardship" if

   a. the emergency is caused by the service provider's (or a dependent's) illness or accident, casualty loss to property, or "similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control" of the individual; and

   b. the amounts distributed do not exceed what is necessary to satisfy the emergency (including resulting taxes), taking into account other sources of funds.

B. Note some common payout provisions that did <u>not</u> make the cut and cannot, therefore, be used as distribution events:

1. upon termination of the plan;

2. at the service recipient's discretion;

3. upon the occurrence of a unscheduled event (such as a child's entering college); or

4. at the same time as qualified plan distributions are paid (although permitted under transition rules through 2007 for plans that supplement Code section 401(a) qualified plans).

VI. <u>Initial Deferral Decisions</u>. Section 409A also places limitations on how and when an` initial deferral election is made.

A. Non-elective deferrals - those dictated by the plan, without the service provider's choice - are automatically acceptable.

B. For deferrals at the service provider's election, the rules are strict. To defer compensation to be earned by services during a particular tax year, the service provider must generally make the initial deferral election before that tax year begins. Two special exceptions are recognized:

1. For the service provider's first year of eligibility, the employee may make a prospective initial deferral election (one that applies to compensation earned after the election) within the first 30 days of eligibility.

2. For "performance-based" bonuses and other performance-based compensation earned over periods of a year or more, the initial election deadline is 6 months before the end of the performance period. Generally, amounts may be treated as "performance-based compensation" eligible for the special election rule, if:

    a. The payment or amount of the compensation is contingent on the satisfaction of organizational or individual performance criteria;

    b. the performance criteria are not substantially certain to be met at the time the deferral elective is permitted; and

    c. although subjective criteria are generally permissible, the criteria must relate to the performance of the service provider (or a group including the service provider) and/or the business unit (which can be the entire organization) in which the service provider works, and the service provider (or a family member) is not the judge of his or her own performance.

3. If the plan offers the service provider or the service recipient choice as to the timing and form of payouts, the choices must be made by the deadline for an initial deferral election.

VII. <u>Changes In Distribution Choices</u>. Section 409A does not permit changes to the time and form of distribution except in very limited circumstances.

A. Payments may not be accelerated, either by making an unscheduled withdrawal (other than for an unforeseeable emergency or for a change in control), by advancing the starting date, or by speeding up the rate of payment, even if the employee suffers a penalty (commonly called a "haircut") for making the withdrawal or accelerating the payments. The final regulations recognize a number of limited exceptions to the anti-acceleration rule.

B. For changes that delay payouts, the change cannot take effect for at least 12 months.; if the change extends payouts that were initially based on separation from service, a time certain, or a change in control, the change must postpone the payment commencement date for at least 5 years; and if the change relates to a time-certain payout, it must be made at least 12 months before the payout would have begun under the initial form and time of payment.

VIII. **Funding Techniques**. If a nonqualified plan is truly funded - by setting aside assets in trust or otherwise placing them beyond the reach of the employer's creditors - federal tax law has long provided that a covered employee will be taxed as soon as the benefit is no longer subject to a substantial risk of forfeiture. Section 409A does not change that; but it makes two changes relating to popular "rabbi trusts," special trusts whose assets are reachable by creditors if the employer becomes insolvent.

A. Under Section 409A, offshore rabbi trusts will produce immediate taxation, unless they are tied to services performed in the same foreign jurisdiction as the offshore trust.

B. In a somewhat aberrational provision, Section 409A also requires immediate taxation as soon as a plan allows for a "springing rabbi trust" with initial or increased funding that is triggered if the employer experiences pre-insolvency financial difficulties (even if the "sprung" trust assets are still reachable by the employer's creditors).

C. Under all other circumstances, rabbi trusts may still be used without causing immediate taxation, whether funded initially or in the future for reasons other than employer financial deterioration.

IX. **Timing of Taxation**. Unless a deferred compensation plan satisfies Section 409A, an employee is obligated to pay taxes on deferred compensation (assuming a "legally binding right") once compensation is not subject to a "substantial risk of forfeiture." That concept is not new. What is new, however, is the way the IRS defines "substantial risk of forfeiture."

A. Under the old rules, the IRS usually restricted the concept of "substantial risk of forfeiture" to compensation "conditioned on the performance of substantial future services."

B. The final regulations recognize a second type of forfeiture risk - "the occurrence of a condition related to a purpose of the compensation," including such conditions as achieving earnings goals or targeted equity value.

C. In one respect, however, the IRS borrowed from old concepts for the "short-term deferral" exemption. If the compensation is paid within 2 1/2 months after the end of the tax year in which it ceased to be forfeitable (even if that happens later than the legally binding right arose), it is not considered "deferred compensation" at all.

D. The final regulations also provide guidance on whether a risk of forfeiture is "substantial." Under this guidance, non-compete covenants do not create a substantial risk of forfeiture.

X. **<u>Adverse Tax Consequences</u>**. The penalties for doing it wrong are surprisingly high.

A. If a plan fails to satisfy the Section 409A standards, an affected service provider must pay:

1. the tax that would have been due on current cash compensation;

2. interest at the IRS underpayment rate;

3. 1% additional interest; and

4. a 20% additional tax on the deferred income.

B. The punitive taxation applies to all past deferrals for the affected service provider under the violating plan (except grandfathered amounts) and plans of the same type, including earnings on deferrals, to the extent those amounts are vested and not already taxed.

C. A violation as to one service provider (such as an incorrect finding of unforeseeable emergency) does not cause taxation for all of the plan's covered service providers, but a violation inherent in the plan itself does subject all covered service providers to punitive taxation.

XI. **<u>Reporting and Withholding</u>**. Section 409A also changes the way service recipients must report, and perform payroll tax withholding obligations for, deferred compensation. Service recipients must generally report amounts deferred on a Form 1099 or a Form W-2. Although the IRS promises more guidance in the future, it has already recognized two exceptions: (1) defined-benefit deferrals need not be reported until the amounts are "reasonably ascertainable," using the same standards that have applied for several years to FICA taxation of nonqualified plan accruals; and (2) annual deferrals are exempt if they do not exceed $600 per individual.

XII. **<u>Limited Voluntary Compliance Program</u>.** IRS Notice 2007-78 announced the intention to establish a limited voluntary compliance program that will permit taxpayers to correct certain "unintentional" violations of Section 409A and thereby limit the amount of additional taxes due under Section 409A.

WHAT'S NEW IN THE FINAL 409A REGULATIONS?
(NON-JUNKIES' EDITION)

This summary highlights the new developments in the IRS' final 409A regulations that are most likely to be of interest to lawyers who face deferred compensation issues from time to time but do not work with deferred compensation plans on a regular basis. The Benefits and Executive Compensation Group has a more detailed outline available for true 409A junkies.

Stock Rights

- Subsidiary Stock Can Be Used for Some Exempt Awards. The available exemptions from 409A for certain stock options and stock appreciation rights only apply to "service recipient stock." The final regulations clarify that "service recipient stock" includes stock of the company for which the grantee provides service or any other entity up (but not down) the corporate chain. (That means, for example, that employees of the parent corporation can't be granted exempt options to purchase stock of a subsidiary.) Going up the corporate chain generally requires at least a 50% ownership interest, but at least a 20% ownership interest is permissible if the grant of a stock right to a service provider is based on "legitimate business criteria" –that is, a sufficient nexus between the service provider and the corporation issuing the stock for the stock grant to serve a legitimate, non-tax business purpose. (The preamble uses an example of a current employee of a joint venture who was formerly employed by one of the corporate joint venture partners or who is expected to become an employee of one of the joint venture partners in the future).

- Broader Definition of Common Stock. Under the final regulations, any class of common stock can be used for exempt options and SARs (but not common stock that has a preference as to dividends (other than a liquidation preference).

- Non-Stock Mutual Companies. The final regulations make clear that interests in a non-stock mutual company can be treated analogously to equity interests in a corporation.

- Use of Different Valuation Methods for Exercise Price and Payment. The final regulations make clear that it is permissible to use one valuation method for purposes of establishing the exercise price of an option or base price of a SAR and a different valuation method for purposes of determining the fair market value at the time of payment (for example, the payment amount of SAR), as long as both valuation methods meet the requirements of the final regulations.

- Use of Average Selling Price. When a valuation method for publicly traded stock uses the average selling price over a specified period, then the service recipient must designate all of the following before the beginning of the specified averaging period: (1) the service provider who will be granted the stock right, (2) the number of shares subject to the right, and (3) the method for determining the exercise price, including the period over which the averaging will occur.

- Fair Market Value—Non-Public Company. The final regulations make a few clarifications to the standard for determining the fair market value of stock that isn't publicly traded (reasonable application of a reasonable valuation method). They clarify that it isn't necessary to show that the value was determined by an independent appraiser, where the taxpayer can otherwise demonstrate that the value was determined by the reasonable application of a reasonable method. Also, the factors to be considered in determining fair market value now expressly include consideration of any recent arm's length transactions involving the sale or transfer of equity interests in the corporation being valued.

- Safe Harbor for Illiquid Stock of Start-Up. The final regulations expand the safe harbor rule for determining the fair market value on date of grant for an illiquid start-up company by (1) reducing the look-back period from 1 year to 6 months in the case of an IPO and to 3 months in the case of a change in control; and (2) clarifying who, aside from a professional appraiser, can perform the valuation (test is whether a reasonable person, knowing the facts, would select the individual to determine value for a sale of stock; it includes someone with more than 5 years of experience in the field of private equity.)

- Date of Grant Defined. Under the final regulations, the "date of grant" of a right or option is determined in the same manner as under the incentive stock option regulations.

- Some Extensions of Stock Options Won't Blow the Exemption. The final regulations provide that the extension of an option exercise period won't be treated as an additional deferral feature or the modification of option for 409A purposes if the exercise period is not extended beyond the earlier of the original maximum term of the option or 10 years from the original date of grant of the stock option, whichever is shorter. Also, the extension of the exercise period of an underwater option is not treated as a modification or an additional deferral feature.

- Substitution. With regard to the substitution of stock rights in connection with corporate transactions, the final regulations clarify that a substituted option may be treated as a continuation of the original option even where the option holder is not employed by or otherwise providing services to the successor entity, as long as the substitution otherwise satisfies the rules provided in the regulations.

- Restricted Property. With respect to the exemption from 409A for grants of restricted property taxed under Section 83, the final regulations clarify that a vested right to receive non-vested property in a future year doesn't constitute deferred compensation, as long as the risk of forfeiture that applies to the restricted property constitutes a substantial risk of forfeiture for Section 409A purposes.

- Section 409A Doesn't Apply to Choices Among Compensation Options that Aren't Deferred Compensation. The final regulations confirm that the Section 409A election rules don't apply to a choice among compensation alternatives, none of which provide for a deferral of compensation (so, for example, they don't apply to a choice between immediate cash and restricted stock or between restricted stock and an exempt stock option). But where one of the alternatives involves a deferral of compensation, the 409A election rules apply.

- <u>No New Guidance on Partnership/LLC Profits Interests</u>. The IRS has still not issued guidance on how 409A applies to options with respect to membership units in an LLC or profits interests in a partnership. Until further guidance is issued, partnerships and LLCs can continue to rely on the interim guidance, which allows them to follow rules and exemptions analogous to those that apply to stock in corporations.

Payment Rules

- <u>More Guidance and Flexibility on Payment Dates</u>. The final regulations provide additional guidance and increased flexibility on when payments are considered timely for 409A compliance purposes. In light of this additional guidance, it is advisable to review the payment provisions of any plan established or revised under previous 409A guidance to determine whether they should be revised to take advantage of the new rules. (For example, under the new rules, it may be more advantageous, at least under some circumstances, to provide expressly that payment will be made within a specified limited period, not greater than 90 days, after a specified payment event, than to provide that payment will be made "as soon as practicable" or "as soon as administratively feasible" after that event.)

- <u>Guidance on Providing Taxable Reimbursements in Compliance with 409A</u>. With limited exceptions, Section 409A applies to deferred compensation in the form of taxable reimbursements and in-kind benefits, such as discriminatory post-employment continuation of medical coverage under self-insured plans and post-employment travel benefits (for example, continued use of company vehicles or aircraft beyond a limited period following termination). The final regulations, however, explain how the provision of discriminatory medical benefits, other taxable reimbursements, and in-kind benefits can satisfy the 409A requirements of payment on a specified date or fixed schedule. The requirements are as follows:

    - The plan provides an objectively determinable, nondiscretionary definition of the expenses eligible for reimbursement or the in-kind benefits to be provided.

    - The plan provides for the reimbursement of expenses incurred, or for the provision of in-kind benefits, during an objectively and specifically prescribed period (which may be the service provider's lifetime).

    - The plan provides that the amount of expenses eligible for reimbursement, or the in-kind benefits provided, during a taxable year of the service provider will not affect the expenses eligible for reimbursement, or the in-kind benefits to be provided, in any other taxable year. (There's an exception for lifetime maximum limits under medical expense reimbursement arrangements.)

    - An eligible expense is reimbursed on or before the last day of the service provider's taxable year following the taxable year in which the expense was incurred.

    - The right to reimbursement or in-kind benefits is not subject to liquidation or exchange for another benefit.

- Payment Delays. The final regulations liberalize the standards under which a payment can fall within the short-term deferral exemption even it is delayed due to an unforeseeable event. Under the final regulations, payment may be delayed—without adversely affecting application of the short-term deferral exemption—where the payment would jeopardize the service recipient's ability to continue as a going concern, as long as payment is made as soon as it would no longer have that effect.

Severance Plans

- List of Exemptions. The final regulations provide for a number of exemptions for separation pay (in addition to the short-term deferral exemption, which will apply to some severance pay arrangements). They include exemptions for:

    - certain collectively bargained separation pay arrangements;

    - certain arrangements providing limited amounts of separation pay, paid during a limited period, due to an involuntary termination or participation in a window program;

    - certain foreign separation pay arrangements;

    - certain reimbursement arrangements providing for expense reimbursements or in-kind benefits (such as outplacement assistance) for a limited period of time; and

    - certain de minimis amounts of separation pay (aggregate total doesn't include the regular qualified plan elective deferral limit, which is currently $15,500.)

- Exemptions Can Be Used in Combination. The final regulations permit the exemptions to be used in combination within a single arrangement (so, for example, part of a severance arrangement may be exempt as a limited arrangement for an involuntary termination, while another part of the same arrangement is exempt as an arrangement providing expense reimbursements or in-kind benefits for a limited period).

- Resignations for Good Reason are Involuntary Terminations. For purposes of the exemption for limited severance pay provided during a limited period following an "involuntary" termination, a termination initiated by the service provider will be treated as "involuntary" if it is for "good reason." The final regulations provide both a general standard for defining good reason (material negative change in the employment relationship) and a safe harbor rule (combining certain deemed good reason conditions with a notice and cure period requirement).

- Severance Payable Upon Resignation for Good Reason Can be a Short-Term Deferral. Severance benefits payable upon a resignation for "good reason" are also treated as subject to a substantial risk of forfeiture, which means that they will fall within the short-term deferral exemption if they are payable within a short time following termination (within 2 ½ months after the later of the end of the service provider's tax year or the end of the service recipient's tax year in which the termination occurs).

- Exemption for Limited Severance Benefits Can Apply to Amounts Up to the Limit. Regarding the exemption for limited amounts of severance pay payable under a window program or upon an involuntary termination, under the final regulations, if the total amount of a service provider's severance pay exceeds the dollar limitation for the exemption, the exemption will apply to the portion that doesn't exceed the limit. Most notably, that means that involuntarily terminated "specified employees" of a public company will be able to receive at least part of their severance pay right away (instead of having to wait until 6 months after the termination).

- Exemption for Limited Amounts of Severance Pay. The final regulations add a new exemption for rights under a separation pay plan for a payment or payments in an aggregate amount not exceeding the regular qualified plan elective deferral limit for the year of separation (it's $15,500 for 2007). The new exemption is intended to avoid applying 409A to incidental benefits often provided upon separation, where the parties might not have realized that the benefits are deferred compensation. The exemption can be applied to exclude any type of separation pay arrangement, but it can be applied only once with respect to amounts paid by a service recipient to a service provider.

Initial Eligibility Elections

- Special Rule for Rehired and Transferred Employees. Section 409A allows newly eligible participants to make deferral elections (including elections as to the form and time of payment) within 30 days after becoming eligible. The final regulations allow rehired and transferred employees to be treated as newly eligible for these purposes if they have been ineligible to accrue any benefits under the plan for at least 24 months.

- Special Rule for Non-Elective Excess Benefit Plans. Also, the final regulations include a special initial eligibility rule that allows new participants in non-elective excess benefit plans (such as supplemental defined benefit pension plans) to make an initial election (as to form and timing of their benefit payment) immediately following the first year in which they accrue a benefit under the plan.

Six Month Delay for Specified Employees

- Guidance for Identifying Specified Employees. The final regulations provide new definitions and other helpful guidance for identifying which service providers of a publicly traded company are "specified employees" subject to the special 6-month delay for benefit payments on account of separation from service. They also allow the plan sponsor to use an alternative, over-inclusive method to identify specified employees or to choose to apply the delay to all service providers (to avoid having to determine which ones are specified employees).

- New Rules for Mergers and Acquisitions. The final regulations change the rules for identifying the specified employees of entities affected by mergers, acquisitions, and certain other corporate transactions. The new rules will generally result in fewer individuals being treated as specified employees in these situations.

- Publicly Traded. The final regulations clarify that, for purposes of the 6-month delay requirement, a "publicly traded" company included one whose stock is traded solely on a foreign exchange or on a US exchange only as American Depository Receipts.

Separation From Service

- Plan Sponsors Can Adopt a Same Desk Rule for Asset Sales. The final regulations allow plan sponsors to voluntarily adopt a "same desk rule" in the event of certain asset sales, which would prevent employees who continue doing substantially the same job for the purchaser from having a "separation from service" that would trigger payment of their benefits.

- Treating Reductions in Service as Separation. Under the regulations, a service provider is generally treated as having separated from service if the level of the provider's services drops to 20% or less than the average over the previous 3 years. The final regulations allow the service recipient to choose to treat a higher level of reduced services (between 20% and 50% of the previous average) as a separation from service.

Change in Control/Plan Terminations

- Lower Threshold for Change in Effective Control. The final regulations lower the threshold for a change in the effective control of a corporation from 35% to 30%.

- Termination of Plans Following Change in Control. The final regulations retain the rule that a deferred compensation plan may be terminated, and benefits distributed upon the termination, within 12 months of a change in control, but they make clear that if the plans covering employees of the acquired company terminate and liquidate pursuant to this option, the acquiring company's plans do not have to be terminated.

- Shorter Wait to Establish New Plan. If a service recipient terminates and liquidates its plans following a change of control, then under the final regulations, it cannot establish a new plan for 3 years (rather than 5 years as under the proposed regulations.)

Exceptions to Anti-Acceleration Rule

- Exceptions Generally Don't Have to be in the Plan. The final regulations add to the list of exceptions to 409A's general rule prohibiting acceleration of the time or schedule of payment. The regulations also make clear that a plan generally doesn't have to include the exceptions in the plan document to take advantage of them (although a couple of the exceptions do have to be put in the plan document.) But the plan sponsor must be able to demonstrate that any acceleration of payment falls within an exception permitted under the regulations.

- Notable Exceptions. The final regulations provide a list of the permissible exceptions to the anti-acceleration rule, which includes the following:

  - Domestic relations orders. A plan may permit acceleration to make a payment to someone other than the service provider (e.g., the service provider's former spouse) pursuant to the terms of a domestic relations order.

  - Conflicts of interest. A plan may accelerate payment to the extent reasonably necessary to comply with a federal government ethics agreement or an applicable federal, state, local, or foreign ethics or conflict of interest law.

  - Cash-outs of small benefits. This is one of the few exceptions that must be added to the plan document if it's to be used. Under this exception, a plan may require, or give the service recipient discretion to require, a mandatory lump sum cash-out of plan benefits that do not exceed a specified amount, which can't be greater than the regular qualified plan elective deferral limit (which is currently $15,500), if the cash-out results in the termination and liquidation of the service provider's entire interest in the plan (and all plans that must be aggregated with it). A plan may also be amended to add this cash-out provisions, but the plan term or amendment must be signed and effective before any such cash-out is paid. If the cash-out provision or amendment gives the service recipient discretion to require cash-outs, then any exercise of that discretion must be evidenced in writing no later than the date on which the cash-out is made.

  - Payment of certain taxes. A plan may accelerate payment to the extent required to pay FICA taxes (and related income tax withholding) on deferred amounts or to pay state, local, or foreign taxes applicable to deferred amounts.

  - Payment of taxes upon income inclusion under Section 409A. At any time that a plan fails to comply with Section 409A, it may accelerate payment to the extent of the amount that the service provider must include in income as a result of the failure.

  - Cancellation of deferrals upon an unforeseeable emergency or disability. A plan may permit a service provider to cancel a deferral election due to an unforeseeable emergency (defined the same way as under the payment rules), but it must be a cancellation—not a suspension or postponement. A plan may also permit cancellation of a deferral election upon a service recipient's disability (defined the same way as under the payment rules), but the cancellation must occur by the end of the service provider's taxable year in which he or she incurs the disability (or, if later, by the 15th day of the 3rd month after the service provider incurs the disability).

- Plan termination upon a corporate dissolution or bankruptcy. A plan may terminate and pay out all of its benefits within 12 months of a corporate dissolution taxed under Section 331 or with the approval of the bankruptcy court as part of bankruptcy proceedings. (All benefits must be included in participants' gross incomes by specified deadlines.)

- Plan termination in connection with a change in control. A plan may terminate and pay out all of its benefits within 30 days preceding or 12 months after a change in control, subject to certain conditions (including that all plans must be aggregated with the terminated plan are also terminated and liquidated—but an asset purchaser doesn't have to terminate its plans upon the termination of the asset seller's plans covering the employees of the purchased business).

- Elective plan termination and liquidation. A plan may terminate and pay out all of its benefits, subject to the following conditions: (1) the termination can't occur proximate to a downturn in the service recipient's financial health; (2) the service recipient must also terminate and liquidate all plans that are required to be aggregated with the terminating plan; (3) no payouts in liquidation of the plan can be made within 12 months of the date on which the service recipient takes all action necessary irrevocably to terminate the plan (other than payments that would have been made in the ordinary course absent termination of the plan); (4) all payments in liquidation of the plan are made within 24 months of the date on which the service recipient takes all necessary action irrevocably to terminate the plan; and (5) the service recipient doesn't establish a new plan of the same type (as defined under the plan aggregation rules) at any time within 3 years (it used to be 5) after the date on which the service recipient took the necessary actions irrevocably to terminate the plan.

- Limited offsets for service provider's debt to service recipient. A plan may permit acceleration to pay a debt that the service provider owes to the service recipient, provided that (1) the debt was incurred in the ordinary course of the parties' service relationship; (2) the entire amount of the of the offset in any of the service recipient's taxable years doesn't exceed $5,000; and (3) the offset is made at the same time that the debt otherwise would have been due and collected from the service provider.

- Settlement of bona fide dispute over right to payment. A payment won't violate the anti-acceleration rule if it occurs as part of the settlement of an arm's length, bona fide dispute as to the service provider's right to the deferred amount, and certain specified conditions are satisfied. (The conditions are presumed not to be satisfied unless the payment made represents at least a 25% reduction in the amount that would have been payable absent a dispute as to the service provider's right to payment.) The conditions are also presumed not to be satisfied if the payment occurs proximate to a downturn in the service recipient's financial health.

Written Plan Requirements

- Required Provisions. The final regulations require every 409A deferred compensation plan to have a written plan document (which can be a combination of multiple documents) containing all of the following provisions:

    - The payment amount of the deferred compensation or the terms of the objective, nondiscretionary formula under which the amount will be determined (must be in the plan at the time an amount is deferred);

    - The payment time or schedule or the payment-triggering event(s) (must be in the plan at the time an amount is deferred);

    - The 6-month delay requirement for payments to specified employees of a publicly traded company on account of separation from service (must be in the plan when the company becomes publicly traded or, if later the effective date of the service provider's addition to the service recipient's specified employee list);

    - If the plan provides for deferral elections, including elections as to the time and form of payment, the conditions under which the elections may be made (must be in the plan by the time at which the election is required to be irrevocable).

- Savings Clauses Won't Save You. General 409A savings clauses won't be effective to nullify non-compliant terms or supply required terms that are missing.

- Retroactive Amendments for Transition Period Not Required. The final regulations make clear that plans do not have to be amended retroactively to reflect how they've operated during the transition period between the effective date of 409A and the effective date of the final regulations (January 1, 2008). It will be sufficient to demonstrate compliance with the transition rule through other documentation and evidence.

SECTION 409A "IS IT COVERED?" CHECKLIST

The following lists are not intended to be exhaustive, but they provide examples of various types of agreements, plans, and arrangements that service recipients should review to determine whether they may be affected by Section 409A

Types of Plans That Will Generally Be Subject to Section 409A

- Elective deferral arrangements (anything that allows a service provider to delay receipt of income). This would include, for example:
    - Supplemental 401(k) plans (allowing executives to defer more than they can defer under the employer's 401(k) plan).
    - Elective bonus deferral arrangements (allowing participants to defer a portion of their awards under annual or long-term bonus plans)
    - Outside director elective deferral arrangements (allowing directors to elect to defer, for example, annual retainers or meeting fees)
- Mandatory bonus deferral arrangements (for example, an arrangement under which payment of a portion of an award is automatically postponed to termination of employment or to a specified future date).
- Sales commissions deferral arrangements (allowing elective deferrals of sales commissions).
- Deferred compensation arrangements for outside directors (arrangements that permit or require deferral of a portion of retainers, meeting fees, or other director compensation).
- Supplemental executive retirement plans (SERPs) or other "defined benefit" non-qualified pension arrangements, which can take many forms, including, for example:

    --Arrangements supplementing a qualified pension plan.

    --Agreements to pay an executive a specified annual or monthly amount for life or a specified number of years following retirement.

    --Agreements to pay, after termination, a payment or series of payments based on results achieved by an executive during a specified period of years.

- Long-term incentive plans (unless they fall within one of the exceptions below).
- Stock option plans or stock appreciation rights (or restricted stock arrangements) that permit additional deferral of recognition of income beyond that which would normally occur under Code Section 83.

- Stock options with an exercise price, or stock appreciation rights with a base price, that is or may be below the fair market value on the date of grant. (Note: there's a special exemption for options issued under a stock purchase plan that meets the requirements of Code Section 423.)

- Phantom stock plans or other phantom equity arrangements.

- Restricted stock unit awards or deferred share unit awards (awards of "units" or other notional measures, rather than awards of actual shares of stock).

- Severance plans (unless they fall within the exemptions described below).

- Change in control agreements (unless they fall within one or more of the exemptions for severance plans or short-term deferral arrangements described below)

- Split dollar insurance arrangements.

- Deferred compensation arrangements between a partner and a partnership.

- Deferred compensation arrangements in an employment agreement (for example, deferred salary provisions in an employment agreement or severance provisions in the employment agreement for a key employee).

- Arrangements providing for taxable post-termination reimbursements or in-kind benefits (including medical reimbursements taxable because they are provided under a self-insured medical plan that discriminates in favor of highly compensated participants), unless a specific exemption applies.

Types of Plans That Aren't Subject to Section 409A

- Tax-qualified retirement plans subject to Code Section 401(a), including 401(k) plans and defined benefit pension plans.

- SEPs, and SIMPLE plans.

- Tax-deferred annuity plans subject to Code Section 403(b).

- Eligible deferred compensation arrangements under Code Section 457(b).

- *Bona fide* vacation, sick leave, compensatory time, disability pay, or death benefit plans.

- Archer medical savings accounts, health savings accounts, medical reimbursement arrangements that satisfy Code Sections 105 and 106, and other non-taxable welfare plan coverage. (Note: discriminatory self-insured medical plans do not fall within this exemption, because their benefits are taxable to highly compensated participants.)

- Payment within 2½ months after the close of a taxable year pursuant to a service recipient's customary payment arrangements. (For example, pursuant to a company's regular payroll practices, an employee is paid in January for services performed during a payroll period that began in December).

- "Short-term deferral" arrangements pursuant to which payment will be made by the later of (1) 2½ months after the end of the service provider's first taxable year in which the amount is no longer subject to a substantial risk of forfeiture, or (2) 2½ months after the end of the service recipient's first taxable year in which the amount is no longer subject to a substantial risk of forfeiture.

- Non-statutory stock options for "service recipient stock" if (1) the exercise price may never be less than the fair market value on the date of grant; (2) the receipt, transfer, or exercise of the option is subject to taxation under Code Section 83; and (3) the option doesn't include any feature for the deferral of compensation other than the deferral of the recognition of income until the later of exercise or disposition of the option under section 1.83-7 of the regulations.

- Incentive stock options.

- Options granted under employee stock purchase plans meeting the requirements of Code Section 423.

- Stock appreciation rights that meet all of the following requirements: (1) the stock used for measuring the value of the right is "service recipient stock"; (2) the base price can never be less than the fair market value on the date of grant; and (3) the right doesn't include any feature for the deferral of compensation other than the deferral of recognition of income until exercise of the right.

- Restricted stock (or other restricted property) taxed under Code Section 83 if the only deferral of compensation is the deferral of the recognition of income until the substantial risk of forfeiture lapses.

- The following types of separation pay arrangements:

    - bona fide collectively bargained severance arrangements providing for separation pay upon an involuntary termination or pursuant to a window program.

    - arrangements providing for separation pay upon an involuntary termination or participation in a window program, to the extent that (1) the amount of the separation pay doesn't exceed the lesser of two times the service provider's annual compensation or two times the qualified plan annual compensation limit (which is $225,000 for 2007); and (2) all of the separation pay is paid by the end of the service provider's second taxable year following the taxable year in which separation occurs.

    - separation pay required to be provided under certain types of applicable law of a foreign jurisdiction.

- arrangements providing non-taxable benefits, paid COBRA coverage (even if taxable, as long as it's not for longer than the applicable COBRA period), or non-taxable expense reimbursements (for example, reasonable moving expenses, business expenses, or outplacement expenses) following an involuntary or voluntary termination, provided that (1) reimbursement is limited to expenses actually incurred no later than the end of the second year following the year in which the separation occurred; and (2) reimbursement is made not later than the end of the third year following the year in which separation from service occurred.

- arrangements providing in-kind benefits (such as outplacement assistance) during a limited period ending not later than the end of the second year following the year in which the separation from service occurred.

- small amounts of separation pay (aggregate amount of payments doesn't exceed the regular qualified plan elective deferral limit for the calendar year in which the separation from service occurs. (This exception can't be used more than once with respect to amounts paid by an employer to a former employee.)

- arrangements providing non-taxable benefits, unless the former employee has received the right in exchange for, or has the right to exchange the benefits for, a taxable amount.

SUMMARY OF TRANSITION RELIEF AND ADDITIONAL 409A GUIDANCE PROVIDED BY IRS NOTICE 2007-78

On September 10, 2007, the IRS issued Notice 2007-78, which provides a limited, conditional extension of the time for amending deferred compensation arrangements to comply fully with Section 409A. While this development will give plan sponsors and practitioners up to an additional 12 months to finalize the details of plan drafting, it really won't provide additional time to make certain key plan design decisions. **Plan sponsors must still take action by year-end.** That's because the conditions for this extension include (1) specifying, in writing, by the end of this year, the time and form of payments under the plan, and (2) consistency between the terms of the final amended document and the plan's actual operation between January 1, 2007 and the date the plan is amended for 409A compliance. Notice 2007-78 also provides some additional guidance regarding the application of Section 409A to employment agreements and regarding lump sum cash-outs, and it announces the IRS' intent to establish a limited voluntary compliance program to correct certain "unintentional" operational violations of Section 409A. It also announces that the transitional relief from Section 409A(b) provided in Notice 2006-33 (relating to certain "grace period assets" in certain arrangements established to pay for deferred compensation) will not be extended past December 31, 2007 (so taxpayers will need to comply with a reasonable, good faith interpretation of Section 409A(b) for all assets in arrangements that are subject to that section).

Limited, Conditional Extension of Retroactive Amendment Period

In General

The Notice does not extend the effective date of the final regulations or any of the transition relief provided in Notice 2005-1, Notice, 2006-79 or the preamble to the Section 409A proposed regulations.

The Notice extends until December 31, 2008, the deadline for amending plan documents to comply fully with Section 409A, subject to the following conditions:

- By December 31, 2007, the plan must designate in writing a compliant time and form of payment for compensation deferred under the plan prior to January 1, 2008. For amounts deferred after December 31, 2007 and before January 1, 2009, a compliant time and form of payment must be designated in writing by the applicable deadline under the final regulations.

- Plan operations must fully comply with the final regulations effective January 1, 2008, except as otherwise provided in the Notice.

- By December 31, 2008, the plan must be amended, retroactive to January 1, 2008, to comply with the requirements of the Section 409A guidance and contain all of the written provisions required by the final regulations.

- The amended plan document must accurately reflect the operation of the plan on and after January 1, 2008 through the date of the amendment, including the terms and conditions under which any initial deferral elections or subsequent elections were permitted, and how the operation of the plan met the requirements of the Section 409A guidance from January 1, 2008 through the amendment date.

- The time and form of payment can't be changed after December 31, 2007, except as provided in the final regulations and the Notice.

- No change in the time and form of payment after December 31, 2007 may cause an amount that was deferred as of December 31, 2007 to qualify for an exclusion from the definition of deferred compensation under the final regulations. (That means, for example, that no post-2007 change to the time and form of payment may cause an amount deferred before 2008 to qualify as an exempt short-term deferral.)

Designating a Time and Form of Payment

- A plan designates the time and form of payment if the plan's written terms, disregarding any written plan provisions that do not comply with the Section 409A guidance (such as a "haircut" early withdrawal option), provide a compliant time and form of payment as described in the Notice.

- A plan sponsor may instead adopt a separate written document. The separate document may either designate the time and form of payment for a specifically identified arrangement, for a group of arrangements that are not separately identified, or a combination of both, as long as the deferred amounts to which each designated time and form of payment applies are objectively determinable.

Designating a Compliant Time and Form of Payment

- A document designates a compliant form of time and payment only if it provides for an objectively determinable form of payment payable upon on of the "safe six" permissible payment events or upon any combination of two or more of those events that is permissible under the final regulations (such as the earliest or latest of two or more of the permissible payment events).

- If a payment event isn't among those specified in writing by December 31, 2007, then it can't be added later except as provided in the final regulations (which means the change in payment events will be subject to the Section 409A anti-acceleration provisions and subsequent deferral rules). The same goes for the deletion of a payment event after December 31, 2007.

- If the objectively determinable form of payment is a series of installment payments, the series will be treated as a single payment unless the plan designates in writing, by the applicable deadline, that the series of installment payments is to be treated as a right to a series of separate payments.

Designating Payment Event Definitions

- For purposes of designating payment events by December 31, 2007, the terms "separation from service," "change in control event," "unforeseeable emergency," and "disability" mean any event that falls within the definition of the term in the final regulations. (For example, the designation of "separation from service" as a payment event may be treated as providing for payment upon any event that qualifies as a separation from service under the definition set forth in the final regulations.) But the plan must be operated in accordance with the final regulations, and the amended plan must accurately reflect how the plan was operated in the interim.

- A plan doesn't have to specify in writing, by December 31, 2007, the particular definition of separation from service, change in control event, disability, or unforeseeable emergency that it will use after that date, but the definition that the plan actually applies after that date must be permissible under the final regulations, and the plan must be amended by December 31, 2008 to reflect accurately how the plan was operated during 2008.

- For the events of separation from service, change in control, unforeseeable emergency, and disability, a plan can adopt a default definition in 2007 and then change to an alternative definition in 2008, as long as the change is not inconsistent with how the plan actually operated. But once an event has occurred in 2008 and has been treated as a payment event (or has been treated as not qualifying as a payment event) for a deferred amount, the service provider and service recipient may not retroactively change the definition of the payment event applicable to that deferred amount.

Designating a Specified Payment Date or a Fixed Schedule of Payments

- The designation of a specified payment date or a fixed schedule of payments (including the use of a specified payment date or fixed schedule of payments after a permissible payment date or the lapse of a substantial risk of forfeiture) must meet the requirements of §1.409A-3(i)(1) by December 31, 2007. (But for tax gross-up payments, the plan doesn't have to state, by December 31, 2007, that payment must be made by the end of the service provider's taxable year following the taxable year in which the service provider remits the related taxes, as long as the plan operates in accordance with that requirement and is amended to add it by December 31, 2008.)

- However, a plan won't be treated as changing the form or time of payment if, between December 31, 2007 and December 31, 2008, the plan is amended to add or delete a designated payment provision that meets the requirements of section 1.409A-3(b) or 1.409A-3(i)(1)(i) and does not affect the taxable year in which the payment will be made. This means, for example, that if as of December 31, 2007, the plan provides for payment in a lump sum upon the service provider's separation from service, it may be amended by December 31, 2008 to provide for the lump sum payment to be made by the end of the taxable year in which the death occurs or within a designated period (not greater than 90 days) after the death occurs.

Six-Month Delay on Payments to Specified Employees of a Public Company

- A plan maintained by a publicly traded company doesn't have to be amended before December 31, 2008 to add the required 6-month delay for payments to specified employees upon separation from service, as long as the plan operates in accordance with that requirement, the plan is amended by December 31, 2008, retroactive to January 1, 2008, to include the requirement, and the written plan provision accurately reflects the operation of the plan through the date of amendment.

- Taxpayers must be able to demonstrate that the required delay was applied to affected payments. (For example, they must be able to demonstrate the method used to identify specified employees and show that it was applied consistently to all plans and service providers.)

Additional Guidance Relating to Employment Agreements

Changing Good Reason Conditions

The Notice describes circumstances in which the definition of "good reason" in an existing employment agreement may be changed before the end of 2007, so that amounts payable upon voluntary termination for "good reason" will be considered subject to a substantial risk of forfeiture and may qualify for one or more exceptions to Section 409A for amounts payable solely upon involuntary termination.

- If the right to a payment subject to an existing good reason condition is currently subject to a substantial risk of forfeiture, then the good reason conditions can be modified by December 31, 2007, to conform to some or all of the "good reason" standards in the final regulations, and those changes won't be treated as an extension of the substantial risk of forfeiture.

- But if the right to a payment subject to existing good reason conditions is not subject to a substantial risk of forfeiture, changing those conditions to conform to the final regulations (for example, adding new conditions or removing one or more existing conditions) will not cause the amount to be treated as subject to a substantial risk of forfeiture.

Application of Substitution Rule to Employment Agreements

The Notice also describes circumstances in which the grant of a separation pay right in an extended, renewed, or renegotiated employment agreement will not be treated as a substitute for a right to Section 409A deferred compensation. The Notice says that, until further guidance is issued, if a right to deferred compensation payable only upon an involuntary separation from service in an existing agreement would automatically be forfeited at the end of the term of the employment agreement, then the grant of a right to deferred compensation in an extended, renewed, or renegotiated employment agreement will not be treated as a substitute for the right that was forfeited at the termination or expiration of the prior employment agreement.

Transitional Payment Elections May Result in Exclusion From Section 409A

The Notice confirms that 2007 transition elections to change the time and form of distributions may result in payments being excluded from Section 409A, for example, as a short-term deferral or exempt separation payment**.** Until the end of 2007, a plan may permit new elections regarding the time and form of distributions. Plan sponsors and participants taking advantage of this transition rule may change an election to cause the right to compensation, or a portion of that right, to be excluded from Section 409A because a payment becomes either a short-term deferral or qualifies for one of the exceptions applicable to distributions payable solely upon involuntary termination. Plan amendments pursuant to this transition relief may not (1) postpone payment of amounts that otherwise would be distributed in 2007 or (2) cause an amount to be distributed in 2007 that would not otherwise be distributed in 2007.

Additional Guidance on Lump Sum Cash-Outs

Under the final regulations, if the value of installment or annuity payments fall below a predetermined threshold at any time after payments commence, the plan may cash out the remaining payments. Unlike the proposed regulations, however, the final regulations do not clearly indicate whether a plan can provide for a mandatory lump sum cash-out, in lieu of installments or an annuity, in the event the total value of a service provider's benefit is below a specified predetermined threshold as of the payment commencement date. The Notice provides that until further guidance is issued, plans may include this types of cash-out provision, but the threshold must be established by the deadline for designating the payment event. Also, the plan sponsor must be prepared to demonstrate that the provision is operated in an objective, nondiscretionary manner and does not operate effectively to give participants a cash-out election.

Announcement of Intent to Adopt Voluntary Compliance Program

The Notice also announces the IRS' intent to adopt, in the "near future," a "limited" voluntary compliance program to correct certain unintentional operational failures to comply with Section r certain unintentional failures to comply with Section 409A. The Notice indicates that the program will likely provide methods by which unintentional operational failures may be corrected in the same taxable year in which the failure occurred to avoid application of Section 409A, as well as methods by which certain unintentional failures will result in only limited amounts becoming includible in income and subject to additional taxes under Section 409A.