

Legal News Alert: Employee Benefits is part of our ongoing commitment to providing up-to-the minute information about pressing concerns or industry issues affecting our clients and our colleagues.

If you have any questions about this alert or would like to discuss these topics further, please contact your Foley attorney or any of the following individuals.

Thank you.

Harvey Kurtz

Managing Editor

Katherine L. Aizawa
San Francisco, California
415.438.6483
kaizawa@foley.com

Christopher S. Berry
Madison, Wisconsin
608.258.4230
cberry@foley.com

Lloyd J. Dickinson
Milwaukee, Wisconsin
414.297.5821
lj Dickinson@foley.com

Gregg H. Dooge
Milwaukee, Wisconsin
414.297.5805
gdooge@foley.com

Robert E. Goldstein
San Diego, California
858.847.6710
rgoldstein@foley.com

Samuel F. Hoffman
San Diego, California
619.234.6655
shoffman@foley.com

Sarah B. Krause
Milwaukee, Wisconsin
414.319.7340
skrause@foley.com

Harvey A. Kurtz
Milwaukee, Wisconsin
414.297.5819
hkurtz@foley.com

Belinda S. Morgan
Chicago, Illinois
312.832.4562
morgan@foley.com

Greg W. Renz
Milwaukee, Wisconsin
414.297.5806
grenz@foley.com

Leigh C. Riley
Milwaukee, Wisconsin
414.297.5846
lriley@foley.com

Michael H. Woolever
Chicago, Illinois
312.832.4594
mwoolever@foley.com

Treasury, IRS Extend Documentation Deadline for Section 409A Compliance

The U.S. Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) announced on September 10, 2007, that taxpayers will have until December 31, 2008 to bring documents into compliance with the final nonqualified deferred compensation regulations under Section 409A of the Internal Revenue Code.

In April, the Treasury and the IRS issued final Section 409A regulations, which provided guidance regarding the requirements for deferral elections and payment timing under Section 409A. Affected plans and arrangements were required to comply with the final regulations by December 31, 2007. IRS Notice 2007-78 extends the document compliance deadline for one year and provides additional limited transition relief, but **does not extend the January 1, 2008, effective date of the final regulations.**

Notice 2007-78 also announces that the Treasury and the IRS anticipate issuing guidance containing a limited voluntary compliance program that will permit corrections of certain unintentional operational violations of Section 409A.

IRS Notice 2007-78: 2008 Transitional Relief and Additional Guidance on the Application of Section 409A to Nonqualified Deferred Compensation Plans

Highlights

The summary of highlights of Notice 2007-78 indicate that many actions and decisions are still required by December 31, 2007, with regard to a wide variety of deferred compensation plans and employment agreements, including change-in-control agreements for key executives, even with the documentation compliance deadline extension. We urge you not to let up in your compliance efforts, but perhaps emphasize strategic decision-making first, and written documentation second, as a way to take best advantage of this extension.

The transition relief is limited. It does not extend any of the transition relief provided in IRS Notice 2005-1, the preamble to the proposed regulations under Section 409A, or IRS Notice 2006-79 (extending the effective date of the final regulations to December 31, 2007). Reasonable good-faith interpretation of the statute will not be sufficient effective January 1, 2008.

Actual compliance with the final regulations generally will be required beginning January 1, 2008, but retroactive amendments to documents may be made on or before December 31, 2008, effective as of January 1, 2008. If there have been deferrals of compensation under a plan as of January 1, 2008, but the deferred compensation has not been paid, the plan will comply with Section 409A only if the plan designates in writing, before January 1, 2008, a compliant form and time of payment of such deferred compensation.

Notice 2007-78 provides guidelines under which a nonqualified deferred compensation plan will be treated as meeting the requirement to designate — in a timely manner — a time and form of payment of an amount deferred under the plan while the plan has not yet been amended. These provisions require that a plan must provide for an objectively determinable form of payment payable upon (1) a separation from service; (2) a change-in-control event; (3) an unforeseeable emergency; (4) a specified date or fixed schedule of payments; (5) death; or (6) disability. During 2008, the plan must be operated in accordance with the final regulations and the amendments regarding form of payment to be adopted no later than December 31, 2008, and must accurately reflect how the final regulations were applied during 2008. Once an event has occurred in 2008, and been treated as a payment event (or as not qualifying as a payment event), the plan may not be amended retroactively to alter the definition of a payment event in a manner inconsistent with that treatment. In other words, plans may be locked into specific

definitions pertaining to payment events based on actions taken long before the documents are required to be amended.

Certain payment requirements must be met by December 31, 2007. A plan must meet the requirement of a specified payment date or a fixed schedule of payments by December 31, 2007 for any amount that will be paid in accordance with (1) a specified payment date or a fixed schedule of payments, generally; (2) payment schedules with formula and fixed limitations; (3) payment schedules determined by timing of payments received by the employer; (4) reimbursement or in-kind benefit plans; and (5) tax gross-up payments. These kinds of payments are found typically in executive employment and change-in-control agreements affecting senior executives.

Guidance is provided for retroactive amendments regarding the six-month delay on payments to specified employees. Final Section 409A rules provide that payments of deferred compensation to a “specified employee” as of the date of a separation from service must be delayed not less than six months after the date of separation from service (except in case of the intervening death of the employee). The final rules provide that this requirement must be included as a written provision of any plan providing for payment on separation from service to a specified employee.

Notice 2007-78 provides that, as long as the payments are properly delayed in accordance with this requirement, a plan may be retroactively amended no later than December 31, 2008 to add this provision to the plan as of January 1, 2008 provided the amendment accurately reflects the operation of the plan to the date of the amendment.

Notice 2007-78 provides that taxpayers must demonstrate that the required six-month delay was applied to affected payments. Accordingly, if the employer has used any provisions other than the default provisions of the final regulations to identify “specified

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employees," the taxpayer must demonstrate the method by which the employer identified any specified employees and that such method of identifying specified employees was applied consistently to all plans and all employees (or service providers in the case of independent contractors). As a result, settling on a means of identifying specified employees by January 1, 2008, may be essential.

The Treasury and the IRS understand that taxpayers may desire to conform existing good reason conditions for separation from service to the requirements under the final regulations of the definition of an involuntary separation from service. It is important for a separation from service to be involuntary in order for the short-term deferral rule to apply to the payment of deferred compensation following the separation from service. A separation from service also must be involuntary for the separation pay exception to the six-month delay rule to apply (the two-year, two-times pay rule). The final regulations define the conditions under which a separation from service is involuntary, including some resignations for good reason (the "safe-harbor good reason conditions"). Many adjustments may be necessary to plans to adjust their definitions of good reason conditions to take advantage of either or both of the short-term deferral rule and the two-year, two-times pay rule. The final regulations also provide that any addition of a substantial risk of forfeiture after the beginning of a service period to which the compensation relates, or any extension of a period during which compensation is subject to a substantial risk of forfeiture, is disregarded.

Accordingly, Notice 2007-78 provides that, to the extent that a right to a payment subject to an existing good reason condition is subject to a substantial risk of forfeiture, the modification of the good reason condition on or before December 31, 2008, to conform to the safe-harbor good reason conditions will not be treated as an extension of the substantial risk of forfeiture.

Internal Revenue Service regulations generally require that, for purposes of avoiding United States federal tax penalties, a taxpayer may only rely on formal written opinions meeting specific requirements described in those regulations. This publication does not meet those requirements. To the extent this publication contains written information relating to United States federal tax issues, the written information is not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal tax penalties, and it was not written to support the promotion or marketing of any transaction or matter discussed in the publication.