

# Quick Reference Guide to Complying with Section 409A deferred compensation plan rules

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New rules for nonqualified deferred compensation plans under Code Sec. 409A went into effect on Jan. 1, 2005. The IRS has issued final regulations to provide guidance on the rules. This Quick Reference Guide provides seven suggested steps for complying with the rules.

Step 1: Identify arrangements that provide for a deferral of compensation.

- Identify the service provider relationships covered by the rules (e.g., employees, independent contractors, board members).
- Identify arrangements with service providers that are deferrals of compensation
  - An arrangement provides for a deferral of compensation if a service provider has a legally binding right during a tax year to compensation that is or may be payable in a later tax year.

- Some specific arrangements are exempt from the rules.
- All other arrangements are subject to the rules.
- Grandfathered amounts are not subject to the rules (i.e., amounts earned and vested prior to Jan. 1, 2005)
- Caution: Grandfathered status is lost if the arrangement is materially modified after Oct. 3, 2004.

Step 2: For each arrangement, decide between removing the deferral of compensation and complying with the rules.

- The deadline for making and documenting this decision is Dec. 31, 2007.
- After the deadline, an arrangement that defers compensation is always required to comply with the rules, even if the deferral feature is later eliminated.
- Weigh the benefits of providing deferred compensation against the costs of compliance and exposure to penalties.

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Step 3: Design each arrangement to comply with the rules.

- For a summary of the rules, see our Quick Reference Guide to the New Deferred Compensation Tax Rules.
- Compliance with the basic rules is required (i.e., restrictions on deferral elections, funding and distributions).
- Decide whether to adopt various special exceptions to the rules which provide certain advantages but make plan administration more complex.

Step 4: Develop and implement policies and administrative procedures.

- The complexity of the rules makes strong policies and procedures important.
- Designate an individual who has ultimate responsibility for developing policies and procedures, and for ensuring that they are followed.

Step 5: Prepare written plan by Dec. 31, 2007.

- The final regulations specify the required content of the written plan.
- The written plan must specify the plan's terms as of Jan. 1, 2008, but is not required to specify the terms for the period prior to Jan. 1, 2008.

Step 6: Obtain service provider elections as to time and form of payment by Dec. 31, 2007.

- Caution: Some elections result in noncompliance with the rules, such as:
  - An election in 2007 to postpone a payment that would otherwise be received in 2007
  - An election in 2007 that would cause a payment to be made in 2007 that would otherwise not be made in 2007
- For additional details, see our Quick Reference Guide to Deferred Compensation Plan Deadlines.

Step 7: Evaluate compliance for the period between Jan. 1, 2005 and Jan. 1, 2008.

- Final regulations are effective for tax years beginning on or after Jan. 1, 2008
- Until then, good faith compliance is required.
  - Compliance with the statute and Notice 2005-1 is required.
  - Compliance with the proposed regulations is not required.
  - Compliance with the final regulations is not required prior to Jan. 1, 2008.
  - However, voluntary compliance with the proposed and/or final regulations is one way to demonstrate good faith compliance.
- Review plan operations to determine whether violations have occurred, and take appropriate actions.

## Important notes

- These rules are current as of May 2007, but are subject to change based on further IRS guidance.
- Deferred compensation plans that are maintained under a collective bargaining agreement that was in effect on Oct. 3, 2004 are not required to comply with Sec. 409A until either Dec. 31, 2009 or the date the collective bargaining agreement terminates (whichever is earlier).
- Certain actions taken, or not taken, with regard to the deadlines for nonqualified deferred compensation plans may have financial statement implications. Accordingly, we recommend that you assess those implications with qualified professionals.

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