

Quick Reference Guide to Deferred compensation plan deadlines

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New rules for nonqualified deferred compensation plans under Code Sec. 409A went into effect on Jan. 1, 2005. In Dec. 2004, the IRS issued Notice 2005-1 to provide initial guidance for these new rules. In Sept. 2005, the IRS issued a 238-page proposed regulation document to provide additional guidance concerning these rules.

Both the notice and the proposed regulations required that certain actions be taken by specified deadlines. In Oct. 2006, the IRS issued Notice 2006-79 to extend some of the deadlines to Dec. 31, 2007. In April 2007, the IRS issued a 397-page final regulation document that did not provide any further extension of the deadlines. This reference guide highlights the required actions.

December 31, 2007 deadlines

- Amendments to a deferred compensation plan to either:
 - Bring the plan into compliance with Sec. 409A, or
 - Change the plan to eliminate any deferral of compensation, so that the plan is not subject to Sec. 409A.

- Employees' elections as to the time and form of payments
 - Caution: If an employee changed payment elections in 2006 for payments he or she would have otherwise received in 2006, this was a violation of Sec. 409A. Similarly, an employee cannot change payment elections in 2007 for payments he or she would otherwise receive in 2007.
 - Caution: If an employee changed an election in 2006 that caused a payment to be made in 2006, this was a violation of Sec. 409A. Similarly, an employee cannot change an election in 2007 that will cause a payment to be made in 2007.
- Actions related to discounted stock options and discounted stock appreciation rights (“SARs”).

Employers should review the valuation standards in the proposed regulations to determine whether their stock options and SARs will be treated as discounted.

- An employer may increase the exercise price to the fair market value on the original grant date. This removes the discount, and the arrangement is no longer subject to

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Sec. 409A. The deadline for this action is Dec. 31, 2007.

- Caution: The above deadline is Dec. 31, 2006 for public companies that report a financial statement expense due to backdated stock options.
- Caution: An employee cannot exercise the option or SAR in 2006 or 2007 if the discount has not yet been eliminated. An employee must wait until the discount has been eliminated to exercise the option.
- If the employer chooses not to remove the discount, then employees must choose their exercise dates in advance in order to comply with Sec. 409A. The exercise dates must be selected by Dec. 31, 2007.
- Caution: If an employee made an election in 2006 to exercise a discounted option or SAR during 2006, this was a violation of Sec. 409A. Similarly, an employee cannot make an election in 2007 to exercise a discounted option or SAR during 2007.
- Payments under a nonqualified deferred compensation plan that are controlled by payment elections made under a related qualified retirement plan, Sec. 403(b) annuity, Sec. 457(b) plan, or a foreign broad-based plan (i.e., “qualified plan”)
- Payment elections made under the qualified plan may be used to determine the payments under the nonqualified plan, even if the resulting payments do not comply with Sec. 409A, as long as the elections under the qualified plan are made by Dec. 31, 2007.
 - Cautions: This is available only for nonqualified plan payments that are made or commence on or before Dec. 31, 2007.

- The determination of the timing and form of payment must be made under the terms of the nonqualified plan as of Oct. 3, 2004.

Good faith compliance is required now

Although the actions described above do not have to be taken until the end of 2007, it is important to remember that good faith compliance with the new rules is currently required.

- Plans must be operated in compliance with Sec. 409A and Notice 2005-1.
- A plan is not required to comply with the proposed regulations. In addition, a plan is not required to comply with the final regulations until Jan. 1, 2008. However, compliance with the proposed or final regulations will be treated as good faith compliance.

Important notes

- These rules are current as of May 2007, but are subject to change based on further IRS guidance.
- The terms “employer” and “employee” are used above, but the new rules apply to other types of service recipients and service providers (e.g., independent contractors).
- 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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