

Client Alert

Latham & Watkins
Tax Department

Section 409A Transition Relief Extended

On October 22, 2007, the US Internal Revenue Service (the Service) extended the deadline for documentary compliance with Section 409A of the Internal Revenue Code until December 31, 2008 under Notice 2007-86 (the Notice). The additional transitional relief set forth in the Notice will generally be welcome news for companies that maintain nonqualified deferred compensation plans. The Notice, however, does require continued operational compliance with Section 409A, and there are still some steps companies should consider taking with respect to nonqualified deferred compensation plans prior to January 1, 2008. In particular, for the reasons discussed below, companies should:

- Identify agreements, plans and arrangements that may be deemed nonqualified deferred compensation plans under Section 409A.
- Analyze the time and form of payment elections with respect to nonqualified deferred compensation plans under which amounts may be paid, or be desired to be paid, during 2008.
- Determine the operational compliance requirements under Section 409A and prior guidance for each nonqualified deferred compensation plan.

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Documentary Compliance Delayed / 2008 Elections May Still be Necessary

The Notice supersedes portions of the documentary compliance requirements provided by Notice 2007-78 published by the Service in September 2007. This means that companies will not be required to meet various December 31, 2007 deadlines set by Notice 2007-78, including that all deferred compensation arrangements designate compliant times and forms of payments and that "good reason" severance provisions conform to the regulations, if necessary.

While under the Notice full documentary compliance is delayed until December 31, 2008, companies may need to take action with respect to nonqualified deferred compensation plans having payments scheduled, or desired to be scheduled, to be made during 2008. Arrangements cannot be amended during 2008 to delay payments otherwise scheduled to be made in 2008 to a later tax year nor to accelerate payments otherwise scheduled to be made after 2008 to be made during 2008; however, under prior guidance such an amendment can be made prior to or on December 31, 2007 to take effect in 2008. For example, if a deferred compensation arrangement that is subject to Section 409A provides that an employee is to be paid in 24 monthly installments commencing in 2008, the

arrangement cannot be amended in 2008 to provide for a lump sum payment that would be made to the employee during 2008, but such an amendment can be made prior to or on December 31, 2007 to take effect in 2008.

Operational Compliance Still Required

Notwithstanding the delay in documentary compliance, the Notice continues to make clear that nonqualified deferred compensation plans must be operationally compliant with Section 409A during 2008. Prior to January 1, 2008, taxpayers can rely on Notice 2005-1, the proposed regulations or the final regulations in maintaining such operational compliance; however, beginning January 1, 2008, generally taxpayers may rely only on Notice 2005-1 or the final regulations. With certain narrow exceptions, taxpayers may not rely on the proposed regulations after December 31, 2007. If an issue is not addressed in Notice 2005-1 or other applicable guidance, then companies may apply a reasonable, good faith interpretation of Section 409A. While reliance on the final Section 409A regulations is evidence of such reasonable, good faith interpretation of Section 409A, full compliance, including documentary compliance, with the final regulations is not required until January 1, 2009. During 2008, taxpayers are not required to comply with the final regulations.

Discounted Stock Right Relief Extended

In a very important provision, the Notice also extends to December 31, 2008 relief allowing companies to correct unexercised discounted stock options and stock appreciation rights held by employees other than Section 16 officers of companies which did not reflect such discount options on their financial statements in a timely manner.

Under the relief, companies may amend unexercised discounted options and stock appreciation rights to either be exempt from, or comply with, Section 409A. The Notice does not provide for any relief with respect to options and stock appreciation rights exercised prior to their amendment.

Other Relief Similarly Extended or Clarified

Other issues addressed in the Notice include:

- Relief allowing the amendment of certain good reason definitions to comply with the definitions, including the safe harbor definition, provided in the final regulations is extended to December 31, 2008.
- Individual elections under a plan that violate Section 409A will not cause the plan to fail to comply with Section 409A with respect to other participants who do not make such an election (*e.g.*, an employee who takes an early distribution subject to a "haircut" will not cause the plan itself to violate Section 409A).
- Payments may commence prior to January 1, 2009 under certain nonqualified deferred compensation plans with payment schedules linked to qualified plan payment elections.

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If you have any questions about this *Client Alert*, please contact Joseph M. Yaffe or James A. Metz in our Silicon Valley office or any of the following attorneys.

Barcelona José Luis Blanco +34.93.545.5000	Madrid José Luis Blanco +34.91.791.5000	Paris Christian Nouel +33.1.40.62.20.00
Brussels Andreas Weitbrecht +32.2.788.60.00	Milan Michael S. Immordino +39.02.3046.2000	San Diego Holly M. Bauer +1.619.236.1234
Chicago Robin L. Struve +1.312.876.7700	Moscow Mark M. Banovich +7.495.785.1234	San Francisco Scott D. Thompson +1.415.391.0600
Frankfurt Hans-Jürgen Lütt +49.69.60.62.60.00	Munich Claudia Heins Stefan Süß +49.89.20.80.3.8000	Shanghai Rowland Cheng +86.21.6101.6000
Hamburg Götz T. Wiese +49.40.41.40.30	New Jersey David J. McLean +1.973.639.1234	Silicon Valley Joseph M. Yaffe James A. Metz +1.650.328.4600
Hong Kong Joseph A. Bevash +852.2522.7886	New York Jed W. Brickner Bradd L. Williamson +1.212.906.1200	Singapore Mark A. Nelson +65.6536.1161
London Stephen M. Brown +44.20.7710.1000	Northern Virginia Eric L. Bernthal +1.703.456.1000	Tokyo Bernard E. Nelson +81.3.6212.7800
Los Angeles James D. C. Barrall David M. Taub +1.213.485.1234	Orange County David W. Barby David A. Calder +1.714.540.1235	Washington, D.C. David T. Della Rocca +1.202.637.2200