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ERISA NEWS BULLETIN

TO: CLIENTS AND COLLEAGUES

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This bulletin (a) discusses an IRS development regarding all *deferred compensation* arrangements under new Internal Revenue Code Section 409A, and (b) reminds you of our *Pension Protection Act seminar next Tuesday, November 14, 2006.*

(a) **DEFERRED COMPENSATION PLAN COMPLIANCE WITH IRC SECTION 409A.** 2004 saw the creation of Internal Revenue Code Section 409A, a new complex layer of tax laws governing deferred compensation plans (and arrangements of all kinds that defer payment, including individual employment agreements). Since that time, employers have struggled to bring their plans into compliance (operationally and in documentation), and the Treasury Department has struggled even more so to provide needed guidance for employers and advisors.

Application and Importance. If you have an arrangement of any kind that promises a benefit today that will be paid in a subsequent taxable year, with limited exceptions for certain retirement plans, and if such arrangement was not reviewed by ERISA tax counsel in 2005, you should review such matter without delay. 409A applies both to plans funded solely by the employer and to plans funded by the employee (for example, an executive's reduction of pay or deferral of a bonus). Failure to comply means that the promised benefits are includable today in the employee's taxable income and also are tagged with a 20% penalty tax.

Extension of Relief. Because the Treasury Department has been slow in issuing the necessary guidance, it recently announced good news, extending certain transition rules. IRS Notice 2006-79 provides, in pertinent part among other items, as follows:

1. The plan document or other writing evidencing the arrangement (for example, an employment agreement) does not need to be amended to comply with the new rules by December 31, 2006. That imminent deadline for plan amendment has been extended to 2007. (Word of advice – never rush to amend an ERISA document. Unless otherwise necessary, wait until things settle and reduce your legal fees.)

2. The operations of the arrangement (I am distinguishing operations from the written plan) do not need to conform with the IRC 409A regulations this year, but also are extended until 2007. Until then employers may rely upon “reasonable good faith” compliance with the new Code section; a number of compliance alternatives are available to the employer in this regard.

3. The transitional relief discussed above and below does not mean that employers may disregard the new rules. Indeed, compliance with the new rules is required now (and was required in 2005), and

adjustments to the plan's operations also were and are required now (for example, modifying the employee's deferral election form or benefit payment forms). The relief just means that reasonable good faith compliance is required, as opposed to strict compliance with the Treasury regulations (which are expected to be finalized shortly). Strict compliance will be necessary after the final regulations are issued.

4. Two of the primary components of Section 409A relate to the timing and manner of benefit payment, and the timing and form of an employee's election to receive payment. Strict new rules govern the date by which an employee or employer may choose the timing and manner of payment under the employment agreement or deferred compensation arrangement. Recognizing that the Service has not issued guidance quickly enough, and/or that employers are finding it hard to comply with the new benefit payment rules, Notice 2006-79 allows certain payment elections to be revised on or before December 31, 2007. This relief will allow many employers and employees to fix any benefit payment elections that have been made which do not comply with the law (and thus avoid a penalty).

5. The IRS Notice states – “A plan will not be operating in good faith compliance if discretion provided under the terms of the plan is exercised in a manner that causes the plan to fail to meet the requirements of section 409A. For example, if an employer retains the discretion under the terms of the plan to delay or extend payments under the plan in a manner that violates section 409A and exercises such discretion, the plan will not be considered to be operated in good faith compliance...[emphasis added]”. This highlights that compliance with the statute is required now and was last year, particularly with respect to the payment of benefits under a deferred compensation arrangement, and that if a plan fails in this regard, the amount is includable in the employee's income along with the 20% penalty tax.

IRS Notice 2006-79 does not provide relief for all noncompliance with 409A. It does, however, provide relief in certain situations which is a welcome development for the employee benefits community.

(b) **PENSION PROTECTION ACT OF 2006 NOVEMBER 14TH, 2-HOUR SEMINAR**. We are hosting a 2-hour seminar in downtown Boise next Tuesday, November 14th, from 8 to 10 a.m. The program discusses what you need to know to comply with the new laws. Space is still available, and thus we hope to entertain you there. For out-of-state clients and colleagues, the program is available live through audio/telephone hook-up (contact John Hughes or me if interested). Attached is information regarding the program.

This email is intended to provide general information only and does not provide legal advice. The application of ERISA laws can be complex. For information regarding the impact of these developments under your particular facts and circumstances, please call us.