

KELLY, HANNAFORD & BATTLES P.A.

ANTHONY R. BATTLES
JULE M. HANNAFORD IV
A. DAVID KELLY
JOHN W. HAINE
THEODORE K. RICE
SONJA LEMMER MARTENS

ATTORNEYS AT LAW
900 BAKER BUILDING
706 SECOND AVENUE SOUTH
MINNEAPOLIS, MINNESOTA 55402
TELEPHONE (612) 341-0881
FACSIMILE (612) 341-1041

WRITER'S DIRECT DIAL:
612/455-6075
DKelly@KHBlaw.com

MARK D. MEYER
OF COUNSEL

September 11, 2007

Re: IRS Extends 409A Plan Document Deadline

Dear Clients and Other Friends:

Yesterday the IRS issued Notice 2007-78 extending the deadline for amending deferred compensation plans to comply with Code §409A to December 31, 2008. This one-year extension is subject to some significant limitations:

- The December 31, 2007 deadline for designating the time and form of payment for existing deferrals was not extended. This means that a written document must be in place by December 31, 2007, specifying the events triggering payment and the form of payment.¹ This document could take the form of a plan amendment, an employer memo, an employment contract, or a written election by a plan participant. These issues, time and form of payment, really are the heart of the matter for most deferred compensation plans, and they must be resolved by the end of 2007. After the December 31, 2007 deadline, only certain details may be changed.
- During 2008, the Plan must be operated in accordance with the final 409A regulations issued April 17, 2007. The “good faith” compliance standard in effect during 2005 – 2007 will no longer apply.
- When the plan document is finalized by December 31, 2008, it must specify the 409A compliant rules which will apply in the future. It must also specify any interim rules used during 2008. For example, the final 409A regulations permit various alternative “separation from service” definitions. The final plan document adopted by December 31, 2008 must specify exactly which of those alternatives will be used in the future. For employees terminating during 2008, the Plan can be administered using a different alternative; the alternative that was used during 2008 will not have to be in writing by the end of 2007, but it must be specified in the final plan document.
- Similarly, the final 409A regulations give public companies a variety of ways to handle the requirement that distributions to “specified employees” may not begin

¹ Payment triggers may include a fixed payment date, the employee’s separation from service, disability, death, or unforeseeable emergency, or a change in control of the employer. Forms of payment may include lump sum, installments, or various forms of annuity.

until at least six months after separation from service. For example, there are a number of different permissible ways to identify exactly who is a specified employee. Again, it is not necessary to make a final choice among the available alternatives until the end of 2008. However, in the meantime, it is necessary for the employer to handle this issue in a way that satisfies at least one of the permissible alternatives, and when the plan document is finalized, it must specify which alternative was used from January 1, 2008 through the date the amendment was finalized.

While this new IRS guidance gives employers flexibility to satisfy some of the plan amendment requirements during 2008 rather than 2007, we believe that in many cases employers will find it desirable to get the amendments completed by the original December 31, 2007 deadline. Employers amending in 2007 will still be free to make minor changes by December 31, 2008 if they discover that some detail approved in 2007 isn't workable or that some other alternative would be preferable.

In addition to the plan amendment issues, Notice 2007-78 also answers some questions that have arisen in connection with the final 409A regulations. One such issue is whether a plan could provide for immediate cashout of a benefit which would otherwise be paid in installments if the total value of the benefit at the time installments were scheduled to begin (and not at any later date) is less than an amount prescribed in the plan document. For example, a plan might provide that a participant's deferred compensation account balance would be paid in 10 annual installments, but that the entire balance would be cashed out in a lump sum if the balance was \$100,000 or less at the time the first installment was due. While the final regulations did not explicitly address this, we have felt that such provisions were implicitly permitted by the regulation permitting various types of fixed payment schedules. The Notice allows this type of provision, provided it is "operated in an objective, non-discretionary manner and did not operate so as to provide either the service provider or the service recipient with rights having substantially the effect of a right to a late election as to the time and form of payment."

Also, the Notice says the IRS will issue separate guidance in the near future establishing a limited voluntary compliance program permitting correction of certain unintentional operational violations of §409A.

If you have questions about how Notice 2007-78 will affect your plans, please let us know.

Sincerely,

A. David Kelly

ADK/jks