

Legal Alert: 409A Transition Relief Extended

October 9, 2006

The IRS has issued Notice 2006-79 extending most of the existing transition rules under Internal Revenue Code section 409A through December 31, 2007. The Notice provides the following relief:

Plan Amendment. Plans now have until December 31, 2007 to be amended to comply with Code section 409A and the final regulations.

Operational Compliance. Plans must continue to comply with Code section 409A, Notice 2005-1 and any other guidance issued through December 31, 2007 on a reasonable and good-faith basis. Until January 1, 2008, compliance with the proposed regulations issued in October 2005 or the final regulations constitutes good-faith, reasonable compliance with the statute but is not required. As before, the good-faith, reasonable standard is violated if the employer exercises discretion under a plan in a manner that causes the plan to fail to meet the requirements of Code section 409A.

Change in Payment Elections. Plans may continue to permit changes to existing elections as to the form and time of payments through December 31, 2007. Any such changes made in 2007 cannot apply to amounts that would otherwise be payable in 2007 or cause an amount to be paid in 2007 that would otherwise not be payable in 2007. Parallel rules already apply for 2006.

Payments Linked to Qualified Plans. A payment election under a nonqualified deferred compensation plan may be linked to an election under a qualified retirement plan, a Code section 403(b) annuity, a Code section 457(b) eligible plan or certain foreign broad-based retirement plans through December 31, 2007.

Stock Options and Stock Appreciation Rights (SARs). The relief provided under Notice 2005-1 and the preamble of the proposed regulations that allows for the substitution of non-discounted stock options or SARs for discounted stock options or SARs is extended through December 31, 2007, except with respect to certain stock options and SARs described below. It will not be a material modification to an existing arrangement to replace, in 2006 or 2007, a stock option or SAR that otherwise provides for a deferral of compensation under Code section 409A with a stock option or SAR that does not provide for a deferral of compensation. The cancellation of the existing stock option or SAR and issuance of the replacement stock option or

SAR cannot, however, result in the cancellation of a deferral in exchange for cash or vested property in the year of cancellation and reissuance. This relief is not available for any stock option or SAR that:

1. was granted with respect to stock of a corporation with publicly traded stock;
2. was granted to a person subject to the reporting requirements under Section 16(a) of the Securities Exchange Act of 1934; and
3. with respect to the grant of such option or SAR, the corporation has reported or reasonably expects to report the financial expense of a discounted stock right that was not timely reported previously.



Please contact any of the following members of our Employee Benefits and Executive Compensation practice if you have any questions regarding this development:

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| George H. Bostick | 202.383.0127 | george.bostick@sablaw.com |
| Daniel M. Buchner | 202.383.0869 | daniel.buchner@sablaw.com |
| Adam B. Cohen | 202.383.0167 | adam.cohen@sablaw.com |
| Ian A. Herbert | 202.383.0644 | ian.herbert@sablaw.com |
| Alice Murtos | 404.853.8410 | alice.murtos@sablaw.com |
| Robert J. Neis | 404.853.8270 | robert.neis@sablaw.com |
| W. Mark Smith | 202.383.0221 | mark.smith@sablaw.com |
| William J. Walderman | 202.383.0243 | william.walderman@sablaw.com |
| Carol A. Weiser | 202.383.0728 | carol.weiser@sablaw.com |