

Legal Alert: IRS Notice 2007-86 Provides General Extension of §409A Transition Relief Through 2008

October 23, 2007

In response to comments from the ABA Tax Section, benefits industry organizations, and law firms that the limited Internal Revenue Code section 409A transition relief for 2008 provided in September was inadequate, the IRS yesterday issued Notice 2007-86 (the “Notice”). The new Notice replaces the transition relief provisions of Notice 2007-78 (the “September Notice”) with broader relief that generally extends prior transition rules that were to expire at the end of 2007 until the end of 2008.

The extended transition period provides the relief that was needed to allow employers, their advisors and the IRS to address thoughtfully the unresolved issues encountered in attempting to apply the final regulations. The Notice extends the period for adopting amendments to nonqualified deferred compensation arrangements subject to Code section 409A and allows continued good faith operational compliance in the interim.

Specifically, Notice 2007-86 provides the following relief:

- **Plan Amendment.** Employers now have until December 31, 2008 to amend plans and arrangements to comply with Code section 409A and the final regulations, including (in contrast to the September Notice) the specification of the time and form of payment.
- **Operational Compliance.** Nonqualified deferred compensation arrangements subject to Code section 409A must continue to comply in operation with Code section 409A on a reasonable, good faith basis based on the statute and any generally applicable guidance issued through December 31, 2008. Until January 1, 2008, compliance with either the proposed regulations issued in October 2005 or the final regulations is not required but will constitute reasonable, good faith compliance. After January 1, 2008, compliance with the final regulations is not required but will constitute

reasonable, good faith compliance; however, reliance on the proposed regulations will no longer be permitted. As before, the reasonable, good faith 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, 2008. Any such changes made in 2008 cannot apply to amounts that would otherwise be payable in 2008 or cause an amount to be paid in 2008 that would otherwise not be payable in 2008. Parallel rules previously applied for 2006 and currently apply for 2007.
- **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, 2008.
- **Stock Options and Stock Appreciation Rights (SARs).** The relief provided under Notice 2005-1 and the preamble of the proposed regulations that allowed for the substitution of nondiscounted stock options or SARs for discounted stock options or SARs has been extended to allow replacing, before the end of 2008, a stock option or SAR that otherwise provides for a deferral of compensation under Code section 409A (*e.g.*, an option with an exercise price that was less than the fair market value of the underlying stock at grant) with a stock option or SAR that satisfies the criteria for exemption from the application of Code section 409A. 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 remains unavailable, however, 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.

- **Guidance in Notice 2007-78.** The guidance and relief provided under Notice 2007-78 regarding certain aspects of employment agreements and predetermined cash-out provisions continues in effect, and the deadlines for certain permitted employment agreement modifications have been extended to December 31, 2008.
- **Correction Program.** Consistent with prior statements by the IRS, the Notice confirms that the IRS intends to establish a program for correcting certain Code section 409A errors in the very near future.

Please visit our [Web site](#) or our special Code section 409A [mini-site](#) for links to the previous IRS guidance, past legal alerts, and other useful information on Code section 409A.



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

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
Vanessa A. Scott	202.383.0215	vanessa.scott@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