

SECTION 409A DEADLINE DECEMBER 31, 2008

As April approaches and we are all thinking about taxes, it might be a good time to be reminded of the upcoming December 31, 2008 deadline imposed by Internal Revenue Code § 409A (“409A”). 409A imposes significant compliance requirements with respect to nonqualified deferred compensation plans. More importantly, 409A extends well beyond the traditional nonqualified deferred compensation plan. For example, 409A applies to certain bonuses, fringe benefits, expense reimbursement arrangements, employment agreements, compensation agreements, tax gross up arrangements, buy/sell agreements, stock option arrangements, severance agreements and separation agreements.

Among the operational compliance requirements, 409A requires that all deferred compensation arrangements are in writing, provide for specific election and funding provisions, and set forth nondiscretionary payment terms relating to both the amount to be paid and the timing of any such payment. Often times, an employer has a plan subject to 409A, but because the plan has simply become a regular staple of doing business (such as a year-end bonus policy), the implications of 409A have not been considered. It is important to know that 409A applies to any arrangement that provides for income (of any kind) earned in one year to be paid in a subsequent year, unless the arrangement fits an exception.

The exceptions, like 409A itself, are complicated. For example, a year-end bonus payment will likely be excepted from 409A under the short-term deferral exception, which provides that compensation that would otherwise be deferred compensation is not deferred compensation under 409A if it is paid within the year the payment vests or within 2½ months after the end of that year. If the bonus arrangement provides that the bonus payment may be made later than 2½ months after the year in which the bonus is vested, the arrangement is subject to 409A and all of its compliance requirements. The problem is that the compliance requirements must be in place before the year in which the performance took place. As such, by the time you realize the plan is not in compliance, it is too late to fix it. Whether or not a nonqualified deferred compensation arrangement meets an exception under 409A should be determined through careful legal analysis.

If the nonqualified deferred compensation arrangement does not satisfy the requirements of 409A or if the operation of the plan does not satisfy 409A, the penalties imposed on the employee or other service provider are severe. Penalties include the recognition of income at the point in time when the income was initially deferred or no longer subject to a substantial risk of forfeiture, interest and penalties on the deferred income, plus a 20% excise tax. The employer may also incur penalties based on failing to withhold or report the income in the proper tax year. More importantly, some are predicting that employers may face legal challenges from employees who will seek to recover the taxes and penalties from the employer under various legal theories. It is still too early to determine the validity or strength of such claims; yet, even defending weak claims can be expensive.

In sum, employers have until December 31, 2008 to amend current nonqualified deferred compensation plans to bring them into compliance with 409A. To the extent you have any questions or would like our assistance in reviewing your current plans, please contact anyone in our Employment, Labor and Benefits group.

The Koley Jessen Employment, Labor and Benefits Group:

Margaret C. Hershiser

402.343.3711

margaret.hershiser@koleyjessen.com

Richard D. Vroman

402.343.3810

richard.vroman@koleyjessen.com

Ryan J. Sevcik

402.343.3859

ryan.sevcik@koleyjessen.com

Joan M. Cannon

402.343.3753

joan.cannon@koleyjessen.com

Leilani M. Harbeck

402.343.3767

leilani.harbeck@koleyjessen.com

Julie A. Schultz

402.343.3766

julie.schultz@koleyjessen.com

Allyson Crossman Slobotski

402.343.3842

allyson.slobotski@koleyjessen.com