



NYLEX News

Premier Executive Benefits Plan Services

October, 2005

Section 409A Transition Relief **Section 409A Alert**

To our clients and friends

This issue of NYLEX News discusses the extension of transition relief just announced by Treasury and the IRS. Notice 2006-79 extends through 2007 most of the Section 409A transition relief previously announced for 2006. Taxpayers are given until December 31, 2007 to amend plans to conform to final regulations. Please send comments about this newsletter, as well as suggestions for future issues, to our Stamford, CT office.

SUMMARY

Section 409A was enacted as part of the American Jobs Creation Act of 2004 and generally provides that unless certain requirements are met, amounts deferred under nonqualified deferred compensation plans are currently includible in taxable income unless the amounts are subject to a substantial risk of forfeiture.

Transition Relief

Companies are granted until December 31, 2007 to amend their nonqualified deferred compensation plans to conform to Section 409A. Reasonable good faith effort to comply with the rules in Section 409A is still required.

Under the law, amounts accruing under supplemental executive retirement plans (SERPs) also are subject to these rules. In October, 2005 Treasury and the Internal Revenue Service (IRS) issued proposed regulations under Section 409A

and included transition rules effective through 2006. Although these regulations were expected to be adopted by the end of summer 2006, they have not yet been issued.

In Notice 2006-79, issued in October 2006, Treasury and the IRS explained that they do intend to issue the final Section 409A regulations before the end of 2006. However, responding to concerns that there would not be enough time for taxpayers to analyze the final regulations and adopt amendments to their plans where necessary, the Notice includes an extension until December 31, 2007 of the transition relief previously announced.

OPERATION AND AMENDMENT OF PLANS

The Notice provides that literal compliance now with the proposed regulations is not required. A plan will not be treated as violating Section 409 if it is operated in reasonable good faith

compliance with Section 409A and the guidance issued so far, and the plan is amended on or before the end of 2007 to conform to Section 409A and the final regulations. However, good faith, reasonable interpretation of Section 409A is required.

Since taxpayers and their advisors have no way of knowing what the final rules will be until the Section 409A regulations are actually issued, extending until December 31, 2007 the date plans must be amended is welcome news.

CHANGES IN PAYMENT ELECTIONS OR CONDITIONS

The Notice also extends the time new and amended payment elections may be made. Under the new rules, plans can be amended anytime on or before the end of 2007 with respect to the time and/or the form of payment. However, an election or amendment made in 2006 cannot result in a payment being made in 2006 or deferral of an amount that otherwise would have been paid in 2006.

Similarly, an election or amendment made in 2007 cannot result in a payment being made in 2007 or deferral of an amount that otherwise would have been paid in 2007.

SUBSTITUTION OF CERTAIN STOCK OPTIONS AND SARs

The Notice extends the date by which a non-discounted stock option or stock appreciation right (SAR) may be substituted for a stock option or SAR that had been issued at a discount.

This permits the substitution of a non-deferral arrangement for one that is subject to Section 409A. The period for such substitution is extended until the end of 2007. However, the rule does not permit the cancellation of a deferral arrangement in exchange for cash or vested property.

However, probably in reaction to news of public companies who had backdated stock options, transition relief is not available for any stock option or SAR that:

- Was granted for stock of a public company;
- Was granted to a person subject to section 16(a) of the 1934 Securities Exchange Act; and
- With respect to the arrangement, the company has or expects to report an expense due to the issuance of the right with a below market exercise price where that expense had not been timely reported.

WHAT THE NOTICE DOES NOT INCLUDE

The Notice includes various transition rules but does not cover all the issues that will be dealt with in final regulations. For example, the Notice does not deal with split-dollar insurance arrangements.

Also, separate guidance is expected on reporting and disclosure requirements. Withholding on Section 409A violations, however, suspended for 2005, is expected to be required for 2006.

In addition, separate regulations are expected to deal with the treatment of partnership plans and the anti-funding rules in Section 409A. These rules have yet to be proposed.

CONCLUSION

Notice 2006-79 brings relief to taxpayers concerned about amending plans by the end of 2006 to comply with rules that have not as yet been made final. However, the Notice repeats the admonition that, even though there are no final regulations, nonqualified deferred compensation plans still must be operated in good faith compliance with Section 409A.

ABOUT NYLEX BENEFITS

NYL Executive Benefits LLC (NYLEX Benefits) provides supplemental executive benefit programs to a wide range of commercial clients. We focus on developing cost effective executive benefit solutions that are designed to attract, reward and retain key employees. Our services are designed to assist clients at all stages in the adoption and operation of executive benefit programs, and include:

- Initial assessment
- Plan design
- Funding
- Plan implementation
- Ongoing administration

NYLEX Benefits' professional staff includes the following professional disciplines, all dedicated to supporting our clients' programs, processes, systems and services:

- Accountants
- Actuaries
- Attorneys

- Benefit specialists
- Insurance specialists

We take great care to assure that client programs are practical and cost effective and that they are designed to achieve our clients' strategic and operational goals.

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