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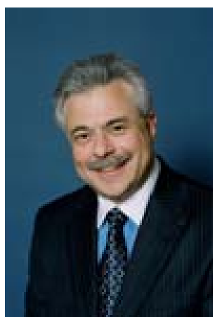
TAX LAW
Code Section 409A: Countdown to Compliance before 1/1/08



By Ronald A. Feuerstein

On April 10, IRS issued its long-awaited final regulations under Code Section 409A. We want to let you know what this important development means for your business and what action is now required.

Code Section 409A imposes strict requirements on nonqualified deferred compensation ("NQDC") plans. These requirements have been in effect since the beginning of 2005, and many companies have already taken preliminary steps to comply with the new rules.

The final regulations that IRS has issued are generally similar to the proposed regulations issued in 2005, but include significant new provisions that make compliance easier in certain situations. These final regulations will take effect on January 1, 2008.

The costs of noncompliance are high. All amounts deferred under a noncompliant NQDC plan are included in the employee's income. Interest is also imposed on that income at a rate one percentage point higher than the interest rate on tax underpayments, plus a 20% penalty.

Identifying plans that are subject to Code Section 409A. A plan provides for deferral of compensation if the employee has a legally binding right to compensation that is payable in a later tax year. However, certain plans enjoy an exemption from the Code Section 409A requirements. Qualified retirement plans, tax-deferred annuities, simplified employee pensions ("SEPs"), and SIMPLE retirement accounts are not considered NQDC plans. Code Section 409A also does not apply to some benefit plans, such as bona fide vacation leave, sick leave, compensatory time, disability pay, and death benefit plans. Severance pay plans may be subject to Code Section 409A unless an exemption applies. The final regulations extend the period in which taxable reimbursements of medical expenses may be provided under a severance pay plan to cover the period during which the employee would be entitled to continuation coverage under COBRA.

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There is also an exception for short-term deferrals. Under this rule, there is no deferral of compensation if the employee receives the compensation by 2 and 1/2 months after the end of the tax year of the employer or employee, whichever is later, in which the amount is no longer subject to a "substantial risk of forfeiture."

Nonstatutory stock options ("NSOs") and stock appreciation rights ("SARs") on employer stock do not provide for deferral of compensation if the option or SAR is not "in the money" on the date of grant and there is no other feature for deferral of compensation.

How to comply with Code Section 409A. If it is determined that Code Section 409A applies to a plan, the next step is to make sure that the plan complies with the Code Section 409A requirements. There are four general requirements that relate to: (1) the initial deferral election, (2) the timing of payments, (3) acceleration of payments, and (4) later deferral elections. Each of these requirements must be spelled out in the plan document, and the plan must be operated in accordance with them.

Initial deferral elections. In general, an employee must make the initial election to defer compensation before the year in which the services are performed. In an employee's first year of eligibility, he may make a deferral election in the first thirty (30) days of participation, but the election may apply only to compensation earned after the election was made. An election to defer performance-based compensation that is based on services performed over twelve (12) months or more must be made no later than six (6) months before the end of the performance period.

Timing of payments. Payments under a NQDC plan must be made at a fixed date, under a fixed schedule, or upon any of these five events: separation from service, death, disability, change in ownership or control of the corporation, or unforeseeable emergency. If the timing of payment is based on a specified event, the plan must designate an objectively determinable date or year after the event on which payment is to be made. This rule prohibits so-called "haircut" provisions under which a participant may take payments at any time, subject to a reduction in amount.

Anti-acceleration rule. Payments of deferred compensation generally may not be accelerated. IRS has provided exceptions to this rule, such as for payments necessary to comply with a domestic relations order, payments necessary to comply with conflict-of-interest rules, and for certain payments upon plan terminations. IRS may allow other exceptions.

Later deferral elections. If a NQDC plan permits an employee to elect to delay or change the form of a payment, the following conditions must be met:

(1) the election may not take effect until at least twelve months after the date on which it was made;

(2) if the election relates to a payment that is not on account of death, disability or unforeseeable emergency, the first payment for which the election is made must be deferred for at least five (5) years; and

(3) any election related to a payment at a specified time or under a fixed schedule may not be made less than twelve (12) months before the date of the first scheduled payment.

Temporary relief will soon expire. Code Section 409A generally applies for: (1) amounts deferred in tax years beginning after 2004; and (2) amounts deferred in tax years beginning before 2005 if the NQDC plan is materially modified after October 3, 2004. However, IRS has given taxpayers until the end of 2007 to amend plan documents to comply with Code Section 409A and the final regulations.

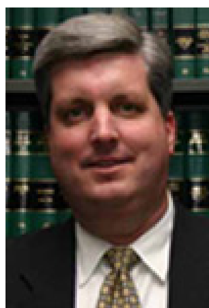
Thus, a plan will not violate Code Section 409A before January 1, 2008, if: (1) it is operated through December 31, 2007, in reasonable, good-faith compliance with Code Section 409A and earlier IRS guidance and (2) it is amended before January 1, 2008, to conform with Code Section 409A and the final regulations.

IRS has also provided relief for payment elections. A NQDC plan may provide, or be amended to provide, for new payment elections on or before December 31, 2007, for both the time and form of payment. If the amendment and election are made before January 1, 2008, they will not violate the rules against changes in the time or form of payment or acceleration of payments.

Action steps for the rest of 2007. In the time that remains before the final regulations take effect, companies must finalize any changes to their deferred compensation plans that are required to comply with Code Section 409A and make sure that those changes are properly reflected in the plan documents. Companies must also make sure that the plans will be operated in accordance with the Code Section 409A requirements. Finally, companies must obtain any new payment elections from plan participants that are permitted under the transitional rules. We will be happy to review your plan and assist in achieving compliance.

IMPORTANT NOTE: AS WE GO TO PRESS, IRS JUST ISSUED NOTICE 2007-78 ON 9/11/07, EXTENDING TRANSITION RELIEF FOR COMPLYING WITH PLAN DOCUMENT REQUIREMENTS FOR NONQUALIFIED DEFERRED COMPENSATION PLANS UNTIL DECEMBER 31, 2008.

New Focus on I-9 Enforcement and Social Security No Match Letters



By Philip M. Keating

In 1986, the Immigration Reform and Control Act ("IRCA") became law and imposed obligations on employers to verify the identity and authorization for employment of all individuals hired. Employers also are responsible for ensuring the proper completion the I-9 form and for the maintenance of those records. Violations of IRCA with respect to the completion and maintenance of I-9 records may result in civil and criminal penalties against employers.

In response to the public debate about immigration, federal government agencies have started very public campaigns to enforce the I-9 laws. U.S. Immigration and Customs Enforcement ("ICE") has started to conduct work site raids and I-9 audits after many years of not doing so. As a result, it is important that employers review their I-9 records to be certain that they could pass a government audit.

Employers may register for a voluntary government program that allows employers to electronically verify the employment authorization of new hires. However, if an employer registers for this program, every new hire must be processed through the electronic verification program. Furthermore, participation in the program does not immunize employers against I-9 enforcement efforts or penalties for violations.

Another major development in the area of employment of immigrants involves the Social Security Administration ("SSA"). In September 2007, new regulations concerning employer obligations in response to social security "no match" letters were set to become effective. (Implementation of the program currently is delayed by a federal court injunction.) Social security no match letters are the notices sent to employers by the SSA stating that the name and social security number listed on tax documents submitted by the employer do not match. Under the new regulation, employers must complete a reconciliation of a discrepancy within 90 days of receipt of the no match letter.

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Upon receipt of a no match letter employers must first check their records to determine if the discrepancy is caused by a clerical error. If so, the employer must correct the error with the SSA and verify that the corrected information matches the records of the SSA. If the discrepancy is not due to a clerical error, the employer must promptly require the involved employee to either verify the existing information or correct it. The employer must then follow up with the SSA and make a record of its actions.

If the discrepancy cannot be resolved within 90 days of receipt of the no match letter, the employer must re-verify the employee's employment authorization by completing a new Form I-9. The documents presented may not include any document with the social security number that was included on the no match letter and must include a document with a photograph.

The new regulation also includes receipt of a no match letter within the definition of "constructive knowledge" for determining violations of the I-9 regulations. Thus, failure to properly respond to a no match letter may subject employers to the civil and criminal penalties under IRCA.

This paper was prepared by Bean, Kinney & Korman, P.C. as a service to clients and friends of the firm. The purpose of this paper is to provide a general review of current issues. It is not intended as a source of specific legal advice. © Bean, Kinney & Korman, P.C. 2007.

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