

Employee Benefit Update

August 2005

It's Time to Establish a Deferred Compensation Action Plan

Section 409A was added to the Internal Revenue Code by the American Jobs Creation Act of 2004, and is generally effective as of January 1, 2005. Section 409A adds a number of complex new rules for nonqualified deferred compensation plans, and imposes severe tax penalties for noncompliance. These new rules were summarized in our November 2004 Employee Benefits Update. Following that update, the Internal Revenue Service ("IRS") issued Notice 2005-1, providing limited guidance on Section 409A. The IRS anticipates issuing additional guidance later this year. In the interim, in view of the December 31, 2005 deadline for amending plans and arrangements to comply with Section 409A, employers should prepare

now to act quickly when the additional guidance is issued.

IRS Guidance to Date

- "Deferred Compensation Plan" is defined broadly. Section 409A applies to plans and arrangements not traditionally thought of as deferred compensation plans. Stock options, phantom stock, restricted stock units, stock appreciation rights, employment agreements, severance plans, bonus plans, incentive plans, separation agreements, and layoff plans all may be "deferred compensation plans" within the scope of Section 409A.
- December 31, 2005 deadline. Employers must amend their deferred compensation plans and

arrangements to comply with Section 409A by December 31, 2005.

- Transition rules for 2005. Notice 2005-1 offers transition relief to employers with plans and arrangements subject to Section 409A. Employers must affirmatively take advantage of these transition rules before December 31, 2005.

Action Steps

Less than six months remain until the December 31, 2005 deadline for amending plans and arrangements. Employers thus need to act now to:

- Identify existing deferred compensation plans and arrangements.
- Review these plans and arrange-

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ments for provisions requiring changes to comply with Section 409A.

- Consider whether to take advantage of the transition rules provided under Notice 2005-1.
- Amend or terminate these plans and arrangements to comply with Section 409A, obtaining any necessary corporate approval.
- If terminated, all amounts deferred under the plan or arrangement must be distributed and included in participant income in 2005.
- Employers should generally postpone amendments to conform with Section 409A until the IRS issues the anticipated additional guidance. This is particularly important since amounts deferred and vested before January 1, 2005 could lose their grandfather status if the plan is materially modified.
- Communicate and implement the adopted changes and transition relief.

The foregoing is merely a summary of the action steps that should be undertaken in response to Section 409A. Please contact our benefits attorneys so we can assist you with the process of bringing your deferred compensation plans and arrangements into compliance with Section 409A.

If you have questions regarding Employee Benefits issues, please contact one of our Employee Benefits attorneys:

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Applicability of the legal principles discussed may differ substantially in individual situations. The information contained herein should not be construed as individual legal advice.