



Recent 409A Guidance Regarding Deferred Compensation Plan Requirements

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Timing Deadlines

- The time period for amending plans to comply with 409A and for good-faith reliance is extended to 12/31/2006.
- The time period for allowing participants to make elections as to the time and form of payment is extended to 12/31/2006. However, in 2006, an employee cannot defer a payment that would otherwise be made in 2006 or cause a payment to be accelerated into 2006.

Timing Deadlines

- The proposed regulations do not extend the 12/31/2005 deadline for terminating participation in a deferred compensation plan or canceling an outstanding deferral election.
 - Cash payment for lost discount on below-market options repriced to original grant date fair market value must be paid on or before 12/31/2005. Otherwise, payment must be made pursuant to a vesting arrangement with an initial vesting date after 12/31/2006.

Timing Deadlines

- The proposed regulations extend the Notice 2005-1 relief that allows nonqualified plan distribution elections to be linked to elections under the related qualified plan through 12/31/2006.

Equity Compensation

- For both public and private companies, SARs are treated in a manner similar to stock options for 409A purposes, regardless of whether SARs are settled in stock or cash.
- SARs and options may not have a discounted option price.
- SARs and options may only be granted with respect to specific types and classes of stock (no preferred stock).

Equity Compensation

- New rules for valuing stock underlying SARs and options.
- A modification of an SAR or option may be considered a new grant for 409A purposes. The following changes will not be considered a modification:
 - Certain cash out rights
 - Addition of stock swap rights
 - Addition of stock withholding rights
 - Acceleration

Equity Compensation

- Renewal or extension of an SAR or option is considered an impermissible deferral feature, which will result in loss of 409A exemption retroactive to the original grant. Limited extension of post-employment exercise period will not be considered a renewal.

Severance Plans

- A severance pay plan is exempt from 409A if:
 - the plan provides severance pay upon involuntary termination or pursuant to a window program,
 - the payment does not exceed 2x the lesser of (i) the employee's annual compensation or (ii) the 401(a)(17) limit (\$210,000 for 2005), and
 - payments are completed by the end of the second calendar year following termination.

Severance Plans

- Where severance pay that is 409A deferred compensation is the subject of bona fide arm's-length negotiations, the election as to the time and form of payment can be made on or before the date the employee obtains a legally binding right to the payment.
- A severance agreement can be structured to meet the short-term deferral rule, and, by doing so, may avoid the six-month payment delay for key employees.

Severance Plans

- The following reimbursements provided during a limited post-separation period are not considered deferred compensation:
 - Reimbursements excludible from gross income
 - Reimbursements deductible under IRC Section 162 or 167
 - Reasonable outplacement or moving expenses
 - Medical expense reimbursements

Severance Plans

- The post-separation “limited period” cannot extend beyond December 31 of the second calendar year following the calendar year of separation.
 - To qualify, the expenses and reimbursements must occur within the applicable period.

Deferral Elections

- Initial deferral election
 - Continuing participants: End of prior year
 - New participants: 30-day rule
 - Short-term deferrals: 12-month/5-year rule
 - Unvested payments: 30-day/12-month rule
 - Fiscal year compensation
 - Performance-based compensation: 6-month rule

Deferral Elections

- Example: On January 1, 2006, Employee is awarded retention bonus payable upon his or her continuation in employment through December 31, 2008
 - Unvested payment election: January 31, 2006
 - Short-term deferral election: December 31, 2007, but payment cannot be made until December 31, 2013

Deferral Elections

- Performance-based compensation may be based on objective or subjective criteria. Criteria must be established within no later than first 90 days of the performance period.
- 401(k) wrap plans can continue.

Distributions

- The short-term deferral provisions of Notice 2005-1 are retained. Payment must be made within 2-1/2 months after the end of the year in which vesting occurs.
- Exceptions exist for administrative impracticability or solvency concerns.

Distributions

- Payments can be earlier or later of any permissible 409A distribution event.
- Objectively determinable date or calendar year following designated event is permissible. Fixed payment schedule tied to a designated event is also permissible.
- Payment deemed made on designated date if paid within same calendar year or, if later, by the 15th day of the third month following the designated date.

Distributions

- The proposed regulations include rules of administrative convenience.
- If a payment date is specified, payment of the benefit must be made by the later of the first date it is administratively possible to make the payment and the end of the calendar year.
- Payment delays are allowed under limited circumstances, including (i) delays to preserve the 162(m) deduction and (ii) delays to avoid violation of securities laws or loan covenants.

Distributions

- The proposed regulations clarify when second elections may be made with respect to a stream of installment payments.
- Payments can be made based on an objectively determinable vesting event, for example, payments to be made only upon an IPO.

Distributions

- Earn outs paid as a result of a change of control may be treated as paid in a manner complying with 409A if:
 - the payments are made on the same terms as payments to other shareholders, and
 - the payments are made no later than five years after the transaction.
- Change of control distribution rules can apply to partnerships.

Acceleration

- The following events will not result in an impermissible acceleration of deferred compensation
 - Cancellation of deferral elections: 401(k) hardship distribution or 409A unforeseen emergency
 - Income inclusion under 409A
 - Certain involuntary cash outs
 - Pre-specified intervening event, provided such event is a permissible 409A distribution event

Plan Termination

- After 2005, a 409A plan can only be terminated under the following conditions:
 - All deferred compensation arrangements of the same type are terminated with respect to all participants, no payments (other than ordinary-course payments) are made within 12 months of the plan termination, all payments are made within 24 months of the plan termination, and no new similar plan is adopted for five years after the plan termination.
 - Within 30 days before or 12 months following a change of control, if all similar plans are terminated.
 - Corporate dissolution or bankruptcy.

Grandfathered Plans

- Participants in a grandfathered plan may not have the choice between remaining in a grandfathered plan and terminating their participation in the plan, without resulting in a material modification.
- An accidental material modification of a grandfathered plan may be rescinded before the end of the calendar year in which the modification is made, as long as additional rights granted under the modification have not been exercised.

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