



Follow-Up Webcasts on New Deferred  
Compensation Rules: How the Newly-  
Released IRS Guidance May Affect You  
*The Path Between a Rock and a Hard Place*  
*Initial 409A Guidance*

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# Agenda

- What you need to do before year-end
  - funding issues
- Grandfather rules
- 2004 deferrals
- 2005 deferrals
- Specific Arrangements
- Reporting Rules
- Recap

## What You Need to Do Before Year End

- Generally nothing!
  - Exception for hardwired “rabbicular” funding arrangements
  - Offshore rabbi trusts still not clear (potential technical correction)

## What You Need to Do Before Year End

- Taxpayers may rely on Notice 2005-1
  - Reasonable, good-faith compliance for topics not covered
  - Limited promise of prospective application of more restrictive future guidance

# Overview of Notice 2005-1

- Definitions and Coverage
  - including:
    - nonqualified deferred compensation plan
    - deferral of compensation
      - includes discounted options and certain SARs
    - substantial risk of forfeiture
    - change in control
- Transition Guidance

## 409A Grandfather

- What amounts are grandfathered?
  - Deferred amounts that are earned and vested as of 12/31/04
  - Binding legal obligation to pay amounts in future year
    - unless material modification
      - Amendment to suspend future deferrals not a material modification

## 409A Grandfather

- What does it mean to be grandfathered?
  - 409A timing rules on deferral elections and distributions do not apply

## 2004 Deferrals - Transition Rules

- Deferral Elections for plans in existence on or before 12/31/04
  - 3/15/05 deadline for nongrandfathered amounts that relate all or in part to services performed on or before 12/31/05
    - no exception for other 409A
  - Plan must in a written document by 12/31/04
    - terms of plan need not be amended to conform to 409A until 12/31/05

## 2005 Transition Guidance

- Plan amendment by 12/31/05
  - Reasonable, good-faith compliance required in the interim
- Distribution elections by 12/31/05
  - Distributions may tie to qualified plans for amounts distributed on or before 12/31/05
  - Form of distribution may be changed on or before 12/31/05

## 2005 Transition Guidance

- Exit Strategies
  - Prior elections may be cancelled by 12/31/05
    - Cancellation may be in whole or in part
    - Applies only to amounts subject to 409A
  - Termination of plan participation by 12/31/05

## 2005 Transition Guidance

- Plan may be terminated on or before 12/31/05
  - Distribution of all amounts is OK
  - Will not be treated as material modification of grandfathered amounts
    - But: why terminate as to grandfathered amounts?
    - Better: freeze - do something else in the future

# Stock Options/SARS

- Discounted Stock Options are subject to 409A
  - 423 options excepted
- SARS
  - Generally deferred compensation
  - Nondiscounted stock-only SARS of publicly traded companies excepted
  - Pre 10/04/04 nondiscounted SARS grandfathered

# Options/SARs

- Exit Strategies
  - Cancellation and reissuance of options or SARs prior to 12/31/05
    - can cash out deferral element

## Defined Contribution Plans

- March 15, 2005 deadline for deferral elections
  - exception to the 409A deferral election timing rule
- December 31, 2005 deadline for plan amendments for 409A compliance

## Defined Contribution Plans

- Acceleration of payments permitted
  - qualified domestic relations order
  - conflict of interest divestiture
  - change in control
    - + 35% stock acquisition
    - + 40% asset acquisition
    - new Board majority
    - applies to sponsor, payor or majority owner
  - employment taxes

## Defined Benefit Plans

- Determination of grandfathered amounts
  - present value of earned and vested amount as of 12/31/04 without inclusion of early retirement subsidies - as if terminated as of 12/31/04
- December 31, 2005 deadline for plan amendments for 409A compliance
- Distributions commencing on or before December 31, 2005 may be tied to elections under a qualified plan

# Defined Benefit Plans

- Acceleration of payments
  - qualified domestic relations order
  - conflict of interest divestiture
  - change in control
  - employment taxes

# Severance

- Excepted from 409A for 2005:
  - Collectively bargained severance pay plans
  - Severance pay plan that provides no payments to “key” employees (416(i))
- Covered by 409A
  - Severance pay programs covered by ERISA
  - IRS still considering exceptions
  - Mandatory lump-sum payments may avoid 409A

## 457(f) Plans

- Covered by 409A
  - timing of elections as to deferrals
- Rolling risk of forfeiture not substantial risk of forfeiture for 409A
- Early distributions permitted for tax payments

# Reporting Requirements

- Effective with 2005 Form W-2 or 1099 Reporting for deferred compensation of \$600 or more
  - amounts that are not reasonably ascertainable are not required to be reported until they become reasonably ascertainable
- IRS Announcement 2004-96
  - For W-2 report in box 12 using Code "Y"

## Withholding Requirements

- Amounts includible in gross income under 409A are considered a payment of wages for income tax and FICA withholding when actually or constructively received
- Amounts includible in gross income under 409A are subject to SECA for self-employed individuals
- No withholding for the 20% penalty tax

## Recap

- Generally no actions required by 12/31/04 for 409A compliance
  - exception for certain funding arrangements
- Deferral elections for amounts partially or fully earned before 12/31/05 must generally be made by 03/15/05
- New elections regarding timing and form can be made by 12/31/05

## Recap

- Plans need to be amended for compliance by 12/31/05
- Nondiscounted SARs of public companies are not subject to 409A
- Distributions tied to qualified plan elections OK for 2005
- Watch out for actions that might destroy grandfather

## Recap

- Wait for (lots) more guidance!
- Note - IRS seeking comments on 409A

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