



December 31, 2008 Deadline for 409A Compliance Quickly Approaching

The December 31, 2008 deadline for employers to comply with the documentation requirements of Section 409A of the Internal Revenue Code is almost here. The IRS is receiving pressure from some corners to further delay the compliance deadline, but for now it remains the end of this year.

Employers will need to ensure that all of their non-qualified deferred compensation (“NQDC”) arrangements (as explained below) are in strict compliance with Section 409A in order to avoid costly penalties. All NQDC arrangements that are subject to Section 409A, whether oral or written, must be brought into compliance with Section 409A, and all material terms of such arrangements must be set forth in writing, by the end of the year.

Failure to comply with the Section 409A requirements for NQDC arrangements may lead to the following costly consequences:

- Employees may be subject to accelerated taxation of the entire amount of non-qualified deferred compensation payable under the non-compliant arrangement and may also be subject to a 20% federal penalty tax (in addition to ordinary income tax) on the non-qualified deferred compensation, plus interest for the underpayment of taxes.
- Employers may be subject to penalties for failing to timely withhold taxes or report includible income that was not properly deferred in accordance with Section 409A.
- Employees may pressure employers to reimburse them for additional taxes and interest paid with respect to arrangements that do not comply with Section 409A.

Types of NQDC Arrangements That Fall Within Section 409A

Section 409A generally applies to any arrangement where an employee or other service provider (e.g., a director or an independent contractor) has a legally binding right during a taxable year to receive some form of compensation that is or may be payable in a later taxable year. Common types of arrangements that may fall within Section 409A include:

- Traditional deferred compensation plans (e.g., deferred salary and bonus plans, supplemental executive retirement plans (“SERPs”), and top-hat plans)
- Employment agreements and offer letters
- Change in control agreements, including earn-out arrangements

- Severance agreements and plans
- Reimbursement arrangements
- Bonus, incentive or commission plans
- Equity based compensation arrangements such as stock options, stock appreciation rights (“SARs”), restricted stock units, phantom stock awards and performance share awards

In addition, Section 409A applies to almost every other arrangement-regardless of its name-under which an employee earns compensation in one year but is entitled to defer receipt of that compensation until a subsequent year. If you are not sure whether an arrangement is subject to Section 409A, now is the time to resolve the uncertainty.

We recommend that employers with potentially non-compliant, non-qualified deferred compensation arrangements identify their NQDC arrangements and contact legal counsel as soon as possible, if they have not already done so, to ensure that their NQDC arrangements comply with Section 409A. Section 409A, the regulations and the interpretive guidance are highly technical and complex. Compliance may entail preparing amendments to non-compliant NQDC arrangements, documenting oral NQDC arrangements in writing, having the board of directors approve amendments to existing NQDC plans, obtaining employee/service provider consent and authorization for required 409A amendments, and/or ensuring that payroll and human resources departments accurately report and withhold any amounts subject to 409A.

This email alert is intended only as a general summary regarding compliance with Section 409A. We recommend that you contact legal counsel regarding any concerns you may have regarding your specific NQDC arrangements. Please feel free to contact any one of Riddell Williams’ Executive Compensation and Benefits attorneys listed below if you have any questions about this email alert or if you would like assistance with Section 409A compliance.

Executive Compensation and Benefits Group at Riddell Williams:

Frank C. Woodruff, Chair
206.389.1519
fwoodruff@riddellwilliams.com

Erin Watanabe Croman
206.389.1592
croman@riddellwilliams.com

Stephen E. DeForest
206.389.1779
sdeforest@riddellwilliams.com

Robert W. Howie
206.389.1561
rhowie@riddellwilliams.com

Karen F. Jones
206.389.1638
kjones@riddellwilliams.com

Erin Joyce Letey
206.389.1585
eletey@riddellwilliams.com

Laurence A. Shapero
206.389.1661
lshapero@riddellwilliams.com

Riddell Williams P.S.
1001 Fourth Avenue, Suite 4500
Seattle, WA 98154-1192
www.riddellwilliams.com

Telephone: 206.624.3600

Facsimile: 206.389.1708