VENABLE LLP

employee benefits & executive compensation alert

A PUBLICATION OF VENABLE'S EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION PRACTICE GROUP

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More Items for Your Section 409A Compliance Checklist

A year after final regulations under Internal Revenue Code Section 409A were issued, Treasury and IRS officials are adamant that the deadline for compliance with the final regulations will not be extended beyond December 31, 2008. Asserting they "basically haven't been enforcing the statute during transition," officials say it's time for practitioners and employers to accept the fact that Section 409A is here to stay. Instead of pressing for another extension, practitioners and employers should focus on coming into compliance. With that in mind, we offer several important items to add to your compliance checklist: 409A compliance procedures, defensive drafting, and rabbi trust agreements.

No Compliance Practices and Procedures? No Corrections!

Late last year the IRS established a limited corrections program under which specified, relatively minor violations can be corrected without incurring full Section 409A penalties. In response to requests for a broader program, Treasury and IRS officials have not been encouraging, despite the likelihood of inadvertent errors and the severity of the 409A penalties. Nonetheless, it's important to lay the groundwork to be able to use the current program or any expanded program the IRS might establish.

A threshold requirement for correction under the current program is that an employer must have established practices and procedures reasonably designed to ensure compliance with Section 409A. So, for example, an employer that simply fails to amend its plans to comply with 409A would not be eligible for any correction relief because the employer hasn't established a 409A compliance program. An important item to add to your Section 409A checklist, therefore, is " 409A compliance program" to ensure that you have the necessary documentation in place to be eligible for the current correction program and any future corrections program that might be put into place.

Defensive Drafting

As we all know, prevention is the best cure. As you review your 409A plans and arrangements with an eye to making final revisions before the December 31, 2008 deadline, think about how to draft your plans to help prevent operational mishaps from being treated as "errors" that need to be "corrected" in the first place. One approach is to avoid unnecessary

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specificity. For example, it might be preferable to describe how elective deferrals will be handled as generally as possible so that any minor variations in that process that have no impact on the expected year-end tax treatment will not be treated as errors.

Rabbi Trust Traps

A final item for your checklist is "Rabbi Trust Review." Section 409A does not generally prohibit the use of a rabbi trust, under which assets are set aside to provide nonqualified deferred compensation benefits, but remain available to satisfy claims of the employer's creditors. However, the agreement establishing the rabbi trust must not include terms that would cause a violation of Section 409A. To date, every agreement we have reviewed has required revision. Provisions to watch for are those that permit:

- Rabbi trust assets to be located outside of the United States (at the time of transfer or any later time);
- The funding of a rabbi trust in response to a change in the employer's financial health; or
- The funding of a rabbi trust when a qualified defined benefit plan is in "at risk" status or is terminated on an underfunded basis.

In addition, some rabbi trusts we have seen include provisions that accelerate benefit payments in some circumstances, such as if the trust is determined to be a non-grantor trust, regardless of what any related plan provision would require or permit. Such provisions are obvious violations of Section 409A and must be removed or revised before the end of the year.

Members of Venable's Employee Benefits & Executive Compensation Group would be happy to help you with your 409A compliance efforts. Please remember, however, that we are already in the third quarter of 2008. Don't let that ticking noise you hear turn into a compliance time bomb.

Please contact any member of our group regarding these or other employee benefits and executive compensation issues.

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