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EMPLOYERS BEWARE
OF NEW SECTION 409A

What is Section 409A? Section 409A was enacted by Congress as part of the American Jobs Creation Act of 2004. This law makes dramatic revisions that could cause immediate taxation of certain amounts deferred under Deferred Compensation Plans if those plans are not timely amended. On December 20, 2004, the Internal Revenue Service ("IRS") issued guidance to help interpret this new law.

Which Deferred Compensation Plans are affected? The affected plans generally include Nonqualified Deferred Compensation Plans, Stock Appreciation Rights, Supplemental Retirement Plans and certain other plans, including phantom stock plans. Section 409A does not impact qualified retirement plans such as plans established under Section 401(a) of the Code or 401(k) plans.

The new rules are effective now. Employers must review and promptly make any necessary modifications to any affected Deferred Compensation Plan, and in no event later than December 31, 2005.

Some of the affected plan provisions that Employers should review immediately are those that deal with the following:

1. Compensation deferrals. The new law generally provides that all compensation deferral elections must be made in the year prior to the year in which the compensation is to be earned. There may be certain exceptions for performance compensation to the extent so provided by the IRS in the future.

2. Restrictions on distributions. Circumstances under which distributions will be permitted have been substantially limited to death, disability (as defined by the law), separation from service (although there are further restrictions on "key employees" of public companies), certain limited changes in control (as defined by the IRS) and certain "unforeseeable emergencies" (as defined by the law and limited to specified times).

3. Elections. Employees may no longer have the same flexibility in determining the time and form of payment from plans after the Employee's initial election. Employees will also have significantly less flexibility changing existing payment schedules.

Failure to comply with the new rules will trigger severe consequences. If an Employer's Deferred Compensation plan does not conform to the new law, Employees will be subject to immediate taxation on amounts improperly deferred, including amounts deferred in prior years. The new law also provides for the assessment of interest and a 20% penalty.

Summary. It is important to act now. Every Employer should confirm that it is complying with the new law by having its plan reviewed and modified as necessary.

If you have any questions about this information or need assistance complying with these new rules, contact the author, Phil Diamond at 407-849-0300, 888-849-9191, pdiamond@carltonfields.com or the editor, Eileen Trautman at 305-539-7353, 888-486-0140, etrautman@carltonfields.com.