Section 409A Final Regulations		Pillsbury Winthrop Shaw Pittman
	Need to Know and Do (and By Wi Employment Agreements and Se	,
May 22, 20	. , .	verance
Presenters:	Howard L. Clemons Peter J. Hunt Kurt Lawson	

 Overview
 Image: Compensation Exemptions

 Deferred Compensation Exemptions
 Short-term deferrals

 • Short-term deferrals
 Separation Pay

 • Reimbursements
 When exemption not available

 • Deferral, time and form of payment elections
 • Separation from service, tax-gross-up issues

 Plan aggregation rules
 Tax-exempt and governmental entities

Deferred Compensation
Legally binding right to compensation payable in
later year

Excluded plans

 "Qualified employer plans," eligible deferred compensation plans under IRC 457(b), bona fide vacation, sick leave, compensatory time, disability pay or death benefits, Section 83 property transfers (including promise to transfer property that will <u>not</u> be substantially vested on transfer) 2

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Deferred Compensation: Exemptions



- · Agreement to transfer unvested property
- · Choice between cash and restricted stock or options
- Indemnification and liability insurance
- > Legal settlements, court awards, attorney fee awards
- Split-dollar "loan" arrangements—where no commitment to forgive loan
 - Notice 2007-34
- Benefits excludable from income (e.g., health insurance, death benefits)
- Education assistance

Short-Term Deferral Exemption $-2\frac{1}{2}$ month rule

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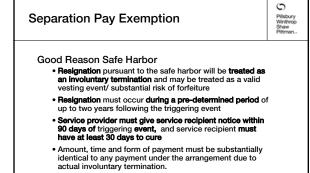
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- Payment must be actually or constructively received by end of applicable 2 ½ month period
 2 ½ months after end of calendar year in which compensation vests or, if later, end of service recipient's fiscal year in which compensation vests
- compensation vests
 Payment that <u>may</u> be made after 2 ½ month period is <u>not</u> short-term deferral even if paid within 2 ½ month period (e.g., payment due on separation from service)
- separation from service)
 If any part of a payment treated as a single payment is deferred beyond the short-term period, entire payment is deferred compensation
- compensation
 No loss of short-term deferral status if payment delayed due to (1) unforeseeable administrative impracticability, (2) payment would jeopardize service recipient's ability to continue as going concern, or (3) failure to be deductible under IRC 162(m) that a reasonable person would not have anticipated

Separation Pay Exemption

- Separation payments on involuntary separation from service, or participation in window program (window not more than 1 year)
 - Involuntary separation can include "good reason" termination-safe harbors provided
 - Payments cannot exceed <u>2 times lesser of</u> annualized compensation for prior calendar year or compensation limit for qualified plans (\$225,000 for 2007)
 - Payments made no later than December 31st of 2nd calendar year following calendar year of separation

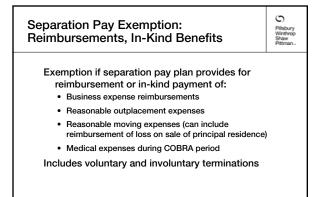


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Separation Pay Exemption Pretury With roop Between Good Reason Safe Harbor Triggers Material diminution in base compensation, budget or geographic work location, or authority, duties or responsibilities of service provider or direct supervisor, or And or har action or inaction which constitutes a material breach of an applicable employment agreement.



Separation Pay Exemption: Reimbursements, In-Kind Benefits

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Time Restrictions

- Expenses must be incurred (or in-kind benefits provided) in calendar year of separation and following 2 calendar years
- Reimbursements must be paid by end of 3rd calendar year following year of separation

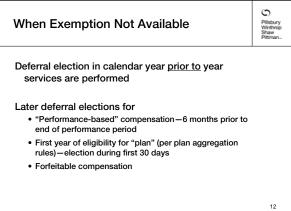
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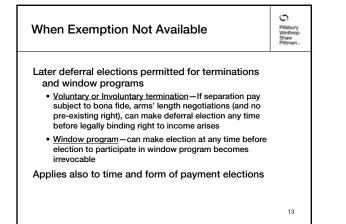
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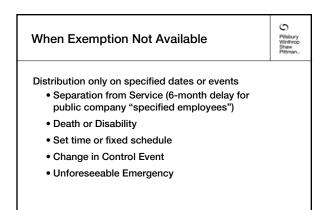
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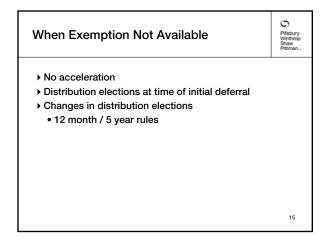
Separation Pay: Other Exemptions

- For 2007, certain broad-based severance plans (Notice 2005-1)
- Collectively bargained plans
- Foreign separation pay plans (amounts required under applicable foreign law)
- De minimis payments- up to Code § 402(g) limit (\$15,500 for 2007)









When Does Separation From Service Occur?

- Separation is permissible distribution event (6-month delay for specified employees of public companies)
- Controlled group rules apply in determining whether separation has occurred; plans may specify particular ownership percentage levels, within limits
- No separation if military leave, sick leave or other bona fide leave of absence (6-month maximum unless reemployment protected by statute or contract)
- Disability leave may continue for up to 29 months before separation is deemed to occur
- "Same desk" rule may be used in asset purchase agreements so that separation will not occur

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Separation From Service – Continued Relationship

- <u>General rule</u>: Separation from service occurs if, based on facts and circumstances, parties reasonably anticipate that no further services will be performed or that level of services will decrease to 20% or less of average service level ("ASL"), determined over preceding 3-year period (as employee or independent contractor)
- Rebuttable presumption that separation occurred if level of services decreases to 20% or less of ASL
- Rebuttable presumption that separation did not occur if level of services continues at 50% or more of ASL
- Plan may define separation from service as specific anticipated reduction of level of services that is greater than 20% and less than 50% of ASL

Separation from Service: 6-Month Rule for "Specified Employees" • Payment cannot be made during first 6 months after separation from service or, if earlier, the date of death • Plan or agreement must specify that 6-month

delay will be implemented by a delay of all payments or a delay of payments for first 6 months only, with catch-up after 6 months

Designated Payment Dates

- If date of distribution is specified, distribution is treated as made on the specified date if made (i) no earlier than 30 days before the specified date, or (ii) on a subsequent date during the same calendar year, or (iii), if later, within 2-1/2 months after the specified date
- Designation of year or period of time during year—specified date is treated as first day of year or period of time
- "As soon as administratively feasible" distribution permitted if payment is made within one taxable year or 90 days after payment event and no election by employee is permitted
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Multiple Payment Events

- Different payment times and forms may apply to different payment events
- Payment may be on later or earlier of two permitted events
 In general, plan may provide for a different form of payment if
- an event occurs on or before a specified date (limited to one such date)
- Also, a different form and time of payment may be elected for separations from service under each of the following conditions: (i) separation during a limited period of time not to exceed 2 years following change of control event; (ii) separation before or after a specified date (or before or after a combination of a specified date and a period of service); and (iii) separation not described in (i) or (ii)

Reimbursements or In-Kind Benefits: Specified Date or Fixed Schedule

Reimbursements and in-kind benefits meet the requirements of payment on a specified date or fixed schedule if:

- The expenses eligible for reimbursement or in-kind benefit are objectively determinable under a nondiscretionary definition
- Reimbursement or benefit period is objectively and specifically
- described
- Expenses paid or in-kind benefits received in one period may not affect the expenses available for reimbursement or receipt in another period
- The reimbursement is made not later than the end of the service providers tax year after the year during which the expense is incurred
- The reimbursement right or right to in-kind benefits is not subject to liquidation or exchange for another benefit

Time and Form of Payment: Subsequent Changes

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- Subsequent election may not take effect for at least 12 months after it is made
- Except for election related to payment on account of death, disability or unforeseeable emergency, payment must be deferred for at least five years from the date the payment would otherwise have been made
- Life annuity treated as single payment
- Installment payments treated as single payment unless election is made to treat each installment as single payment
- No restriction on changes in actuarially equivalent forms of life annuities (certain features of an annuity are disregarded for the purpose of determining whether a payment form is a life annuity)

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Time and Form of Payment: C Tax Gross-Ups Platary Satisfy time and form of payment requirements only if:

- Gross-up must be paid by end of calendar year next following calendar year in which related taxes are remitted to taxing authority.
- Reimbursement of expenses due to a tax audit or litigation must be paid by the <u>later of</u> (1) end of calendar year next following calendar year in which related taxes are remitted or, if none, (2) end of calendar year next following calendar year in which audit or litigation is completed.

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Plan Aggregation Categories Elective deferrals under account balance plans Nonelective deferrals under account balance plans Nonaccount balance plans (DB plans) In-kind benefits or reimbursements of expenses Separation pay plans providing benefits (other than in-kind benefits or expense reimbursements) due to involuntary termination or window program Certain split-dollar life insurance programs Certain modified foreign income Covered stock rights Other

Tax-Exempt and Governmental Entities

Section 409A generally applies to tax-exempt and governmental entities, regardless of whether they are subject to Section 457

- · Applies to church plans and other plans specifically exempt from Section 457
- Does <u>not</u> apply to Section 457(b) eligible deferred compensation plans

409A exemptions for stock rights unlikely to apply to tax-exempt and governmental entities, as require employer stock

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Tax-Exempt and Governmental Entities

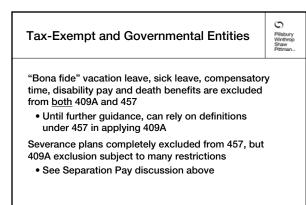
Section 457(f) "ineligible" plans

 Short-term deferral rule should exempt many 457(f) plans from 409A, as amounts are included in income when substantial risk of forfeiture lapses

Similar definitions of "substantial risk of forfeiture"

- 457(f) income inclusion treated as constructive receipt under 409A
- However, 409A regulations do not treat following as creating substantial risk of forfeiture:
 - Covenant not to compete

 - "Rolling" extensions of period during which forfeiture can occur
 Certain elections to defer compensation that otherwise would have been received (e.g., salary deferral)
- · Earnings on 457(f) deferrals may be subject to 409A



Future Teleconference on 409A Final Regulations	Pillsbury Winthrop Shaw Pittman
Session 4: Multinational Employers Tuesday, June 5, 2007 10:00am Pacific / 1:00pm Eastern To register for Sessions 4, visit the Events on our web site: <u>www.pillsburylaw.com</u>	page
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