







<p>Section 409A Final Regulations</p>	
<p>What You Need to Know and Do (and By When)</p> <p>Session 3: Employment Agreements and Severance</p> <p>May 22, 2007</p> <p>Presenters: Howard L. Clemons Peter J. Hunt Kurt Lawson</p>	


<p>Overview</p>	
<p>Deferred Compensation Exemptions</p> <ul style="list-style-type: none"> • Short-term deferrals • Separation Pay • Reimbursements <p>When exemption not available</p> <ul style="list-style-type: none"> • Deferral, time and form of payment elections • Separation from service, tax-gross-up issues <p>Plan aggregation rules</p> <p>Tax-exempt and governmental entities</p> <p style="text-align: right;">2</p>	


<p>Deferred Compensation</p>	
<p>Legally binding right to compensation payable in later year</p> <p>Excluded plans</p> <ul style="list-style-type: none"> • "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) <p style="text-align: right;">3</p>	


Deferred Compensation: Exemptions	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ 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 <ul style="list-style-type: none"> • Notice 2007-34 ▶ Benefits excludable from income (e.g., health insurance, death benefits) ▶ Education assistance 	
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Short-Term Deferral Exemption—2 ½ month rule	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ Payment must be actually or constructively received by end of applicable 2 ½ month period <ul style="list-style-type: none"> • 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 ▶ 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) ▶ If any part of a payment treated as a single payment is deferred beyond the short-term period, entire payment is deferred 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 	
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Separation Pay Exemption	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ Separation payments on <u>involuntary separation from service</u>, or participation in <u>window program</u> (window not more than 1 year) <ul style="list-style-type: none"> • Involuntary separation can include "good reason" termination—safe harbors provided • Payments cannot exceed 2 times lesser of 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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<h2 style="margin: 0;">Separation Pay Exemption</h2>	
<p>Good Reason Safe Harbor</p> <ul style="list-style-type: none"> • Resignation pursuant to the safe harbor will be treated as an involuntary termination and may be treated as a valid vesting event/ substantial risk of forfeiture • Resignation must occur during a pre-determined period of up to two years following the triggering event • Service provider must give service recipient notice within 90 days of triggering event, and service recipient must have at least 30 days to cure • Amount, time and form of payment must be substantially identical to any payment under the arrangement due to actual involuntary termination. <p style="text-align: right;">7</p>	


<h2 style="margin: 0;">Separation Pay Exemption</h2>	
<p>Good Reason Safe Harbor Triggers</p> <ul style="list-style-type: none"> • Material diminution in base compensation, budget or geographic work location, or authority, duties or responsibilities of service provider or direct supervisor, or • Any other action or inaction which constitutes a material breach of an applicable employment agreement. <p style="text-align: right;">8</p>	


<h2 style="margin: 0;">Separation Pay Exemption: Reimbursements, In-Kind Benefits</h2>	
<p>Exemption if separation pay plan provides for reimbursement or in-kind payment of:</p> <ul style="list-style-type: none"> • Business expense reimbursements • Reasonable outplacement expenses • Reasonable moving expenses (can include reimbursement of loss on sale of principal residence) • Medical expenses during COBRA period <p>Includes voluntary and involuntary terminations</p> <p style="text-align: right;">9</p>	


Separation Pay Exemption: Reimbursements, In-Kind Benefits	 Pillsbury Winthrop Shaw Pittman...
<p>Time Restrictions</p> <ul style="list-style-type: none"> • 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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Separation Pay: Other Exemptions	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> • 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) 	
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When Exemption Not Available	 Pillsbury Winthrop Shaw Pittman...
<p>Deferral election in calendar year <u>prior to</u> year services are performed</p> <p>Later deferral elections for</p> <ul style="list-style-type: none"> • “Performance-based” compensation—6 months prior to end of performance period • First year of eligibility for “plan” (per plan aggregation rules)—election during first 30 days • Forfeitable compensation 	
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<p>When Exemption Not Available</p>	
<p>Later deferral elections permitted for terminations and window programs</p> <ul style="list-style-type: none"> • <u>Voluntary or Involuntary termination</u>—If separation pay subject to bona fide, arms’ length negotiations (and no pre-existing right), can make deferral election any time before legally binding right to income arises • <u>Window program</u>— can make election at any time before election to participate in window program becomes irrevocable <p>Applies also to time and form of payment elections</p> <p style="text-align: right;">13</p>	


<p>When Exemption Not Available</p>	
<p>Distribution only on specified dates or events</p> <ul style="list-style-type: none"> • Separation from Service (6-month delay for public company “specified employees”) • Death or Disability • Set time or fixed schedule • Change in Control Event • Unforeseeable Emergency <p style="text-align: right;">14</p>	


<p>When Exemption Not Available</p>	
<ul style="list-style-type: none"> ▶ No acceleration ▶ Distribution elections at time of initial deferral ▶ Changes in distribution elections <ul style="list-style-type: none"> • 12 month / 5 year rules <p style="text-align: right;">15</p>	


When Does Separation From Service Occur?	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ 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	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ <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 	
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Separation from Service: 6-Month Rule for "Specified Employees"	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ 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 	
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Designated Payment Dates	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ 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	 Pillsbury Winthrop Shaw Pittman...
<ul style="list-style-type: none"> ▶ 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) 	
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Reimbursements or In-Kind Benefits: Specified Date or Fixed Schedule	 Pillsbury Winthrop Shaw Pittman...
<p>Reimbursements and in-kind benefits meet the requirements of payment on a specified date or fixed schedule if:</p>	
<ul style="list-style-type: none"> • 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 	
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Time and Form of Payment: Subsequent Changes	
<ul style="list-style-type: none"> ▶ 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) <p style="text-align: right;">22</p>	


Time and Form of Payment: Tax Gross-Ups	
<p>Satisfy time and form of payment requirements only if:</p> <ul style="list-style-type: none"> • 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. <p style="text-align: right;">23</p>	


Plan Aggregation Categories	
<ul style="list-style-type: none"> • 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 <p style="text-align: right;">24</p>	

<h2>Tax-Exempt and Governmental Entities</h2>	
<p>Section 409A generally applies to tax-exempt and governmental entities, regardless of whether they are subject to Section 457</p> <ul style="list-style-type: none"> • 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 <p>409A exemptions for stock rights unlikely to apply to tax-exempt and governmental entities, as require employer stock</p> <p style="text-align: right;">25</p>	

<h2>Tax-Exempt and Governmental Entities</h2>	
<p>Section 457(f) "ineligible" plans</p> <ul style="list-style-type: none"> • Short-term deferral rule should exempt many 457(f) plans from 409A, as amounts are included in income when substantial risk of forfeiture lapses <ul style="list-style-type: none"> • 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: <ul style="list-style-type: none"> • 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 <p style="text-align: right;">26</p>	

<h2>Tax-Exempt and Governmental Entities</h2>	
<p>"Bona fide" vacation leave, sick leave, compensatory time, disability pay and death benefits are excluded from <u>both</u> 409A and 457</p> <ul style="list-style-type: none"> • Until further guidance, can rely on definitions under 457 in applying 409A <p>Severance plans completely excluded from 457, but 409A exclusion subject to many restrictions</p> <ul style="list-style-type: none"> • See Separation Pay discussion above <p style="text-align: right;">27</p>	

<p>Future Teleconference on 409A Final Regulations</p>	
<p>Session 4: Multinational Employers Tuesday, June 5, 2007 10:00am Pacific / 1:00pm Eastern</p> <p>To register for Sessions 4, visit the Events page on our web site: www.pillsburylaw.com</p> <p style="text-align: right;">28</p>	

<p>Presenters</p>	
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