

Winter
2006

Benefits Alert

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Year-End Action Items for Sponsors of Nonqualified Deferred Compensation Plans

The Department of the Treasury recently issued proposed regulations providing additional guidance to sponsors of nonqualified deferred compensation plans subject to Internal Revenue Code section 409A. While these regulations extend certain compliance deadlines into 2006, such as the deadline for establishing Section 409A-compliant plan documents, sponsors of nonqualified deferred compensation plans should be aware that certain actions are still required to be taken within the 2005 calendar year.

As year-end approaches, you should be aware of the following action items:

- 2006 Deferral Elections. Distribution elections for amounts earned in calendar year 2006 must generally be made by December 31, 2005.
- Revised Distribution Elections. Revised distribution elections for amounts payable in 2006 must be made by December 31, 2005 in order to take advantage of the special transition rule outlined in IRS Notice 2005-1. If applicable, plan amendments permitting these revised payment elections must also be adopted by December 31, 2005.

This transition rule allows participants to avoid the general requirements under Section 409A that revised payment elections must (i) be made at least 12 months prior to the scheduled payment date, (ii) result in a delay of payment of at least an additional 5 years, and (iii) not accelerate the payment. Any elections not made by the December 31, 2005 deadline will be subject to these requirements.

- Opt-Out Elections. Elections to terminate participation in a deferred compensation plan with respect to amounts subject to Section 409A or to cancel deferral elections involving such amounts must be made by December 31, 2005. If applicable, plan amendments permitting these elections must be adopted by December 31, 2005.
- Termination of "Grandfathered" Plans. The last day to terminate a "grandfathered" deferred compensation plan without the amendment being treated as a "material modification," causing the plan to lose its grandfathered status, is December 31, 2005. Note that any such amendment must result in the distribution of all amounts deferred under the plan in the year the termination takes place.
- Discount Stock Options or SARs. Discounted stock options or Stock Appreciation Rights must be either exercised or replaced with non-discounted options or SARs by December 31, 2005. Any discounted options or SARs remaining after this deadline will become subject to Section 409A.
- No Reporting Obligations. The IRS issued guidance in early December 2005 (Notice 2005-94) indicating that employers are not required to report nonqualified deferred compensation deferrals for the 2005 calendar year. This reporting requirement goes into effect in 2006. Employers should make sure to save any records necessary for the computation of these amounts, including those attributable to 2005, in order to respond to potential IRS audits.

The Employee Benefits team at Kaufman & Canoles is available to assist you with any of these requirements.

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Employee Benefits & Executive Compensation Group

The attorneys who practice in the firm's Employee Benefits Practice Group have established a full-time commitment to this practice. They offer clients the highest level of experience and sophistication in the area of employee benefits.

The benefits arena has become exceedingly complex with each new layer of state and federal regulation. Due to the continuing stream of complex and technical employee benefits litigation since ERISA, the federal government plays an active role in how you plan and administer your employee benefits programs. Every employee benefit program demands frequent evaluation in light of fast changing federal laws and regulations.

The Employee Benefits Practice Group works with the legal, financial, and human resource professionals of our clients to implement and maintain the most effective and cost efficient benefits programs.

If you would like to be added to the Kaufman & Canoles mailing list or if your name, title, company or address needs to be revised, please notify:
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