

Nonqualified Deferred Compensation Guidance Issued: IRS Notice 2005-1

On December 20, 2004, the Internal Revenue Service released initial guidance on the nonqualified deferred compensation provisions of the American Job Creation Act of 2004, which added new Section 409A to the Internal Revenue Code. The guidance, which appears in IRS Notice 2005-1 and is presented in Q&A format, addresses many outstanding issues, including the following:

- *Definitions* – The guidance sets forth definitions of “deferred compensation,” “change in control,” “material modification,” “substantial risk of forfeiture” and other key terms.
- *Transitional Relief and Good Faith Compliance* – Taxpayers may rely on Notice 2005-1 and if any later guidance is less favorable, Treasury and the IRS will apply the new rule prospectively with adequate transition relief to permit plans to be modified.
- *Forms of Payment May Be Tied to Qualified Plan in 2005* – The form of payment under a nonqualified plan may continue to be based on the participant’s election under a qualified plan through December 31, 2005.
- *Late Deferral Elections Permitted* – For plans in existence on December 31, 2004, deferral elections may be made by March 15, 2005, and be treated as valid under Section 409A.
- *Plan Termination Permitted until December 31, 2005* – A plan sponsor may terminate and make distributions from a pre-October 4, 2004, arrangement on or before December 31, 2005, without it constituting a material modification triggering penalties under Section 409A.
- *SARs Relief for Publicly Traded Companies* – Notice 2005-1 provides a limited safe harbor that excludes from coverage by Section 409A certain stock appreciation rights for publicly traded companies.
- *Temporary SARs Relief for Pre-October 4, 2004, Programs* – Pending further guidance, payment of stock or cash pursuant to the exercise or cancellation of a non-discount stock appreciation right under a pre-October 4th program is excluded from coverage by Section 409A if the stock appreciation right does not include any feature for the deferral of compensation other than the participant’s exercise right.

Duane Morris is reviewing the new guidance and will soon release an Alert reflecting our analysis and planning recommendations based on this preliminary guidance and any other guidance issued by the IRS. For further information on Section 409A and nonqualified deferred compensation plans, see our October 20, 2004, Alert, "The Impact of the American Jobs Creation Act of 2004 on Nonqualified Deferred Compensation Plans."

For Further Information

If you have any questions about this Alert or would like to learn more about the new NQDC plan rules, please contact one of the following lawyers or the lawyer in the firm with whom you are regularly in contact.

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