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HRO Alert

ACTION PLAN AND CHECKLIST – SECTION 409A PLAN AMENDMENT DEADLINE

Companies and their advisors have been anxiously awaiting the release of the final regulations under Section 409A of the Internal Revenue Code. The Treasury Department and the IRS issued the final regulations on April 10, 2007. The final regulations apply beginning January 1, 2008. Companies must take action **by December 31, 2007!**

Background

Section 409A of the Internal Revenue Code was enacted in 2004 to address concerns involving abuses of nonqualified deferred compensation plans. The new rules are very broad and have required significant changes to common compensation arrangements.

The rules include restrictions on deferral elections, changes to elections, and time of payments, prohibitions on accelerated payments, restrictions on funding and requirements for reporting and tax withholding.

The penalties for failing to timely comply with the Section 409A requirements are significant. The service provider (e.g., the employee, director, or independent contractor) will be immediately taxed on all vested deferred compensation of the same type and will be subject to an additional 20% tax, plus interest. Some states apply a similar additional tax at the state level. The company that receives the services could be liable for reporting and tax withholding penalties.

Compliance

Section 409A includes both operational and documentation requirements. Note that good faith operational compliance has been required since January 1, 2005. Now that the final regulations have been issued, plans and agreements must be amended to comply with the documentation requirements set forth in the final regulations **by December 31, 2007.**

The final regulations make clear that the material terms of each deferred compensation plan must be **in writing**. The material terms include:

- who is covered;
- the amount of compensation to be paid;
- the time of payment; and
- the form of payment.

The six-month delay rule (for any payment triggered by a separation from service of a key employee of a publicly traded company) must be stated in the plan or agreement.

A plan is considered to be established on the **latest of**:

- the date it is adopted;
- the date it is effective; or
- the date on which the material terms are set forth in writing.

April 24, 2007

If the plan permits a deferral election, the election must be included in the plan document by the time the election is irrevocable. A transition rule applies to certain unwritten plans adopted and effective before December 31, 2007, provided the material terms of the plan are set forth in writing by December 31, 2007.

Changes to the Rules

The final regulations include modifications and clarifications to guidance previously issued by the IRS and Treasury and a number of new detailed rules. For example, the regulations clarify when the short-term deferral exception may be available and how it may apply to a stream of payments. Other examples include an expansion of permitted extensions in option exercise periods and several changes that apply to severance arrangements.

Many of the changes included in the final regulations apply to common compensation arrangements: employment and severance agreements, stock options and other equity compensation awards, bonus awards, and reimbursement arrangements. It will take some time to fully understand the impact of the changes included in the final regulations and how the rules apply to specific compensation arrangements.

Action Plan

Now that the document deadline has been firmly established, we recommend that companies work with their advisors to develop a plan of action to ensure that all required amendments are **completed by December 31, 2007**.

In some cases the rules permit several alternatives for consideration, which may add to the length of the amendment process. For many companies, this will mean the amendment (and full execution) of numerous individual agreements and plan documents.

We encourage you to start now to prepare an action plan in coordination with your advisors. We have attached a checklist to help get you started. If you have any questions concerning this alert or with Section 409A, please contact any of the individuals listed on this alert.

This article is a periodic publication of Holme Roberts & Owen LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances, nor is it intended to address specific disclosure or compliance issues that may arise in particular circumstances or provide an exhaustive discussion of the topics discussed herein. The contents are intended for general informational purposes only, and you are urged to consult counsel concerning your own situation and any specific legal questions you may have. For further information regarding the topics described herein, please contact any of the individuals listed on the left side of page one.

CHECKLIST - 2007 RECOMMENDED ACTION**SECTION 409A - DEFERRED COMPENSATION**

1. Prepare an inventory of "deferred compensation" arrangements. Remember almost any type of compensation arrangement (written or unwritten) can constitute deferred compensation under these rules. Some common examples include:
- Employment Agreements
 - Bonuses
 - Severance Agreements
 - Stock Options
 - Offer Letters
 - Restricted Stock Units
 - Consulting Agreements
 - Phantom Stock
 - Change in Control Agreements
 - Reimbursement Arrangements
 - Director Fee Deferrals
 - Excess or Supplemental Benefit Plans
 - Deferred Compensation Plans
 - 457(f) Plans
2. Make a list of provisions that must be changed (e.g., add the six-month delay for public companies, remove haircut withdrawal provisions, and determine whether changes to definitions of disability and change in control are necessary).
3. Ensure that all "material terms" (including the six-month delay) are included in each written plan or agreement.
4. Communicate the changes and actions required with employees, directors, independent contractors and other service providers. In some cases, negotiation may be required.
5. Remember that operational compliance is required beginning January 1, 2005. Finalize documentation of good faith operational compliance.
6. Establish systems to comply with the reporting and withholding requirements.
7. Arrange to obtain board of director or compensation committee approvals for new plans and agreements or amendments to existing arrangements.
8. Determine whether shareholder approval is required for new plans and agreements or amendments.
9. Determine whether SEC reporting requirements apply to new or modified plans or agreements:
- Form 8-K (4-day reporting)
 - Form 10-K or 10-Q (material contracts)
 - Proxy Statement (disclosures)
 - Form S-8 (update prospectus)
10. Complete all amendments to comply with Section 409A **by December 31, 2007**.
11. Watch for additional IRS guidance.

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