

YEAR END ACTION REQUIRED WITH RESPECT TO NON-QUALIFIED PLANS AND ARRANGEMENTS UNDER CODE § 409A

REQUIREMENT TO AMEND NQDCS

In 2004, Congress enacted Section 409A of the Internal Revenue Code (“Code”) which requires non-qualified deferred compensation plans and agreements (“NQDC”) to satisfy certain new rules. NQDCs subject to Code § 409A must be carefully structured to comply with detailed rules regarding elections to defer compensation, the time and form of payment of that compensation, and how and when payments can be further deferred. A memorandum, entitled “Non-Qualified Deferred Compensation Plans and Arrangements under Section 409A of the Internal Revenue Code,” describing these rules in more detail, can be found on our Web site at www.armstrongteasdale.com in the “Articles” section under News and Publications.

While NQDC’s have been operationally required to comply with Code § 409A since January 1, 2005, such plans and agreements must be amended in writing by December 31, 2008 to comply with the new law. For public companies, these changes could require reporting to shareholders and the SEC and, in some cases, shareholder approval.

NQDCs plans must be identified in 2008 so they can be made compliant with the new law by December 31, 2008. Any plan or arrangement that gives an employee or an independent contractor a legally binding right to be paid compensation in the future potentially may be subject to Code § 409A.

NQDC features can be present in:

- Non-qualified deferred compensation plans and arrangements
- Bonus plans and arrangements
- Employment contracts
- Offer letters
- Phantom stock and stock appreciation rights agreements
- Discounted stock options
- Separation and retention plans and agreements
- Post-retirement fringe benefit arrangements
- Certain types of split dollar life insurance arrangements
- Top hat and supplemental employee retirement plans (“SERPs”)
- Section 457(f) plans and agreements
- Change in control arrangements

Qualified retirement plans; tax deferred annuities (Code § 403(b) plans); simplified employee pensions (“SEP”); SIMPLE retirement accounts; bona fide vacation, sick leave, disability pay and death benefit plans; certain severance arrangements; amounts payable by March 15 of the year immediately following the year in which they vest; and equity compensation arrangement, (stock options, phantom stock, stock appreciation rights), the exercise price of which is based upon the fair market value of the underlying stock on the grant date, are not subject to Code § 409A.

COSTS OF A CODE § 409A VIOLATION

At the time of a Code § 409A violation, the costs of non-compliance are as follows:

- All vested deferrals are subject to regular income taxes which employers are required to withhold.
- An excise tax of twenty percent is imposed on vested, accrued deferred compensation.
- An additional excise tax equal to the Federal interest rate on tax deficiencies plus one percent is imposed on deferrals for years they are vested. This rate is now approximately eight percent.

While participants are directly responsible for those penalties, employers could be impacted either through indemnification obligations to affected employees or other employee claims or concerns.

TRANSITION RELIEF AVAILABLE IN 2008

The Internal Revenue Service has made available the following transitional relief for sponsors of and participants in NQDCs:

Change in Payment Elections

A NQDC may provide or be amended before the end of 2008 for new elections as to the timing and form of benefit payments. In this event, participants must make new written elections before the end of 2008. Such elections cannot delay payments that would otherwise be made in 2008 or accelerate payments that would not otherwise be made this year.

If you have any questions regarding Code § 409A or would like to discuss this law, please contact:

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Change Stock Options and Stock Appreciation Rights to Provide for Fixed Terms

A stock option or stock appreciation rights arrangement, which was granted at an exercise price below fair market value on the grant date, is subject to Code §409A. Such option or arrangement will comply with Code §409A if it is amended before the end of 2008 to provide for a specific date on which it can be exercised.

Exchange Discounted Stock Options or Stock Appreciation Rights for Non-Discounted Awards

A non-discounted option or stock appreciation award may be substituted for a discounted option or stock appreciation award which is not subject to Code § 409A. There can be no payment made in connection with such an exchange. This relief does not apply to discounted stock options held by individuals who were subject to Section 16(a) of the Securities Exchange Act of 1934 at the time the options were granted.

Modify Good Reason Condition

Under some circumstances, severance paid on account of an involuntary severance of employment is not subject to Code §409A. Termination for “good reason,” as defined in the Code §409A regulations, can constitute an involuntary termination of employment. Employment and severance agreements must be amended by December 31, 2008 to provide for termination for good reason in order to take advantage of this exception to Code §409A.