September 21, 2007

Ms. Linda Stiff
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments Concerning Internal Revenue Code Section 409A Relating to Compliance Deadline

Dear Acting Commissioner Stiff:

Enclosed are comments concerning Internal Revenue Code section 409A relating to compliance deadline. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stanley L. Blend
Chair, Section of Taxation

Enclosure

c: Donald L. Korb, Chief Counsel, Internal Revenue Service
Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury
Karen Gilbreath Sowell, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Michael J. Desmond, Tax Legislative Counsel, Department of the Treasury
Nancy “Nan” J. Marks, Division Counsel/Associate Chief Counsel, Internal Revenue Service
Alan N. Tawshunsky, Assistant Chief Counsel-Employee Benefits, Internal Revenue Service
Service Stephen B. Tackney, Attorney (Executive Compensation), Internal Revenue Service
Service W. Thomas Reeder, Benefits Tax Counsel, Department of the Treasury
Helen Morrison, Attorney Advisor, Office of Benefits Tax Counsel, Department of the Treasury
COMMENTS CONCERNING INTERNAL REVENUE CODE SECTION 409A
RELATING TO COMPLIANCE DEADLINES

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for drafting these Comments was exercised by James R. Raborn and Rob Fowler of the Section’s Employee Benefits Committee (the “Committee”). Contributions were also made by David E. Gordon, Thomas R. Hoecker, Alden Bianchi, Mark Dray and Max Schwartz. The Comments were reviewed by David Mustone, Chair of the Committee and by the Quality Assurance Group of the Committee, which is chaired by Thomas R. Hoecker and whose members are former chairs of the Committee. The Comments were further reviewed by T. David Cowart of the Section’s Committee on Government Submissions, and by Priscilla E. Ryan, Council Director for the Committee.

Although the members of the Section of Taxation who participated in preparing these comments have clients who might be affected by the federal income tax principles addressed by these comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

Contacts:

James R. Raborn  
Phone: (713) 229-1579  
Fax: (713) 229-7779  
Email: james.raborn@bakerbotts.com

David Mustone  
Phone: (703) 714-7509  
Fax: (703) 918-4009  
Email: dmustone@hunton.com

September 21, 2007
EXECUTIVE SUMMARY

These Comments address the deadline for compliance with section 409A and the transition relief provided in Notice 2007-78, 2007-41 I.R.B. (October 9, 2007).\(^1\) These Comments are submitted in response to informal requests by the Department of Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) for comments concerning the final Regulations published on April 17, 2007 (the “Final Regulations”).\(^2\)

We appreciate the opportunity to submit these Comments, and we commend the efforts of both Treasury and the Service in (i) providing comprehensive guidance and rules under this new far-reaching statute and (ii) extending the applicability date for some of the documentation requirements under the Final Regulations. We also commend Treasury and the Service for the issuance of Notice 2007-78, and its recognition of the difficulties of taxpayers to amend existing plans to comply with the Final Regulations by the December 31, 2007 deadline.

For the reasons discussed below, we respectfully submit that Notice 2007-78 does not provide sufficient relief, and we recommend that Treasury and the Service delay for one additional year the applicability date for compliance with all aspects of the Final Regulations to January 1, 2009 and, at the same time, extend to December 31, 2008, all of the current transition relief which expires at 2007 year end on the same terms and conditions as set out in Section 3 of Notice 2006-79.\(^3\)

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\(^1\) All section references used herein are references to the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated and all references to “Regulations” are to the applicable Treasury Regulations.


\(^3\) 2006-43 I.R.B. (October 23, 2006).
COMMENTS

The Final Regulations contain extensive and complex rules addressing both the form and operation of all arrangements subject to section 409A. These regulations were first issued in proposed form on October 5, 2005. In general, the Final Regulations become applicable to all covered arrangements on January 1, 2008. On September 10, 2007, the Service issued Notice 2007-78, which delays the compliance deadline for some but not all of the “form” requirements under the Final Regulations until December 31, 2008.

The Final Regulations generally provide that a covered nonqualified deferred compensation arrangement must comply in both form and operation with the requirements of section 409A as of January 1, 2008, with good faith compliance relief expiring December 31, 2007. Notice 2007-78 generally extends the deadline for form compliance to December 31, 2008 (although significant aspects of the form compliance requirements must still be met by December 31, 2007). Thus, a covered arrangement which is not in full operational compliance with the Final Regulations or which does not comply with the form requirements specified in Notice 2007-78 by December 31, 2007 will be in violation of section 409A as of January 1, 2008, resulting in the immediate taxation of all affected benefits under the defective arrangement and other arrangements of the same type on that date (or, if later, at the time of vesting) and the imposition of the 20 percent additional tax and interest.

We recommend that Treasury and the Service delay for one additional year the applicability date for compliance with all aspects of the Final Regulations to January 1, 2009 and, at the same time, extend the good faith compliance period to December 31, 2008 on the same terms and conditions as set out in Notice 2006-79.

DISCUSSION

Even with the partial extension of the form compliance deadline provided in Notice 2007-78, we respectfully submit that there is insufficient time to finalize in a thoughtful and careful manner the required operational and form compliance by year-end. Because of the scope and complexity of the process for (i) analyzing and complying with the Final Regulations in operation and (ii) making the form decisions required by Notice 2007-78, finalizing all times and forms of payment and deciding other matters, it will be extremely difficult, indeed impossible, for many employers (especially small businesses) to meet the December 31, 2007 deadline for bringing all covered arrangements into compliance.

5 Reg. § 1.409A-6(b).
7 See Notice 2007-78 (Part III).
Section 409A was enacted on October 22, 2004. The Final Regulations were issued more than 29 months later. Although generous transition relief has been provided throughout the process, service recipients and their outside advisers have been given less than eight months to digest, comprehend and apply all of the nuances reflected in some 190 pages of regulations (and less than four months to understand and apply Notice 2007-78) and bring covered arrangements into full operational and the required form compliance by year-end. Moreover, the recent extension of the form compliance deadlines provided in Notice 2007-78 provides little relief from the looming 2007 year-end compliance deadline as all decisions as to operational compliance must be made (and any corresponding documentation required under Notice 2007-78 must be completed) by the close of 2007.

Not only are employers having difficulty integrating the time into the other business priorities of their human resources, tax, legal and accounting personnel necessary to devote the required attention to this undertaking, but their outside professionals (primarily counsel and consultants) are having similar difficulties. As a practical matter, because of the need in many cases to obtain both internal approvals (e.g., from boards and compensation committees) and any needed employee consents to any operational, time and form of payment or other needed changes by December 31, 2007, decisions as to these changes must be made well in advance of that deadline—a task that based on our experience may be beyond the capacity of most employers to accomplish in a thoughtful manner. Indeed, the issues involved in obtaining employee consent alone provide a compelling example as to why the 2007 year-end operational and form deadlines are unworkable. Further, as the ability to make changes to arrangements, potentially even changes to correct minor operational and scriveners’ errors after 2007, is presently narrowly constrained by section 409A, the need to get the operational and document changes exactly right is particularly acute. Lastly, the decision on whether to take advantage of any available transitional relief could, in many cases, be finally determined without completing the full analysis of how the Final Regulations will apply to the arrangement in question.

In short, any operational or form changes that are implemented must be thoughtful and comprehensive. We understand that the reason Notice 2007-78 calls for full operational compliance and partial form compliance by the end of 2007 is that the statute has been in effect since 2005. However, the Final Regulations provide many detailed rules that could not have been anticipated by reading the statute and its legislative history. For this reason, we believe compliance is actually hindered by the requirement to effectuate operational and limited documentary compliance with the numerous fine points in the Final Regulations by December 31, 2007. We submit that the one-year delay we request will enhance, rather than adversely affect, compliance. Indeed, fully delayed form compliance (with interim good faith operational compliance) has been acceptable in the qualified plan area, and there appears to be little reason

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9 The announcement in Notice 2007-78 that a remedial program for minor section 409A violations will be established is greatly appreciated. As discussed in our June 14, 2007 letter, the establishment of such a correction program would encourage voluntary compliance, facilitate consistent tax administration by providing a mechanism to address inadvertent errors where the violation was not intentional, and promote equitable tax treatment by providing a forum to develop uniform responses to similar violations. However, the scope of “minor” is as yet unspecified and we believe there will be many cases of inadvertent noncompliance that could still be viewed as other than minor.
for it not to be acceptable in the section 409A context. A similar rationale – the complexity of the issues involved, the necessity for sufficient time for the government to issue and practitioners to absorb and understand guidance and the requirement of good faith operational compliance prior to the deadline for final document compliance – is applicable in both contexts. Unfortunately, Notice 2007-78 does not go far enough in this regard as employers will still need to be fully compliant operationally (as well as compliant in form to the extent required in Notice 2007-78) within a short period of time. The well established practice of providing an extensive good faith compliance period to allow the implementation of new and complex qualified plan legislation and regulations has demonstrated the compliance advantages that can be obtained by this approach.

Nor is fair to say that there has been “foot dragging” in complying with section 409A. Although transitional guidance and the proposed regulations have been available for some time, the process of definitively determining what arrangements are subject to section 409A and considering the alternative approaches for achieving compliance could not begin in earnest until the Final Regulations were issued and understood. There are, in this regard, a number of complicated aspects of the Final Regulations that will require considerable time and effort to evaluate fully and put into effect. Moreover, despite the excellent work of the drafters of the Final Regulations, there is still considerable ambiguity in numerous areas regarding what is required or permitted which will make it extremely difficult to carefully and intelligently resolve all aspects of operational compliance. Service recipients and their advisors are struggling with these ambiguities and uncertainties as they consider different alternatives, evaluate the pros and cons of their choices, the risk of a later challenge by the Service, and indeed whether a given plan provision is required by the Final Regulations. And, while Notice 2007-78 provides relief as to the documentation deadline, the need to comply fully in operation and with the documentary requirements specified in Notice 2007-78 by December 31, 2007 will require much effort.

Special Concerns For Publicly Traded Service Recipients.

The effort necessary for most publicly traded companies to come into full operational compliance with the Final Regulations (as well as comply with the documentary requirements specified in Notice 2007-78) by year-end will be monumental. The steps involved in this process will require the dedication of significant human resource, legal, tax and financial resources to at least the following:

1. Completing an inventory of all arrangements potentially subject to section 409A (including arrangements maintained outside the U.S.).

2. Consultations regarding the application of section 409A to various arrangements and consideration of compliance alternatives.

3. Coordination with consultants, recordkeepers and counsel retained by the company or the compensation committee of the company’s board to consider potential alternative approaches to compliance.
4. Deliberations and consideration by the compensation committee and board of directors of material changes to the company’s programs and any changes to executive officer arrangements.

5. Communications with plan participants (and, in some cases, their counsel) to obtain needed consents (which will be required for many nonqualified deferred compensation arrangements, employment agreements and other arrangements).

6. Drafting and approval of new or amended plan documents to implement compliance decisions.

Most publicly traded companies establish their board and compensation meeting schedules in advance of or at the beginning of the year. At present, the Final Regulations and Notice 2007-78 are still being reviewed and analyzed by external and internal counsel and outside consultants. In general, there is only one board meeting planned for the remainder of the year. Given the amount of work required to (i) evaluate a company’s arrangements under section 409A, (ii) consider possible approaches to compliance, and (iii) consult with advisers and participants, we do not believe that there is enough time to provide the decision makers with the required information to enable them to make informed decisions in an orderly process and to adopt the decisions required by Notice 2007-78 and to put into place the systems changes needed to implement operational compliance before year-end.

Lastly, it should not be overlooked that boards and compensation committees will be evaluating the uncertainty and complexity of section 409A compliance in an environment of heightened scrutiny of executive compensation. Whereas in the past many boards might have delegated to management the authority to finalize many of these issues, boards and compensation committees are now charged with more specific responsibilities for overseeing executive compensation.

Special Concerns For Private and Tax Exempt Organization Service Recipients.

Many private employers and tax exempt organizations (particularly those that are smaller) do not have ready access to the sophisticated tax advice and planning services necessary to understand, comprehend, and evaluate section 409A issues and implement compliance solutions on a timely basis. For example, it takes a significant amount of time to determine the corporate actions necessary to terminate a section 457(f) plan, implement a section 457(b) plan in its place and explain how distributions will be handled, let alone to convince the board or executive committee to take action. In addition, many tax exempt organizations have large boards which meet on a limited basis and rotate regularly. With limited time, budgets and available expertise, it will be especially difficult for many tax exempt organizations to come into compliance with the Final Regulations by the end of 2007 (particularly if it becomes necessary to evaluate the reasonableness of any solutions under the intermediate sanction rules). In our experience, many of these employers as well as private employers especially in the small business community are well behind the curve in inventorying, assessing and implementing compliance steps. Indeed, many of them do not yet understand or appreciate the potential impact of section 409A on their organizations.
While private employers may have less bureaucracy and regulatory hurdles to obtaining the needed approvals for changing covered arrangements than public companies, the issues they face can be just as complicated. At the same time, private employers often do not have human resources personnel dedicated to executive compensation and benefits, making the compliance process that much more difficult to coordinate and finalize in a short period of time.

**Other Considerations**

Responsibility for assisting employers with complying with section 409A will, for the most part, fall to senior compensation consultants and benefits lawyers. This is a relatively small group to handle the twin tasks of education and compliance. Granting the relief requested will allow a more rational deployment of resources.

The process of trying to understand and educate clients, recordkeepers and other administrative service providers on the complexities of section 409A is no simple task and will take considerable time to accomplish. This is greatly complicated by the fact that the concept of deferred compensation under section 409A is much broader than what was previously understood to be deferred compensation. Benefits practitioners continue to be surprised by the breadth of the Final Regulations as they struggle with applying these complex new rules to unanticipated situations.

Finally, it goes without saying that the consequences of a failure, even a minor failure in form, are draconian. The immediate taxation at vesting, additional interest and the 20 percent additional tax on deferred compensation under all arrangements of the same type mean that a minor “foot-fault” in form or operation can have significant unacceptable negative consequences for both employees and employers. This does not appear to be what Congress intended, nor what the Treasury and the Service intend to happen.

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10 See, e.g., section 3121(v)(2) and the Regulations thereunder. Although the 409A guidance issued beginning with Notice 2005-1 clearly indicated that section 409A encompassed severance arrangements, many employment lawyers still have no understanding of the impact of section 409A on employment and severance arrangements.