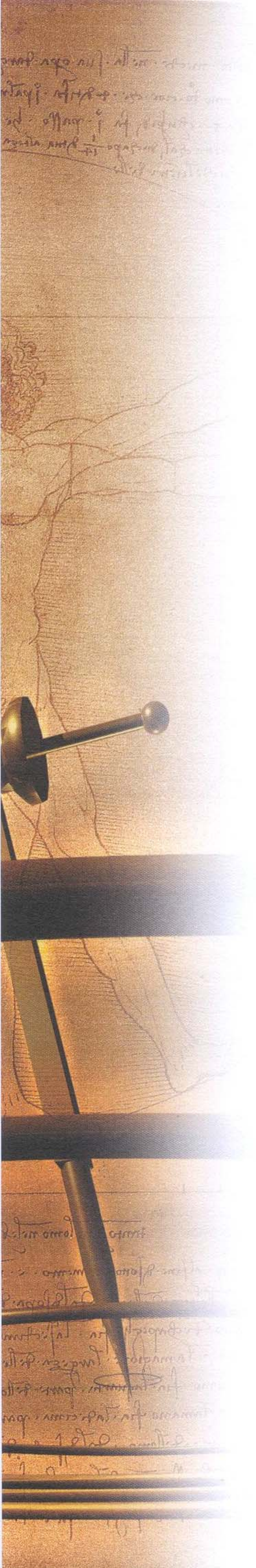

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Nolan Financial Report

Non-Qualified Executive Compensation plans

The Transition Period Has Ended- Operating In A 409A Environment

SECTION 409A

The American Jobs Creation Act of 2004 created IRC Section 409A, which has a broad impact on nonqualified deferred compensation plans. Although IRS guidance was slow to develop, following a series of IRS notices, it appeared clear that compliance with the new rules would be required by December 31, 2007. However, we (along with others in our industry) were taken by surprise late in 2007 when IRS Notice 2007-86 extended transition relief for an additional year to December 31, 2008.

The impact of Section 409A is broad and far reaching. Compliance with Section 409A became required as of January 1, 2009 and because of the complexities, new guidance items and regulations have been released frequently and will certainly continue to be issued often in the coming months.

TREASURY REGULATION SECTION 1.409A-4

This proposed regulation was released on December 5, 2008 and addresses the calculation of amounts includible in income and the additional taxes imposed if the requirements of Section 409A are not satisfied.

If the new requirements, which generally became effective for amounts deferred after January 1, 2005, are not satisfied, significant adverse tax consequences will be imposed. These include:

1. all deferred compensation must be included in income in the current taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in income,
2. an additional tax is imposed equal to the interest (using the IRS underpayment rate plus 1 percent) that would have been imposed during the deferral period if the deferred compensation had been includible in income when first deferred (or not subject to a substantial risk of forfeiture), and
3. an additional tax is imposed equal to 20% of the deferred compensation.[1]

These calculations are generally applicable for taxable years beginning on or after the date the regulations are finalized.

IRS NOTICE 2008-113

Also released on December 5, 2008, this new notice provides additional guidance for an operational correction program issued originally as Notice 2007-100 in December, 2007. The former notice becomes obsolete effective January 1, 2009 and may be relied upon for taxable years both before and after that date. The notice limits its applicability to certain detailed operational failures, but also includes a request for comments on whether it should be expanded.

IRS NOTICE 2008-115

In this notice issued December 10, 2008, the IRS has said that until further guidance is provided, a taxpayer is not required to report amounts deferred during the year under a nonqualified deferred compensation plan in box 15a of Form 1099-MISC. This guidance is effective for

[1] Association for Advanced Life Underwriting (AALU) Bulletin No: 08-108, December 5, 2008.

calendar year 2008 and will stay in effect until the next round of guidance documents is published.

AT RISK PLANS

We originally reported on the correlation between a company's defined Benefit Plan and its deferred compensation plan in our July, 2007 *Nolan Financial Report*. Section 116 of the Pension Protection Act of 2006 adds a new subsection (b) (3) to Section 409A of the Internal Revenue Code that imposes new restrictions on the funding of nonqualified deferred compensation plans of public companies.

The new restrictions apply to any amounts set aside or reserved (directly or indirectly) or to assets that become restricted to the payment of benefits under a nonqualified deferred compensation arrangement when a **"restricted period"** applies to a defined benefit plan. The assets that are set aside or restricted would become immediately taxable to certain top executives. This new rule applies even if the assets remain available to satisfy the claims of general creditors, so it applies even to amounts set aside in a Rabbi Trust during a "restricted period."

Restricted Period Defined

A "restricted period" is:

1. any period during which a defined benefit pension plan of an employer is in an at-risk status (meaning that the plan's funding target attainment percentage for the preceding year was less than 70 percent),
2. any period during which the employer is in bankruptcy, or
3 The period that begins six months before and ends six months after the date any defined benefit pension plan of the employer is terminated in an involuntary or distress termination.

The rule does not apply to assets that are set aside before the defined benefit pension plan is in at-risk status. Additionally, plans with fewer than 500 participants are generally exempt from the at-risk rules. However, the overall funding rules will still apply. In order to qualify for an exemption, a plan must have had fewer than 500 participants on every day of the preceding plan year.

Impact of Current Financial Crisis

If as of January 1, 2009 a company's assets in its defined benefit plan fall below the funding target, the plan becomes "at risk." The tremendous decline in investment asset values in recent months could easily trigger a "restricted period." However, it is important to note that the calculation of the "at risk" funding percentages occur at the beginning of a plan year. So if a qualified plan hits the threshold limit as of January 1, 2009, it's "at risk" status would not begin until January 1, 2010.

Companies that experience a significant reduction in its qualified pension plan's funding as of January 1, 2009 as a result of the current negative economic conditions will want to carefully explore their options for taking corrective measures with both their qualified and nonqualified plans especially as they relate to funding rabbi trusts and as they apply to the company's CEO.

An experienced and skilled benefits consulting firm like Nolan Financial will be invaluable to companies who may be impacted by the potential pitfalls of Section 409A. Nolan will collaborate with them to create a detailed "game plan" for dealing with the requirements. We will also be prepared to consider additional planning opportunities that may surface during the process.

Perhaps most importantly, Nolan Financial has the sophisticated, "state of the art" recordkeeping capabilities that corporate executives have come to expect and are now demanding. Many of these executives have far more assets in their deferred compensation accounts than they will ever have in their 401(k) plan, so they expect a technologically robust recordkeeping system to help them manage their accounts.

A 2007 survey[2] determined that 90% of employers offer nonqualified deferred

[2] PLANSPONSOR.com, July 11, 2008

compensation plans (up from 85% a year ago). They provide corporate executives retirement planning opportunities and represent a key recruiting and retention tool for companies.

<u>Plan Terminations under Section 409A</u>

In addition to the transition relief permitting termination of plans in 2005, plans may be terminated after 2005(Post 409A) in connection with a change in control, corporate liquidation, or bankruptcy.

Plans also may be terminated for other reasons and the benefits distributed without violating 409A, if the termination meets certain restrictions under the regulations:

- All deferred compensation arrangements of the same type are terminated with respect to all participants
- No payments, other than ordinary course payments(i.e. those already scheduled for payment), are made within 12 months of the plan termination
- payments must be made within 24 months of the plan termination
- A new plan of the same type may not be established for at least 3 years

In the meantime, if you have any questions or concerns about how your company may be impacted, please contact:

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