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AALU Teleseminar On Final 409A Regulations and Notice 2007-34

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This Washington Report summarizes the questions that were addressed in a Teleseminar sponsored by the AALU on April 23, 2007 with respect to the recently released final regulations under Code Section 409A and Notice 2007-34. The Notice provides specific guidance regarding the application of 409A to split-dollar life insurance arrangements. (See Washington Report Nos. 07-44, 07-41 and 07-38.) The questions were presented by two AALU panelists to a key drafter of the regulations).

The panelists who presented the questions were AALU member Lee Nunn who was also the moderator, and Stuart Lewis, AALU Counsel. Dan Hogans, Attorney-Advisor, Office of Benefits Tax Counsel U.S. Treasury and a key drafter of the final regulations and the Notice, responded to the questions.

The questions asked and a summary of Mr. Hogans' responses are presented below. At the outset, Mr. Hogans emphasized that he was responding as an individual and not on behalf of the government, and that his comments were his personal views on the issues.

1. ***Effective Date/Transition/Future Guidance*** **(Stuart Lewis)**

The final regulations are applicable for taxable years beginning on or after January 1, 2008 and generally do not change the existing transition rules, with the exception of several items of additional transition guidance in the preamble to the final regulations. The preamble also indicates that the IRS and Treasury intend to issue further guidance regarding the calculation and timing of amounts required to be included in income under 409A and the reporting and withholding requirements, including additional transition guidance "as may be appropriate."

A. Are the IRS and Treasury expecting to issue any additional transition relief or guidance with respect to the matters addressed in the final regulations before the end of this year?

B. What is the expected form and timing of the additional guidance mentioned in the preamble to the final regulations?

Response: Mr. Hogans explained that the final regulations primarily address the scope of 409A and the operational requirements that must be satisfied in order to comply with the substantive rules of 409A. The final regulations do not address the calculation and timing of amounts required to be included in income under 409A, the funding requirements or the reporting and withholding requirements. As a result, there is a lot of guidance that must still be issued. The additional guidance will probably be issued in the form of proposed regulations, and in certain cases, temporary regulations. With respect to reporting deferrals, Mr. Hogans indicated that the Treasury understands that employers and payroll administrators need a certain amount of advance notice before the deferral reporting requirements become applicable. Accordingly, if the additional guidance is not issued soon, the deferral reporting requirements may be extended for at least another year (i.e., not applicable for 2007).

2. ***Plan Documentation Requirements*** **(Stuart Lewis)**

All arrangements that are subject to 409A must be in writing and must be in full compliance by the end of 2007. The final regulations provide that a plan must specify the following items in order to satisfy the written plan requirement:

(i) the amount the employee has a right to be paid;

(ii) the schedule or triggering events that will result in a payment of the amount;

(iii) the six-month delay requirement for payments to specified employees of publicly-traded companies upon separation from service; and

(iv) the conditions under which a deferral election may be made.

The preamble to the final regulations indicates that the written plan does not need to specify when amounts may be accelerated or to reflect any amendments made or actions taken under the transition rules to the extent such amendments or actions do not affect the plan's compliance with section 409A for periods on or after January 1, 2008, provided that the taxpayer can demonstrate that the plan was operated in compliance with the acceleration rules or transition guidance, as applicable.

A. Are there any other items that must be reflected in the written plan document?

B. With respect to amendments or actions taken during the transition period, it would seem that the procedures followed to obtain new distribution elections on or before December 31, 2007 would need to be reflected in the written plan document because such elections would affect the plan's compliance with section 409A on or after January 1, 2008. Is that correct? If so, what other transition amendments or actions should be reflected in the written plan document?

Response: In order to minimize inadvertent violations of 409A, Mr. Hogans explained that the IRS and Treasury have taken a minimalist approach to the documentation requirements. Essentially, a plan document must contain the items summarized above (to the extent applicable), which represent the minimum statutory requirements. In addition, to the extent a plan deviates from any of the default provisions in the regulations, Mr. Hogans indicated that the plan document should reflect the alternative plan provisions. For example, if a plan uses a non-standard definition of compensation for purposes of determining specified employees (i.e., for the six-month delay rule), the non-standard definition should be reflected in the plan document. Similarly, if a plan uses a non-standard approach to deferral elections, the approach should be reflected in the plan document. A plan document does not need to be amended to reflect actions taken or amendments made during the transition period, but plan sponsors must be able to demonstrate that the actions and amendments were in compliance with the transition rules. As a result, plan sponsors should make sure that all actions and amendments are properly documented and that all documents are retained. With respect to new distribution elections on or before December 31, 2007 in accordance with the transition rules, to the extent the elections affect amounts that will remain in the plan after 2007, the new distribution elections should be reflected in the plan document on and after January 1, 2008.

3. ***Split-Dollar - General Overview*** **(Lee Nunn)**

The IRS and Treasury issued Notice 2007-34 in conjunction with the final regulations to provide guidance for purposes of applying the general 409A rules to split-dollar insurance. Consistent with the discussion in the preamble to the proposed regulations, Notice 2007-34 includes the following three general principles with respect to split-dollar:

(i) nonequity split-dollar that provides only a death benefit is not subject to 409A;

(ii) collateral assignment split-dollar is not deferred compensation except in limited circumstances (e.g., if all or a portion of the payments on the loans are waived, cancelled, or forgiven); and

(iii) endorsement split-dollar is deferred compensation (unless excluded under the short-term deferral exception).

A. To the extent split-dollar is subject to 409A (primarily non-equity endorsement split-dollar), what is the "amount deferred" for purposes of 409A? Is it the premium payments made by the employer? Is it the policy cash value in excess of the amount required to be re-paid to the employer (i.e., the "equity")?

B. With respect to collateral-assignment split-dollar, what circumstances, other than loan waiver, cancellation or forgiveness, would cause the arrangement to be subject to 409A (i.e., what would generate deferred compensation)? Specifically, the preamble to the proposed regulations mentioned that below-market interest on the deemed loan from the employer to the employee may cause the arrangement to be subject to 409A. This was not specifically mentioned in Notice 2007-34. Is below-market interest still a factor that may subject an arrangement to 409A?

Response: Mr. Hogans initially commented that the IRS and Treasury have not addressed in much detail the value of life insurance for 409A purposes. In general, they are looking at the present value of future cash flow for determining value. For purposes of Notice 2007-34, the amount deferred is generally based on the premiums paid. With respect to collateral-assignment split-dollar, anything that is going to defer income recognition may generate deferred compensation and subject the arrangement (or portion thereof) to 409A. Mr. Hogans explained further that the IRS and Treasury removed below-market interest as a factor after thinking it through further - they are not as concerned that it constitutes deferred compensation for purposes of 409A.

4. ***Split-Dollar - Determining 409A Grandfathered Benefits*** **(Lee Nunn)**

Notice 2007-34 provides guidance for determining the 409A grandfathered benefits (i.e., benefits that were earned and vested before January 1, 2005). The general rule for determining 409A grandfathered benefits provides that such benefits do not include any increase in policy cash value attributable to premium payments made on or after January 1, 2005, but the safe harbor method prescribed in the notice seems to provide that 409A grandfathered benefits include increases in policy cash value attributable to premiums paid on or after January 1, 2005 to the extent they were paid pursuant to a legally binding right that was earned and vested as of such date.

A. How should taxpayers reconcile these two items of guidance - Does the safe harbor method supersede the general rule?

B. Notice 2007-34 provides that if the safe harbor is not used any reasonable method may be used for determining the 409A grandfathered and non-grandfathered components. If the policy cash value is allocated between 409A grandfathered and non-grandfathered components based on a calculation that computes what the policy cash value would have been if only the premiums paid before January 1, 2005 were taken into account (i.e., a "with or without" computation), and subtracts this amount from the policy cash value as of the valuation date to determine the 409A non-grandfathered amount, would that be considered a reasonable method under the notice?

Response: Mr. Hogans explained that the general rule applies except to the extent premium payments made on or after January 1, 2005 are pursuant to a legally binding right that was earned and vested as of such date. Mr. Nunn also asked whether an arrangement that includes a strong economic incentive for the employer to continue to make premium payments would be tantamount to a legally binding right that was earned and vested before January 1, 2005. Mr. Hogans responded that such a determination is a case-by-case determination based on the particular facts and circumstances. However, Mr. Hogans noted that under the general rule for determining whether there is a legally binding right, negative discretion may be ignored if it lacks substantive significance.

With respect to alternative methods for determining the 409A grandfathered and non-grandfathered components, whether the method is reasonable depends on all of the relevant facts and circumstances. The IRS and Treasury cannot give a categorical response whether a particular method is reasonable in all cases. Mr. Hogans commented that the fact that an alternative method would provide a different allocation (particularly if it is significantly different) would raise concerns about whether it is in fact reasonable. However, there may be situations where such a result is appropriate - for example, if the growth of the policy has significantly outpaced the average market return, such a method may be reasonable.

Mr. Lewis also mentioned that, in connection with two "swap" cases in which he is representing the taxpayers in the U.S. Tax Court, the IRS recently conceded. One of the cases involved the swap of deferred compensation for a split-dollar life insurance arrangement and the other involved a swap of stock option gains for deferred compensation.

5. ***Split-Dollar - Arrangements That Are Not Subject to the Final Split-Dollar Regulations*** **(Lee Nunn)**

Notice 2007-34 includes specific guidance for split-dollar that is not subject to the final split-dollar regulations - generally split-dollar arrangements that were entered into before September 18, 2003 and are not materially modified thereafter.

With respect to split-dollar that is taxed as a loan in accordance with Notice 2002-8, the guidance provides that it is generally analyzed in the same manner as the general collateral assignment split-dollar - it does not provide deferred compensation except in limited circumstances.

In addition, Notice 2007-34 seems to provide that, in the case of split-dollar that is not taxed as a loan, if all other requirements of Notice 2002-8 are satisfied (primarily the value of the current life insurance protection is treated as an economic benefit provided by the employer to the employee), the IRS will not assert that there has been a transfer of property either before or after termination of the arrangement and will not treat the right to the economic benefit of current life insurance protection as deferred compensation for purposes of 409A.

A. This guidance seems to provide that if the requirements of Notice 2002-8 are satisfied, both split-dollar taxed under the loan regime and split-dollar taxed under the economic benefit regime of Notice 2002-8 do not provide for deferred compensation and are not subject to 409A. Is that the correct interpretation of the guidance under Notice 2007-34?

B. If so, it appears that the only "grandfathered" split-dollar arrangements (i.e., entered into before September 18, 2003) that will need to be modified to comply with 409A are those that do not satisfy the requirements of Notice 2002-8, and therefore, those are the only grandfathered split-dollar arrangements that will need to rely on the material modification transition relief prescribed in Notice 2007-34 - which provides that if certain requirements are satisfied, amendments necessary to comply with 409A will not be treated as material modifications under the final split dollar regulations. Is this correct?

Response: Notice 2007-34 does not change the guidance (including the "no inference" guidance) provided in Notice 2002-8 respecting split dollar arrangements entered into before September 18, 2003. Mr. Hogans did not, however, despositively address the degree to which the section 409A deferred compensation character, if any, of split dollar arrangements is affected by this fact. The issues raised by this question will be addressed in more detail in a future *Washington Report*.

6. ***Independent Contractors*** **(Stuart Lewis)**

The final regulations retain the special rule in the proposed regulations which provided that 409A does not apply to deferred payments to independent contractors if certain requirements are satisfied, the most significant of which is that the independent contractor provide “significant services” to two or more unrelated service recipients. The final regulations also retain the safe harbor in the proposed regulations which provided that an independent contractor is deemed to provide significant services to two or more unrelated service recipients if the revenues generated from any service recipient do not exceed 70 percent of the independent contractor's total revenues. In response to comments, the final regulations added a new safe harbor which provides that an independent contractor that has actually met the 70 percent threshold in the three immediately previous years is deemed to meet the 70 percent threshold for the current year, but only if at the time the amount is deferred the independent contractor does not know or have reason to anticipate that the independent contractor will fail to meet the threshold in the current year.

Many insurance agents are independent contractors who sell the products of more than one insurance carrier. It is possible that in some years more than 70% of their earnings would come from only one company, so they would not qualify for the safe harbor, unless they had actually met the 70 percent threshold in the three immediately preceding years and did not know or have reason to anticipate that they would not meet the threshold in the current year.

A. Please confirm that if an independent contractor does not actually meet the 70 percent threshold for a particular year, the new 3-year safe harbor would not be available again until at least the 4th year following the year of such failure.

B. If so, then an independent contractor could actually satisfy the 70 percent threshold for 6 out of 7 years (failing in year 4) and only be able to rely on the new 3-year safe harbor for the first 4 years. Is that correct?

Response: Mr. Hogans confirmed that if an independent contractor does not actually meet the 70 percent threshold for a particular year, the new 3-year safe harbor would not be available again until at least the 4th year following the year of such failure. However, the general 70 percent safe harbor would be available in future years (i.e., actually meet the 70 percent threshold in such a year) and the general standard - "significant services" - could also be satisfied, which would depend on the particular facts and circumstances in each case. Mr. Hogans commented that the fact that one of the safe harbors were satisfied in prior years could be a factor, depending on the particular circumstances, in determining whether the general significant services standard is met for a particular year.

7. ***Performance-Based Compensation*** **(Stuart Lewis)**

The proposed regulations included a special provision with respect to the election to defer performance-based compensation, which generally provided that the initial deferral election did not have to be made until six months before the end of the performance period as long as the period is at least 12 months and, at the time of the deferral election, either the amount was not readily ascertainable or the right to the amount was not substantially certain. The final regulations retain this rule, but modify the readily ascertainable/substantially certain requirement to provide that the initial election can only be made if the amount is not readily ascertainable at the time of the election.

A. Why was this change made and what is its significance?

B. In addition, what factors should be taken into account in determining whether an amount is readily ascertainable?

Response: Mr. Hogans explained that the change was not intended to make any meaningful substantive change to the requirements - it was primarily made to more closely track the legislative history of 409A. The general rule remains that, to the extent an amount is pretty well certain to be paid at the time of an election, it is not eligible for the special deferral timing rule for performance-based compensation.

8. ***Death Benefit Plans*** **(Lee Nunn)**

Plans that qualify as death benefit plans under the 3121(v) regulations are not subject to 409A. In this regard, please consider an arrangement in which an employer agrees to pay the premiums on a term life insurance policy owned by the employee. The employee is taxed annually on the premium payments paid by the employer and the employer is not entitled to recover any of the premium payments made (i.e., this is a 162 bonus plan, not split-dollar).

A. If the employee can surrender the policy and receive unearned premiums in cash, is the arrangement a death benefit plan excepted from 409A?

B. If not, would the ability to surrender the policy and receive the unearned premiums in cash violate 409A?

Response: Mr. Hogans indicated that there were not enough facts presented for him to give a definitive answer with respect to this particular situation. He would want to review the exact wording and substance of the arrangement further. Nevertheless, Mr. Hogans commented that based on the general description of the arrangement it does not appear to violate the spirit of the exception for death benefit plans. There does not appear to be any deferral potential with this type of arrangement - any unearned premiums that could be received would appear to have been previously taxed to the employee.

9. ***Voluntary Good Reason Separations Treated as Involuntary*** **(Stuart Lewis)**

The final regulations provide that if certain requirements are satisfied, an employee who quits for good reason will be treated as having been involuntarily separated from service for purposes of the exception for separation pay plans and the definition of substantial risk of forfeiture. The determination of whether the good reason requirements are met is generally based on a facts and circumstances analysis. However, the final regulations also contain a safe harbor under which a voluntary separation for good reason will be treated as an involuntary separation if certain specific requirements are satisfied (e.g., amount, time and form of payment is identical to the payment that would be made upon an involuntary separation, there is a notice and cure period, and the good reason conditions consist of one or more of 6 specific good reason conditions prescribed in the regulations).

A. If an employment agreement currently provides for a certain payment upon a voluntary separation from service for good reason that does not satisfy all of the safe harbor requirements, can the employment agreement be amended during the 409A transition period (i.e., by the end of 2007) to meet all of the safe harbor requirements and thereafter qualify for the short-term deferral exception (i.e., the good reason separation is now a substantial risk of forfeiture and the payment is made within the 2-1/2 month period for short-term deferrals)?

B. If so, could such an employment agreement be amended in the same manner after the end of the 409A transition period and qualify for the short-term deferral exception?

Response: Mr. Hogans explained that, in accordance with the transition guidance provided in Notice 2006-79, to the extent a payment is not substantively vested and payable, the conditions for payment can be modified during the transition period or new payment elections can be made by either the service provider or service recipient. After the close of the transition period (i.e., December 31, 2007), any changes would have to comply with the general subsequent deferral rules and other applicable requirements of 409A and the final regulations.

10. ***New Payment Elections and Constructive Receipt*** **(Lee Nunn)**

To what extent, if any, do the old deferred compensation rules, including the constructive receipt doctrine, apply to new payment elections under the 409A transition rules? For example, assume that under the terms of a plan, or pursuant to a prior payment election by a current employee, an amount of deferred compensation that is subject to 409A is currently payable upon the employee's separation from service in the form of 10-year installments. In addition, in accordance with the 409A transition rules, the employee is provided with a new payment election period in the fall of 2007 in which he or she can elect a new time and form of payment, including an election to receive the amount of deferred compensation in the form of a lump sum on January 1, 2008.

A. Does this new payment election raise any issues under 409A or the old deferred compensation rules, including the constructive receipt doctrine?

B. If so, what changes or safeguards should the employer implement to address any such issues?

Response: Mr. Hogans indicated that this particular fact pattern raises issues under the constructive receipt doctrine. There is no "free pass" under the existing rules during the transition period. In addition, Mr. Hogans commented that prudence would dictate that there should be some reasonable delay period between the new payment election and the first date an amount could be received in the form of a lump sum.

11. ***Renewal Commissions*** **(Stuart Lewis)**

The final regulations include modifications to the proposed regulation provisions addressing the timing of deferral elections with respect to commissions. The proposed regulations generally treated the services related to the commission payment as performed in the year in which the customer remits payment to the service recipient. This rule was retained and a new rule was added under which the taxable year in which the transaction is consummated can be substituted for the year in which the customer remits payment. The final regulations also include a new rule for investment commissions. Under this new rule, the services with respect to investment commission compensation are deemed to be performed over the 12 months immediately preceding the date as of which the overall value of the assets or asset accounts is determined for purposes of calculating the investment commission compensation.

A. How do these special rules apply in the case of insurance renewal commissions if the insured does not make any additional premium payments during the year the commissions become due? For example, the underlying insurance policy is fully paid up, and the renewal commissions are paid directly from the insurance company's general assets.

B. Is the renewal treated as the consummation of a new transaction?

C. Are renewal commissions eligible for the new rule for investment commissions?

Response: Mr. Hogans indicated that a renewal commission should qualify under either the original rule in the proposed regulations (i.e., when customer remits payment) or the new rule under the proposed regulations (i.e., when the transaction is consummated) depending on the particular facts and provided that all other requirements are satisfied. Mr. Hogans also commented that renewal commissions were the type of transaction contemplated to be covered by the new rule. With respect to whether renewal commissions are eligible for the new rule for investment commissions, Mr. Hogans indicated that it will depend on how the renewal commissions are actually structured. If the renewal commissions satisfy the conditions for the new rule for investment commissions, they should be eligible for the new rule.

12. ***Actuarially Equivalent Annuities*** **(Stuart Lewis)**

The final regulations clarify the circumstances under which two actuarially equivalent life annuities may be treated as one form of payment and thereby allow elections among such annuity forms at any time before the initial annuity payment without regard to the rules on subsequent deferral elections. Specifically, the final regulations provide that certain features are ignored for purposes of determining whether an annuity is a life annuity, including (1) term certain features, (2) pop-up provisions, (3) cash refund features, (4) Social Security or Railroad Retirement leveling features, and (5) features applying a permissible cost-of-living index. The final regulations also provide that a subsidized joint and survivor annuity is treated as actuarially equivalent to a single life annuity provided that none of the annual benefits payable under the joint and survivor annuity are greater than the annual lifetime annuity benefit available under the single life annuity.

Can a plan that offers one or more actuarially equivalent annuities add additional actuarially equivalent annuities or modify the existing annuities to include one or more of the "ignored" features after the date a participant makes his or her initial time and form of distribution election and allow a participant to make new elections among such annuity forms without regard to the rules on subsequent deferral elections?

Response: Mr. Hogans indicated that during the transition period, which ends December 31, 2007, there is broad authority to add new distribution options, including annuities, regardless of whether the plan previously offered annuities. However, after the close of the transition period, actuarially equivalent annuities can be added without regard to the subsequent deferral rules only if the plan previously had a life annuity option and only to the extent permitted under the final regulations (as summarized above). Thus, if a plan has a life annuity option, the plan generally can add actuarially equivalent annuities and allow participants to elect between such annuities without regard to the subsequent deferral rules.

13. ***Above-Market Earnings (or Unreasonable Rates of Return)*** **(Lee Nunn)**

The final regulations provide that the use of an unreasonable rate of return to determine "earnings" generally will result in some or all of the "earnings" being treated as additional deferred compensation and not earnings on deferred compensation for purposes of 409A.

A. What are the consequences under 409A of such a "recharacterization"?

B. What are some examples of commonly-used rates of return that are not reasonable?

C. The final regulations seem to provide that the use of a rate of return on a predetermined actual investment will always be considered "reasonable" for this purpose. Is that correct?

D. What constitutes a predetermined actual investment for this purpose? For example, if a plan uses a straight Moody's interest rate, is that a predetermined actual investment that will always be treated as reasonable (even though participants receive the interest crediting rate, but not the actual market fluctuations in the bond market)?

Response: Mr. Hogans responded that not too much should be read in to the definition of "earnings" and the reference to "unreasonable rates of return." The definition was primarily included because the term "earnings" is referred to in several sections of the final regulations. The IRS and Treasury did not view the issue as significant and that is the reason it is not discussed in the preamble to the final regulations. To the extent a plan provides for above-market earnings, it should only impact what gets allocated to "principal" (i.e., additional deferred compensation) and to earnings for purposes of applying 409A.

14. ***Salary Deferrals and Substantial Risk of Forfeiture*** **(Lee Nunn)**

The final regulations retain the rule in the proposed regulations that salary deferrals generally may not be made subject to a substantial risk of forfeiture unless the amount subject to a substantial risk of forfeiture is materially greater than the amount the employee could have elected to receive in cash.

A. What standards apply for purposes of determining whether an amount is "materially greater?"

B. Assume that a salary deferral is made in a manner that qualifies as a substantial risk of forfeiture in accordance with the regulations and that the amount is required to be paid within the short-term deferral period so that the amount is not subject to 409A. Can the employee "re-defer" the amount subject to a substantial risk of forfeiture before the amount is actually paid provided that the amount re-deferred is "materially greater" than the previously deferred amount?

Response: Mr. Hogans explained that whether an amount is materially greater depends on the particular facts and circumstances. With respect to the ability to "re-defer" a short-term deferral, Mr. Hogans initially commented that the subsequent deferral rules (i.e., the one year/five year rule) is generally not applicable (although the final regulations do include a special rule for re-deferrals of short-term deferrals - the expiration of the substantial risk of forfeiture is treated as the original payment date for the subsequent deferral rules). If the payment arrangement is changed (i.e., a short-term deferral is re-deferred), the arrangement generally will continue to be excepted from 409A if the change is economically driven (and the requirements for the exception continue to apply). However, if the change is tax driven, the arrangement generally will become subject to 409A and must comply with the requirements.

15. ***Delayed Distributions for Key Employees*** **(Lee Nunn)**

Payments to key employees of publicly traded corporations must be delayed at least six months following a separation from service. If payments are scheduled to commence on a specified date or pursuant to a fixed schedule (and not conditioned on the employee's separation from service), can the payments be made even if all or a portion are made during the six month period following a specified employee's separation from service?

Response: Mr. Hogans confirmed that if the payments are not being paid on account of separation from service, the payments are not subject to the six-month delay rule, even if the payments are made during the six-month period following separation from service.

16. ***Section 457(f) Plans*** **(Stuart Lewis)**

The final regulations provide that for purposes of the short-term deferral rule, an amount is treated as paid when it is included in income under Code section 457(f) whether or not an actual or constructive payment occurs. The final regulations provide further that where the income inclusion stems from the lapse of a substantial risk of forfeiture that is also treated as a substantial risk of forfeiture for purposes of 409A, the amount included in income will be considered a short-term deferral for purposes of 409A.

A. This language indicates that the definitions of substantial risk of forfeiture are different for purposes of 409A and 457(f). Please discuss how the two definitions are different.

B. If an amount deferred under a 457(f) plan does not qualify for the short-term deferral exception because the lapse of the restriction does not constitute a substantial risk of forfeiture for 409A purposes, does the lapse of the restriction constitute a prohibited acceleration of the amount under 409A (i.e., under the special rule that treats income inclusion under 457(f) as a payment)?

Response: Mr. Hogans explained that he could only speak with respect to the 409A definition and that a separate group within the IRS and Treasury is responsible for the definition of substantial risk of forfeiture for purposes of 457(f). Mr. Hogans also mentioned that the 457(f) group is currently re-considering the definition of substantial risk of forfeiture under 457(f) and that, at least at this stage in the process, the 457(f) group likes the 409A definition, which is more stringent than the definition under 83(b). For example, under 83(b), certain noncompetes and rolling risks of forfeitures may constitute a substantial risk of forfeiture, but they would not for 409A purposes.

With respect to 457(f) plans, which are subject to both 409A and 457(f), Mr. Hogans commented that it is his sense that such plans should be analyzed with two overlays - (1) first, the arrangement should be reviewed for compliance with the 457(f) rules; and (2) second, after concluding that the 457(f) rules are satisfied, the arrangement should be reviewed for compliance with 409A. He emphasized that the compliance checks should be done separately.

17. ***Wrap Plans*** **(Lee Nunn)**

The final regulations retain the special rules provided in the proposed regulations that allow wrap plans (i.e., nonqualified plans linked to qualified plans) to continue to operate if certain requirements are satisfied. For example, the regulations provide that wrap 401(k) plans can be maintained if the actions or inactions of a participant under the 401(k) plan do not result in an increase in the amounts deferred under the nonqualified plan in any calendar year in excess of the deferral limits under Code section 402 (g) (i.e., $15,500 in 2007). The proposed regulations included an example of a "traditional" wrap arrangement under which the amount is initially deferred to the nonqualified plan and then the maximum amount that can be deferred under the 401(k) plan (generally determined after the close of the taxable year in which the deferral occurs) is reduced under the nonqualified plan and contributed to the 401(k) plan. The final regulations did not retain this example.

A. Why was the example not retained in the final regulations? Are "traditional" wrap arrangements still permissible?

B. Can the deferred amounts initially go into the 401(k) plan and any excess contributions (determined after the end of the plan year) be credited under the nonqualified plan?

Response: Mr. Hogans explained that the example in the proposed regulations was not included in the final regulations because it raised potential issues in areas that are not within the "jurisdiction" of the 409A group - namely, (1) the prompt remittance of 401(k) deferrals (primarily a Department of Labor issue), and (2) the contingent benefit rule (primarily a 401(k) group issue). In addition, the two types of wrap plans referred to in the question should work under 409A, provided all of the requirements are satisfied, but may raise other issues (as discussed in the preceding sentence).

Any AALU member who wishes to obtain a copy of the final 409A regulations or IRS Notice 2007-34 may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at http://www.aalu.org/ and enter the *Member Portal* with your social security number and select *Current Washington Report* for linkage to source material or (3) email Angela Street at street@aalu.org and include a reference to this *Washington Report*.