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Time Running Out to Take Full Advantage of Certain Section 409A Corrective Relief Ahead of December 31, 2010 Deadline

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Earlier this year, the Internal Revenue Service, in response to taxpayer angst over the complexities of Code § 409A and criticism of the lack of means to voluntarily correct documentary non-compliance under Code § 409A, issued Notice 2010-6, "Relief and Guidance on Corrections of Certain Failures of a Nonqualified Deferred Compensation Plan to Comply with Code § 409A" (the "Notice"). The Notice allows companies maintaining deferred compensation arrangements to voluntarily correct certain documentary deferred compensation arrangement failures with either no or reduced penalties under Code § 409A. As we are getting closer to the deadline for taking advantage of the relief opportunities offered by the Notice, we wanted to make sure you are focused on the limited opportunity window that remains available.

As a reminder, for more than five years now, Code § 409A and the proposed and final regulations promulgated under Code § 409A have provided complex, vexing and esoteric rules for the documentation and operation of so-called "nonqualified deferred compensation" plans and arrangements that businesses have sponsored to benefit their employees, directors, and, in certain cases, independent contractors. Businesses must follow these rules to avoid stiff penalties being imposed on the compensation recipient and to a certain extent, the businesses (including accelerated inclusion in income and 20% excise tax). These rules include, among others:

- limitations on when elections to defer compensation must be made;
- when or upon what events, and how, payment can be made under such deferred compensation arrangements; and
- how and to what extent payment structures can be changed after such a deferred compensation arrangement is created.

The Notice not only sets out certain procedures that allow taxpayers to avoid the impact of Code § 409A by correcting "plan documentation failures" but arguably may be read to expand upon what constitutes plan document failures vis-a-vis ambiguous/undefined terms. To take advantage of many of these relief opportunities, action must be taken prior to January 1, 2011. ***Thus, prompt review of your deferred compensation plans is advisable.***

Failures that may be eligible for correction under the Notice include:

- ambiguous plan terms that could have an impermissible meaning;
- impermissible discretion in the payment period following a permissible payment event;
- impermissible payment events;
- impermissible payment schedules;
- impermissible discretion of the company to accelerate payments; and
- failure to provide for the required six-month delay in payment following separation from service (a/k/a "termination of employment") of certain employees of certain public companies.

Another common pitfall that can be corrected under the protection of the Notice is where the payment date(s) of deferred compensation is tied to employment-related actions, such as the date that a release of claims happens to become

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effective, rather than being tied solely to the "separation from service." This problem regularly appears in employment and severance arrangements.

We recognize that, under the Notice, certain corrections may be able to be effectuated even after the December 31, 2010 deadline. Doing so after the deadline might trigger certain "partial" penalties and acceleration, however. Thus, it is important that, in advance of the end of year, you should have your tax advisors review any suspected deferred compensation plans that have not previously been reviewed from the perspective of the Notice in order to see if there is Code § 409A non-compliance and to possibly take advantage of penalty free correction under the Notice. It also may be beneficial to have arrangements re-checked, even if they were previously reviewed for Code § 409A issues by your tax advisors.

The Notice also contains several other important features. The IRS states that "savings" clauses will be effective to allow ambiguous terms (i.e., terms that could mean something that would cause an arrangement to be Code § 409A either compliant or non-compliant) to be interpreted to mean what would be permissible under Code § 409A, whereas previously, the effectiveness of savings clauses was in question. Also, going forward, newly created arrangements discovered to have documentary failures generally may be corrected without penalty prior to the later of the calendar year of creation or the fifteenth day of the third month following creation of the plan, so long as the applicable company did not previously have in place a similar arrangement that would be aggregated with the non-compliant arrangement under Code § 409A's aggregation rules.

Thus, it is important for you quickly to identify employment agreements and compensation plans that include payment of post-termination compensation or other nonqualified deferred compensation and let us or your other counsel for such matters know so we can have enough time to review those documents and get them amended, where necessary, before the end of December 2010. ■

Your Buy-Sell Book Value Formula May Not Be Appropriate

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If the valuation formula used in your practice or business buy-sell agreement is based on book value and your books are maintained on a tax-basis rather than on a GAAP or cash basis, generous depreciation allowances claimed for tax purposes may have resulted in a book value of your practice or business that is substantially below market value. If that is the case, you need to reevaluate your valuation methodology and consider revising your buy-sell agreement.

In general (subject to certain annual investment limitations), a taxpayer may elect under section 179 of the Internal Revenue Code to deduct the cost of tangible personal property (other than buildings and land improvements), and non-customized software (placed in service in taxable years beginning before 2011), purchased for use in the active conduct of a trade or business, rather than recover such costs through depreciation deductions. Subject to the annual investment limitations, for taxable years beginning in 2009, the maximum amount that a taxpayer may expense is $250,000 of the cost of qualifying property placed in service for the taxable year, and for taxable years beginning in 2011 and thereafter, assuming no further changes by congress, the maximum amount that a taxpayer may expense is $25,000 of the cost of qualifying property placed in service for the taxable year.

Also, for taxable years 2008 and 2009, certain additional first year bonus depreciation was permitted on certain eligible property.

Check with your accountant as you may find that your books reflect an expensing or quick depreciation of a substantial amount of the cost of tangible personal property acquired for use in the business. If so, the amount expensed or depreciated will not be reflected in the buy-sell value of your practice or business if the assets are valued at book value under your buy-sell agreement. When the accounting books are kept on a tax-basis and an agreement calls for the assets to be valued at book value, the asset value (i.e., the price paid for the property) is reduced by the amount of depreciation (including the section 179 expense allowance, the additional first year depreciation and regular depreciation). As a consequence, under such circumstances, even assets that are relatively new may not have an appropriate book value.

Some of the alternatives to such a book value determination are (i) appraisal by a qualified appraiser, (ii) calculating book

value by instead using straight-line depreciation over the asset's useful life, but imposing a minimum floor value (e.g., 20% of cost) if the asset has been fully expensed or depreciated but continues to be used in the business, and (iii) use of the values as assessed for tangible personal property tax purposes.

Before making any such change, however, you should check to see if shares or other proprietary interest in the business were issued to an employee as compensation for services and the formula set forth in the buy-sell agreement was used for purposes of limiting the fair market value for Federal income tax purposes (e.g., in connection with a section 83(b) election). If so, you should be aware that a revision of the formula that results in a greater value for those shares will subject the employee/shareholder to taxation at ordinary income tax rates, as compensation income, on the amount of the increase in value and could result in stock options not qualifying for certain exemptions from excise tax for nonqualified deferred compensation. Although there is an exception from such taxation under the Internal Revenue Code if the employee can establish that the revision of the formula for valuing the shares was not compensatory and the employer does not deduct the amount that would otherwise be required to be included in income by the employee, it is not necessarily easy to satisfy the requirements of the exception. Indeed, the mere fact that the employer is willing to forego a deduction and to reflect that willingness in a written statement filed with the employee's Federal income tax return is insufficient evidence, by itself, to establish that the revaluation was done for noncompensatory purposes. As always, you should consult with you accountant or lawyer on these issues. ■

Section 125 Cafeteria Plan Documents Should Be Reviewed for Changes Required under Health Reform

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Employees are able to pay their share of the cost of health insurance on a pre-tax basis when made under a cafeteria plan that complies with Section 125 of the Internal Revenue Code. Those rules require that a cafeteria plan operate under a written plan document for the payments to be made pre-tax. Failure to comply with the requirements of Section 125, including the requirement of a valid written cafeteria plan document, makes these payments taxable to the employees.

The Patient Protection and Affordable Care Act ("PPACA," commonly known as the health reform bill) made several changes to the requirements for employer-sponsored health plans cafeteria plans. One of these changes is the new requirement to provide coverage to employees' children until the age of 26, beginning on January 1, 2011 for calendar-year plans (or the first day of the plan year for plan years beginning in October through December). Under the new rules, the health plan must allow employees to cover their children up to their 26th birthday. New IRS rules allow those dependents to be covered on a pre-tax basis, but employee payments for that coverage only will be pre-tax if the cafeteria plan is amended before the effective date of the change. So, for example, the amendment needs to be in place by December 31, 2010 for calendar year plans. This means that cafeteria plan documents for all employers who provide health plans for their employees should be reviewed as soon as possible, with any required amendments made before the end of the plan's current plan year. Please contact a member of the Trenam Kemker employee benefits group if you would like our assistance with reviewing your cafeteria plan document, or to discuss any of the changes required by PPACA. ■

New Florida Law Allows Extension of Certain Development Approvals Despite Appellate Court Decision Holding SB 360 Unconstitutional

By: John R. Hixenbaugh; E-Mail: jhixenbaugh@trenam.com

In 2009, the Florida legislature passed Senate Bill (SB) 360, which included a comprehensive amendment to Florida's Growth Management Act intended to encourage growth and economic development. Specifically, SB 360 exempted development in certain urban areas from transportation concurrency requirements and rescinded much of Florida's time-consuming and expensive review process for Developments of Regional Impact (DRI). Shortly after its adoption, several cities sued, alleging that SB 360 unfairly required local governments to rewrite their comprehensive land use plans (City of Weston v. Crist). In August 2010, the First District Court of Appeal agreed with the cities and struck down SB 360. A motion for rehearing has been

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filed and if the motion is denied, further review is anticipated.

Suspecting that the courts might strike down SB 360, however, the 2010 legislature reenacted key provisions of SB 360 in new SB 1752, also known as the "Jobs for Florida" bill. Governor Crist signed SB 1752 into law in May 2010. While the new law provides a variety of incentives intended to stimulate employment, such as tax incentives and credits for business expansion, real estate developers will be interested in the permit extensions options available under SB 1752.

SB 1752 provides the opportunity to obtain a two-year extension of development approvals, building permits, and certain state-issued environmental permits (such as DEP and water management district permits), that would otherwise expire between September 1, 2008 and January 1, 2012. The extension is not automatic, however. Further, under certain circumstances, approvals and permits cannot be extended due to statutory limitations set forth in SB 1752.

To obtain an extension, developers must file a written notice of intent (essentially a written application) for an extension of the approval with the governing body or agency that issued the permit before December 31, 2010. The application must identify the permit to be extended and state an anticipated timeframe for action on the permit, for example, commencing construction.

Developers who missed filing for extensions under SB 360 by the then-applicable December 31, 2009 deadline may now be able to take advantage of the new permit deadline established by SB 1752. In addition, although it remains to be determined whether the extensions approved under SB 360 will be upheld after the appellate court's ruling, the uncertainty created by the court's decision raises some concern about the future validity of the 2009 permit extensions. Therefore, a prudent developer holding a permit extension granted under SB 360 should file again for the extension permitted under SB 1752. Time is of the essence, because each governing body or agency is allowed to establish its own process for the review and granting of an extension. Developers seeking an extension would be wise to contact the governing body or agency well before the deadline to determine the process, application requirements, procedures, and fees.

Trenam Kemker is pleased to assist its developer clients with filing the appropriate notice for an extension under SB 1752 and to provide any assistance or clarification regarding the impact of the court's decision and the new law on any particular development projects, approvals, or permits. ■

Trenam Kemker Listed on US News & World Report's Best Law Firms List

Trenam Kemker ranked very well on the US News & World Report's inaugural listing of Best Law Firms. U.S. News Media Group and Best Lawyers released the 2010 Best Law Firms rankings last month. The firm was ranked in Tier 1 (the highest rating) in the following practice areas for the Tampa metro area:

- Banking and Finance Law
- Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law
- Construction Law
- Corporate Law
- Eminent Domain and Condemnation Law
- Employee Benefits (ERISA) Law
- General Commercial Litigation
- Private Equity Law
- Real Estate Law
- Securities / Capital Markets Law
- Tax Law
- Trusts & Estates Law

The methodology for the U.S. News - Best Lawyers "Best Law Firms" involved surveying thousands of law firm clients; leading lawyers and law firm managers; partners and associates; and marketing officers and recruiting officers. Each were asked what factors they considered vital for clients hiring law firms, for lawyers choosing a firm to refer a legal matter to, and for lawyers seeking employment.

The rankings, including 30,322 rankings of 8,782 law firms in 81 practice areas, are posted online at www.usnews.com/bestlawfirms

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