WILLKIE FARR & GALLAGHER LLP

CLIENT MEMORANDUM

# PROPOSED AMENDMENT TO SECTION 409A OF THE CODE LIMITING ANNUAL DEFERRAL AMOUNT

The Senate Finance Committee today unanimously approved legislation that would make a significant change to Section 409A of the Internal Revenue Code of 1986, as amended, by placing a cap on the amount of compensation that can be tax-deferred each year. Senator Max Baucus, Chairman of the Committee, announced the proposed change yesterday on the Committee's website. The change to Section 409A, if enacted, would be part of the Small Business and Work Opportunity Act of 2007, legislation that would raise the minimum wage and provide tax relief to small businesses, the costs of which would be offset by a series of so-called "loophole closers", including the annual cap on tax-deferred compensation.

Under the legislation approved by the Senate Finance Committee today, an individual would be limited in the amount of income that could be deferred each year to the lesser of (a) $1,000,000 or (b) the average annual compensation paid to the individual (and included in the individual's gross income) during the preceding five years for services performed by the individual for the employer sponsoring the deferred compensation plan. The proposed legislation does not address how the limitation is computed for individuals who have performed services for less than five years for an employer sponsoring a deferred compensation plan. The measure would further limit traditional tax accounting concepts under which a cash-method taxpayer is not required to include an amount in income until it is actually or constructively received.

Failure to comply with the proposed limitation on deferral amounts would result in the current inclusion in income of all amounts deferred under a nonqualified deferred compensation plan for all taxable years (to the extent such amounts were not subject to a substantial risk of forfeiture or had not previously been included in income). In addition, interest at the underpayment rate plus one percent and a 20% penalty would apply. The proposed effective date for this change is for tax years beginning after December 31, 2006. Individuals would be permitted to modify outstanding deferral elections in order to reduce deferrals for tax years beginning after December 31, 2006 without violating the requirements of Section 409A.

Because deferred compensation plans are structured in many different ways, the precise impact of this proposed legislation on any particular plan will not be clear unless and until the measure is approved by the House and signed into law.

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If you have any questions about this memorandum, please contact Richard L. Reinhold (212-728-8292, rreinhold@willkie.com), James R. Brown (212-728-8287, jbrown@willkie.com), Joseph A. Riley (212-728-8715, jriley@willkie.com), Frank A. Daniele (212-728-8216, fdaniele@willkie.com), Elizabeth Buckley Lewis (212-728-8964, elewis@willkie.com), or the attorney with whom you regularly work.

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