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## IRS Notice 2009-49 Clarifies Issue with TARP Recipients With Nonqualified Deferred Compensation Plans.

On June 4, 2009, the Internal Revenue Service ("IRS") issued Notice 2009-49 which clarifies that an entity which has received a capital infusion from the Department of Treasury will not be permitted to treat that capital infusion as a change of control event for purposes of Internal Revenue Code §409A. Under Code §409A, and its regulations, a change of control event is one of six permitted distribution events from a nonqualified deferred compensation plan.

### I. Background on Code §409A.

Code §409A mandates that a nonqualified deferred compensation plan meet certain requirements. Failure to do so will require plan participants to include the deferred compensation in current income and pay taxes on such income. Failure to comply with Code §409A may result, not only in immediate inclusion of the deferred compensation in income, but also an additional 20%

income tax penalty, as well as an additional 1% interest penalty for income which is included in a later year.

A nonqualified deferred compensation plan must comply with limited distribution options. One such permissible distribution option is defined in Code §409A(a)(2)(A) as following a "change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation" (hereinafter "a change in control event").

Congress specifically authorized Treasury to clarify and define when a change in control event occurs. Final regulations were adopted in 2007 (effective January 1, 2009), which clarified numerous issues regarding Code §409A including what constitutes a change in control event which is defined in Treas. Reg. §1.409A-3(i)(5). However, the Code §409A regulations do not account for a change in ownership as a result of the federal government taking

ownership in a financial institution as has been permitted by the Department of Treasury's Capital Purchase Program ("CPP") enacted as a part of the Troubled Asset Relief Program ("TARP").

## **II. Troubled Asset Relief and Capital Purchase Programs.**

The TARP and CPP were authorized by the Emergency Economic Stabilization Act of 2008 ("EESA"). The CPP extended the TARP program to authorize infusions of capital by the Treasury in exchange for preferred stock, common stock, warrants to purchase common stock, or other types of equity in the participating financial institution (hereinafter "EESA Equity Acquisition").

## **III. IRS Guidance in Notice 2009-49.**

The IRS clarified in Notice 2009-49 that an EESA Equity Acquisition, "is not a change in ownership or effective control, or a change in the ownership of a substantial portion of the assets of the corporation and. . . is not a permissible §409A payment event." Further, the Notice is effective for "transactions occurring on or after June 4, 2009," and the Code §409A regulations will be amended accordingly with the same effective date. The effect of this ruling is to prohibit a nonqualified deferred compensation plan from making an early distribution under the change of control exception based solely on the ownership change that results from the EESA Equity Acquisition.

If you have questions about this or any other issue regarding executive compensation or employee benefits, contact the author, Jeff Dixon. Notice 2009-49 is printed below in its entirety.

## Part III – Administrative, Procedural, and Miscellaneous

Guidance under § 409A(a)(2)(A)(v) on certain transactions pursuant to the Emergency Economic Stabilization Act of 2008

### Notice 2009-49

#### I. PURPOSE

This notice provides guidance with respect to whether a transaction under the Emergency Economic Stabilization Act of 2008, as amended (12 U.S.C. 5021 et seq.) (EESA), that involves the acquisition by, or on behalf of, the Treasury Department of preferred stock, common stock, warrants to purchase common stock, or other types of equity of a financial institution or other entity, is an event with respect to which a payment can be made under a nonqualified deferred compensation plan pursuant to § 409A(a)(2)(A)(v) of the Internal Revenue Code (Code) and § 1.409A-3(a)(5) of the Income Tax Regulations (a permissible § 409A payment event). This notice clarifies that, for purposes of § 1.409A-3(a)(5), such a transaction is not a change in ownership or effective control, or a change in the ownership of a substantial portion of the assets of the corporation and, accordingly, is not a permissible § 409A payment event. The Treasury Department and the IRS intend to amend the regulations under § 409A to incorporate the guidance set out in this notice. The guidance in this notice is effective for, and the amended regulations will be applicable to, transactions occurring on or after June 4, 2009.

#### II. BACKGROUND

##### A. Section 409A and Permissible Change in Control Event Distributions

Section 409A prescribes certain requirements applicable to nonqualified deferred compensation plans. If a plan does not meet those requirements, participants in the plan are required to include immediately compensation otherwise deferred under the plan in income and pay taxes on such income. As provided by § 409A(a)(1)(A)(i), a nonqualified deferred compensation plan must comply with the requirements of § 409A(a) both in form and in operation.

Section 409A(a)(2)(A) provides that compensation deferred under a nonqualified deferred compensation plan may not be distributed earlier than one of six specified events or times that include, in the case of a plan maintained by a corporation, to the extent provided by the Secretary of the Treasury (Secretary), a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation. Section 409A(e)(2) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 409A, including regulations relating to changes in ownership and control of a corporation for purposes of section 409A(a)(2)(A)(v).

The Treasury Department and the IRS issued final regulations under § 409A in April 2007 (72 Fed. Reg. 19234 (April 17, 2007)). The final regulations apply to taxable years beginning on or after January 1, 2009. Section 1.409A-3(a) provides that the requirements of § 409A(a)(2)(A) are met only if the plan provides that an amount of deferred compensation under the plan may be paid only upon one of the six payment triggers set forth in § 1.409A-3(a). These permissible payment triggers include, under § 1.409A-3(a)(5), a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation (in accordance with

§ 1.409A-3(i)(5)). Section 1.409A-3(i)(5) provides a definition of a change in the ownership or effective control of a corporation, or a change in the ownership of a substantial portion of the assets of the corporation (collectively referred to in this notice as a change in control event).

## **B. The Emergency Economic Stabilization Act of 2008**

The Treasury Department established the Troubled Asset Relief Program (TARP) under EESA, which was enacted on October 3, 2008. EESA provided immediate authority and facilities that the Secretary could use to restore liquidity and stability to the financial system. Section 101(a) of EESA authorizes the Secretary to establish the TARP to “purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures developed and published by the Secretary.”

As part of its effort to restore liquidity and stability to the financial system, the Treasury Department has developed several programs and may develop additional programs. Under these programs, the Treasury Department has participated, and may participate in the future, in numerous transactions with financial institutions and other entities that involve the acquisition by, or on behalf of, the Treasury Department of preferred stock, common stock, warrants to purchase common stock, or other types of equity of the financial institution or other entity (collectively referred to as Treasury EESA Equity Acquisition Transactions).

The Treasury Department and the IRS anticipate that most of the financial institutions and other entities involved in Treasury EESA Equity Acquisition Transactions are, and will be, sponsors of nonqualified deferred compensation plans subject to § 409A of the Code. Questions have arisen whether the Federal government’s acquisition of an equity interest in a financial institution or other entity in connection with a Treasury EESA Equity Acquisition Transaction constitutes a change in control event and accordingly a permissible § 409A payment event.

The final regulations under § 409A were promulgated before the enactment of EESA. Therefore, the final regulations do not explicitly provide guidance with respect to whether a Treasury EESA Equity Acquisition Transaction constitutes a change in control event and a permissible § 409A payment event.

The Treasury Department and IRS have determined that a Treasury EESA Equity Acquisition Transaction is not a change in control event under § 409A and the final regulations. Treating a Treasury EESA Equity Acquisition Transaction as a change in control event and, therefore, a permissible payment event, would be inconsistent with the purposes of EESA and § 409A, and would be contrary to the public interest. For example, payment of nonqualified deferred compensation amounts as a result of a Treasury EESA Equity Acquisition Transaction could reduce the liquidity of the financial institution or other entity, which is directly contrary to the purpose of a Treasury EESA Equity Acquisition Transaction.

## **III. Guidance**

For purposes of § 409A, a Treasury EESA Equity Acquisition Transaction is not a change in control event and, accordingly, is not a permissible § 409A payment event. (This notice does not address whether a Treasury EESA Equity Acquisition Transaction constitutes a change in control event for any other purpose). Accordingly, a nonqualified

deferred compensation plan will fail to satisfy the requirements of § 409A(a) if a payment is made on account of a Treasury EESA Equity Acquisition Transaction and will not fail to satisfy the requirements of § 409A(a) merely because the plan fails to make a payment on account of a Treasury EESA Equity Acquisition Transaction. A nonqualified deferred compensation plan will not fail to satisfy the plan document requirements of §409A(a) and the regulations thereunder merely because the plan fails to explicitly provide that a Treasury EESA Equity Acquisition Transaction will not trigger a payment under the plan, regardless of whether the plan incorporates the definition of a change in control event by reference to the final regulations or sets forth a definition of a change in control event that otherwise meets the requirements of the final regulations. The guidance in this notice is effective June 4, 2009.

#### **IV. Anticipated Regulations**

The Treasury Department and the IRS intend to amend the regulations under § 409A(a) to incorporate the guidance set out in this notice. Such amended regulations will be applicable to Treasury EESA Equity Acquisition Transactions entered into on or after June 4, 2009.

#### **V. Drafting Information**

The principal author of this notice is Bill Schmidt of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), although other Treasury and IRS officials participated in its development. For further information on the provisions of this notice, contact Bill Schmidt at (202) 927-9639 (not a toll-free number).