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KIRKLANDPEN

KIRKLAND & ELLIS LLP

Private Equity Newsletter

The End is Near: Deferred Compensation Plan (IRC §409A) Compliance Required by December 31, 2008

PENpoints

Effective January 1, 2009, all deferred compensation arrangements not only must be operated in compliance with 409A, they must also comply in form with 409A's provisions.

Background: §409A of the Internal Revenue Code and its endless treasury regulations impose strict guidelines on the operation of nonqualified deferred compensation plans. Since its 2004 adoption, companies and executives have been living in a liberal transition period requiring only "good faith" 409A compliance in the operation of deferred compensation arrangements. As with Cinderella, however, at the stroke of midnight on December 31, 2008, this fairy tale existence ends and the stark reality of full 409A compliance begins.

What Does This Mean? Effective January 1, 2009, all deferred compensation arrangements not only must be operated in compliance with 409A, they must also comply in form with 409A's arcane and Byzantine provisions. In other words, a deferred compensation arrangement will violate 409A if it doesn't comply in form with 409A before January 1, 2009, even if participants haven't actually received payment of any deferred compensation.

Why Does This Matter? If a deferred compensation arrangement fails to comply with 409A (either in form or operation), participants will be subject to serious tax penalties (including 20 extra points of tax, i.e., a 55% top rate rather than 35%) when their rights to the compensation vest for tax purposes. Considering the inverse relationship between employee happiness and applicable tax rates, it is very important for companies to review their arrangements to insure that they have, to the extent necessary, been brought into 409A compliance by December 31, 2008. Moreover, a company, although not itself subject to penalty, is required to report all 409A violations.

What Should Be Done? The first step to ensure 409A compliance is to review and evaluate every deferred compensation arrangement that could be covered — both at the fund level and at the portfolio company level. These arrangements include:

- Employment, consulting, severance and change in control agreements.
- Equity incentive plans and underlying equity grants, including stock options and SARs.
- Cash bonuses and similar incentive plans.
- Fringe benefits, expense reimbursements and similar programs or policies.
- Foreign plans with United States taxpayer participants.
- Any other deferred compensation arrangement (such as a SERP or other nonqualified pension program) with amounts or benefits earned in one tax year and paid in a future tax year.

Once all potentially covered arrangements have been reviewed, those not 409A compliant must be amended by December 31, 2008, frequently by revising the terms to fit one of the many horrendously complex regulatory exemptions. This can be time consuming, requiring board approval and negotiation with individual executives. Accordingly, we recommend commencing this painstaking process well in advance of the December deadline.

Hasn't This Deadline Been Extended Before? Yes, but absent an extraordinary and unexpected event, the end is near — the December 31, 2008, deadline is not likely to be extended.

If you have any questions about the matters addressed in this Kirkland PEN article, please contact the following Kirkland authors or your regular Kirkland contact.

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The 8th Annual IVCA CFO Summit
Chicago, Illinois
October 16, 2008
This annual event, held at the University of Chicago's Gleacher Center, is offered for the benefit of venture capital and private equity firm CFOs and their staff. Topics covered will include: tax and accounting issues, fund formation structuring issues and non-cash compensation. Kirkland partner Bruce I. Ettelson, P.C., will discuss fund formation issues and updates.

PEI Infrastructure Investor Forum
New York, New York
October 22 - 23, 2008
This inaugural forum in New York will look at infrastructure from the perspectives of both fund managers and investors. Kirkland partners Bruce Gelman and Thomas Geraghty will lead a workshop focusing on "State of the Art Structuring for Infrastructure Funds and Investments."

KICP for Clients: The Fundamentals of Investing in Public Companies
Chicago, Illinois
October 28, 2008
Join Kirkland partners Christopher Butler, P.C., Keith S. Crow, P.C., Peter D. Doyle, R. Scott Falk, P.C., Robert M. Hayward, Marc Kieselstein, P.C., R. Henry Kleeman and Gerald T. Nowak at this Kirkland seminar, which will focus on the fundamentals of investing in public companies. Featured topics will include: "Investing through the Public Stock Markets," "Tactics of and Defenses Against Activist Shareholders" and "Alternative Investments in Public Companies." There is no charge for this seminar.

The Ninth Annual European Real Estate and Private Fund Investing Forum
London, England
October 29 - 30, 2008
This two-day seminar will focus on topics including: a macroeconomic overview, fund allocation and portfolio management strategies, the latest structures and debt financing available in today's market, U.S. residential distress and distressed opportunities in Europe. Kirkland partners Gary E. Axelrod and Jennifer M. Morgan will speak.

The Kellogg School of Management's 2008 Real Estate Conference
Evanston, Illinois
November 5, 2008
This year's conference will focus on a variety of relevant, action-oriented topics such as: the challenges and opportunities of operating in a volatile market, distressed strategies, executing deals in a changing global landscape and the multi-prong approach to true sustainable development. Kirkland is a sponsor of this event.

University of Chicago's Second Annual Real Estate Conference: Gridlock in the Capital Markets
Chicago, Illinois
November 10 - 11, 2008
This year's conference will feature prominent alumni from the university's Graduate School of Business and guest speakers discussing current issues effecting the commercial real estate industry. Kirkland partner Nathaniel M. Marrs will speak at this event.

Yale School of Management Private Equity Conference
Greenwich, Connecticut
November 14, 2008
This year's conference, "The Road Ahead," will focus on looking at longer term opportunities in sectors and regions that represent the next frontier of private equity investing. Specific topics will include: investment opportunities in clean technology and infrastructure, global sourcing and deployment of private capital, and the emerging operational imperative within private equity firms. Kirkland partners Stephen Fraidin and Kirk A. Radke will speak.

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Kirkland & Ellis LLP's Private Equity Practice

Kirkland & Ellis LLP's private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms in every major market around the world.

Kirkland has been widely recognized for its preeminent private equity practice. Most recently, Kirkland's London office was named "Banking Team of the Year" at the *Dow Jones Private Equity News* Awards for Excellence in Advisory Services 2008. In addition, *The Lawyer* magazine recently recognized Kirkland as one of the firms in "The Transatlantic Elite," noting that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent." In 2008, Mergermarket ranked Kirkland first by volume for Global and North American Buyouts in its "League Tables of Legal Advisers to Global M&A for Full Year 2007." Also in 2008, Kirkland received prestigious first-tier rankings in both private equity and fund formation from Chambers & Partners. Kirkland was named the "International Law Firm of the Year" in 2007 by *The Lawyer* magazine.

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