

March 24, 2006

## Limited §409A Transition Relief Provided for Offshore Trusts and Financial Health Triggers

On March 21, 2006, the IRS and Treasury Department released Notice 2006-33 (the “Notice”), which provides limited transition relief from the application of Internal Revenue Code §409A(b) to nonqualified deferred compensation arrangements. §409A(b) prohibits the use of (i) an offshore trust in connection with the payment of nonqualified deferred compensation, or (ii) an arrangement in which assets become restricted to the payment of nonqualified deferred compensation upon a change in the employer’s financial health (a “financial health trigger”). §409A(b) does not limit the use of a domestic rabbi trust to provide for payment of nonqualified deferred compensation, provided the trust does not include a financial health trigger. As described below, the Notice provides a grace period ending December 31, 2007, for employers to determine whether a trust or other arrangement would be in violation of §409A(b) and to bring such an arrangement into compliance with §409A(b) and related guidance.

By way of background, in 2005, technical corrections to §409A(b) clarified that offshore trusts and financial health triggers would not be eligible for “grandfathering” (i.e., all amounts set aside in such an arrangement would be in violation of §409A(b) beginning January 1, 2005). However, the technical corrections also required Treasury to issue guidance within 90 days of its enactment under which employers would be provided with a limited period of time to bring such arrangements into compliance. The Notice provides this transition relief.

The Notice indicates that Treasury and the IRS intend to issue additional guidance regarding the application of §409A(b). Until such guidance is provided, the Notice incorporates a “good faith” compliance standard under which employers may rely on a good faith, reasonable interpretation of §409A(b) to determine whether a trust or other arrangement is in violation of §409A(b). Importantly, the Notice provides a grace period for assets set aside in, transferred to or restricted under an arrangement subject to §409A(b), as of March 21, 2006, and subsequent earnings attributable to such assets (referred to in the Notice as “grace period assets”), during which the arrangement will not be treated as being in violation of §409A(b), provided it is brought into compliance with §409A(b) and subsequent guidance by December 31, 2007. However, this transition relief is not available for additional assets set aside in, transferred to or restricted under such an arrangement after March 21, 2006 (i.e., such assets would immediately be treated as being in violation of §409A(b)).

A copy of the Notice is included with this *Executive Benefits Bulletin* for your reference. Clark Consulting will continue to keep you apprised of any developments as they occur regarding §409A.

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