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Employee Benefits Alert

December 31 Deadline for Section 409A Amendments Relating to Release Conditions

September 11, 2012

In our Employee Benefit alert, dated July 7, 2010, we highlighted the position set forth by the Internal Revenue Service in IRS Notice 2010-06 regarding the payment of compensation that is conditioned on actions to be taken by an employee, such as the execution of a release of claims or a restrictive covenants (e.g., noncompetition) agreement.

Many existing employment, severance and similar arrangements provide that severance payments will commence on the date that the employee executes and delivers a release without specifically setting forth a time frame within which the release must be returned.

The IRS stated in Notice 2010-06 that if an employee's (or other service provider's) receipt of nonqualified deferred compensation (e.g., certain severance payments that extend beyond March 15th of the year following the year in which the severance event occurs) is contingent upon the execution of a release of claims that does not contain time limits for the return of such release or that has a designated time frame that spans multiple tax years, the service provider could manipulate the timing of payment in violation of Code Section 409A.

IRS Notice 2010-06 and subsequent IRS Notice 2010-80 provide permissible correction methods for taxpayers' arrangements having these types of provisions. Accordingly, it is still possible for these agreements to be corrected prior to the date a separation from service occurs by removing the ability of the employee to delay or accelerate the timing of the payment as a result of the employee's actions (such as returning and not revoking a release). The manner of correction depends upon whether the agreement already provides a time frame for return of the release:

- If the arrangement **provides** for payment within a specific time frame following separation from service, then the amendment must provide either for (i) payment only on the last day of such specific time frame or (ii) payment to be made in the second taxable year if in any event the specific time frame spans two tax years.

- If the arrangement **does not provide** for such a time frame, the amendment must provide either for (i) payment on the 60th or 90th day following the employee's separation from service or (ii) a period of up to 90 days for payment, but that if such period spans two taxable years, payment will be made in the later year.

Consistent with the requirements of the correction program for plan document failures under IRS Notice 2010-06, the corrections of the type described above require that an information statement be filed with the employer's federal tax return for the year of the correction. Pursuant to Notice 2010-80, however, no information statement is required to be provided to the employee, and the employee is not required to attach any statement to its return in respect of such correction.

The ability to correct these defects expires on **December 31, 2012** for any amounts that remain deferred under such arrangement as of December 31, 2012.

Thus, employers should **promptly review** compensation arrangements that contain release and similar conditions in order to identify arrangements that may have noncompliant provisions and to arrange for timely amendment of such arrangements.

CONTACT INFORMATION

If you have any questions regarding this alert, the ability to correct Code Section 409A documentary or operational failures, or other executive compensation or employee benefits issues, please contact—

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