

EMPLOYEE BENEFITS ALERT

IRS ISSUES GUIDANCE FOR CORRECTING DOCUMENT FAILURES UNDER SECTION 409A

In general, Section 409A of the Internal Revenue Code of 1986, as amended, imposes certain additional taxes and penalties on nonqualified deferred compensation plans that fail to comply, in both form and operation, with Section 409A's substantive provisions. On January 5, 2009, the Internal Revenue Service (IRS) issued Notice 2010-06, which, under certain circumstances, could permit taxpayers to voluntarily correct certain failures to comply with the documentary requirements of Section 409A. Notice 2010-06 supplements Notice 2008-113, which addressed correction of certain operational failures to comply with Section 409A. Until Notice 2010-06 was issued, it remained unclear whether form failures could be corrected without incurring penalties under Section 409A.

Of particular importance, Notice 2010-06 provides transitional relief for certain form failures corrected by December 31, 2010. In general, if a nonqualified deferred compensation plan fails to satisfy the documentary requirements of Section 409A, and the plan is corrected in accordance with Notice 2010-06 on or before December 31, 2010, the plan may be treated as having been corrected on January 1, 2009 (i.e., the date set by the IRS for nonqualified deferred compensation plans to be in compliance). Although Notice 2010-06 would permit corrections after December 31, 2010, the relief is limited and certain penalties may apply.

Document failures that may be corrected pursuant to Notice 2010-06 include, but are not limited to, the following—

- terms providing for a payment “as soon as practicable” or substantially similar language following a permissible payment event (e.g., “payment as soon as practicable following separation from service” should be amended to read “payment no later than 90 days following separation from service”)
- permissible payment event with no definition or an ambiguous definition (e.g., “payment upon an employee’s termination of employment” should be amended to read “payment upon an employee’s separation from service within the meaning of Section 409A and the regulations thereunder”)
- impermissible definition of separation from service, change in control or disability

- payment periods of longer than 90 days following a permissible payment event (e.g., “payment within 180 days following separation from service” should be amended to read “payment no later than 90 days following separation from service”)
- plans with permissible and impermissible payment events (e.g., a vested right to a payment upon the earlier to occur of a separation from service or an initial public offering should be amended to remove the ability to make the payment upon an initial public offering)
- plans with only impermissible payment events
- certain impermissible alternative payment schedules (e.g., “payment in a lump sum upon involuntary separation from service and payment in 10 annual installments upon voluntary separation from service” should be amended to read “payment in a lump sum upon separation from service”)
- impermissible service recipient discretion to accelerate payment events (e.g., payment in 10 annual installments upon separation from service unless the employer otherwise elects in its sole discretion to pay the amount in a lump sum should be amended to remove the employer’s discretion to change the time and form of payment)
- failure to include six-month delay of payment for specified employees of public companies
- impermissible initial deferral elections and subsequent deferral elections (e.g., a plan that provides that an employee may elect to defer a non-performance-based bonus no later than June 30 of the year in which the bonus is earned should be amended to require the initial deferral election no later than the end of the year prior to the year in which the bonus is earned).

In order to avail themselves of the relief afforded by Notice 2010-06, taxpayers must take commercially reasonable steps to identify all other nonqualified deferred compensation plans that have a document failure that is substantially similar to the failure initially identified and corrected and correct all such failures in a manner consistent with Notice 2010-06. Taxpayers should promptly review all of their nonqualified deferred compensation arrangements to identify document failures and take steps to correct those plan provisions in accordance with Notice 2010-06.

CONTACT INFORMATION

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