



EMPLOYEE BENEFITS PRACTICE

ALERT

SECTION 409A PLAN DOCUMENT CORRECTION PROGRAM RELIEF PROVIDED FOR DOCUMENT FAILURES IN NONQUALIFIED DEFERRED COMPENSATION PLANS

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In Notice 2010-6, which was published in early January, the IRS at long last provided guidance as to how taxpayers may voluntarily correct certain document failures that otherwise would cause a nonqualified deferred compensation plan to contravene the requirements of Internal Revenue Code Section 409A, triggering severe income tax consequences. The Notice also clarifies earlier guidance dealing with operational failures by nonqualified deferred compensation plans.

All amounts deferred under nonqualified deferred compensation plans are taxable to the employee as current income to the extent not subject to a substantial risk of forfeiture unless the plan complies, in form and in operation, with the requirements of Section 409A, which was added to the Internal Revenue Code as part of the American Jobs Creation Act of 2004. In addition to the deferred amounts being currently includible in gross income, the employee for whose benefit the deferrals were accumulated is subject to a 20 percent additional tax and an interest charge calculated at the underpayment interest rate.

In December 2008, the IRS prescribed procedures for the correction of certain operational failures allowing taxpayers to secure relief from the full impact of the income inclusion and additional penalties. For more than a year, taxpayers have been waiting for similar opportunity to correct document failures.

Plan Document Failures Available for Correction

Notice 2010-6 provides for the correction of the following types of plan document failures:

- Ambiguity in plan terms such as language providing for payment “as soon as reasonably practicable” or payment in the event of “disability” that either is not defined or is defined only in vague, noncompliant terms;
- Impermissible definitions of otherwise permissible payment events, such as change in control, that are not defined in a Section 409A compliant manner but otherwise do not violate Section 409A;
- Impermissible payment periods following a permissible payment event, as when a plan provides that a payment will be made following a Section 409A compliant trigger event but designates a payment period that violates Section 409A;
- Impermissible payment events and payment schedules, including discretion to accelerate payment events;
- Failure to include six-month delay for specified employees of public companies, and
- Impermissible initial deferral elections.

Effects of Correction

The correction program of Notice 2010-6 is intended to encourage taxpayers to review deferred compensation plans, to identify those provisions that do not conform with Section 409A and to bring the

documents into compliance, but it is not designed to provide an advantage to those taxpayers who failed to comply earlier. Consequently, it provides less than full relief in situations in which the corrected plan document affects the operation of the plan within one year following the date of correction.

For the most part, the program provides for self-correction without filing or fee requirements (as apply under other IRS correction programs), but some corrections include information and reporting obligations. In these circumstances, a statement titled "Section 409A Document Correction Under Section [_____] of Notice 2010-6" must be prepared and attached to the federal tax returns filed by both the employee and the employer. When required, the statement must include information regarding the taxpayer and the plan with respect to which the failure occurred, verification of eligibility for correction and the amount involved in each failure.

Availability of Correction

Correction of nonqualified deferred compensation plans, and the associated relief, is not available in certain circumstances. The Notice makes it clear that relief is available only to failures that are inadvertent and unintentional. Additionally, relief is unavailable when the taxpayer's return is under examination by the IRS with respect to nonqualified deferred

compensation for any taxable year in which the plan document failure existed.

It also should be noted that for purposes of applying the relief available under Notice 2010-6, corrections that are completed by December 31, 2010, may be treated as having been corrected on January 1, 2009. Thus, these transitional relief rules emphasize the importance of acting quickly to review deferred compensation plans and bringing documents into compliance this year.

Conclusion

Now that the IRS has provided this limited window of opportunity, it is even more critical that *all* documents that provide for deferral of compensation, whether they be deferred compensation plans, employment contracts, shareholder agreements or the like, be reviewed for Section 409A compliance. This new guidance makes it clear that the sooner plan document failures are identified and corrected, the more likely it is that income inclusion and penalties can be avoided.

If you have any questions regarding the information contained in this alert, please contact [Susan Foreman Jordan](#) or [Seth I. Corbin](#) at 412.391.1334 or any of the attorneys in the [Employee Benefits Practice Group](#) at Fox Rothschild LLP.



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