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[Time Running Out to Obtain Maximum Relief for Correcting 409A Document Failures under IRS Notice 2010-6](#)

With less than ten weeks remaining in 2010, companies should once again consider reviewing their compensatory plans and agreements to ensure that such agreements are in documentary compliance with Internal Revenue Code section [409A](#) ("409A"). 409A is the federal tax statute governing the taxation of nonqualified deferred compensation arrangements. While all compensation agreements should be prepared either to be exempt from or in compliance with 409A, the Internal Revenue Service has provided additional impetus for companies to re-review their compensation plans and agreements.

First, the IRS announced in 2009 that it is randomly auditing 2,000 businesses each year from 2010 through 2012 under its [Employment Tax National Research Project](#) to determine if taxpayers are properly complying with employment tax laws. More specifically with respect to 409A, the IRS in January 2010 issued [Notice 2010-6](#). Notice 2010-6 provides tax relief for certain 409A non-compliant plans or agreements that are *timely* corrected in accordance with Notice 2010-6 as generally discussed below.

Notice 2010-6 409A Plan Document Correction Program

Notice 2010-6 provides a program to correct inadvertent and unintentional plan document failures for nonqualified deferred compensation plans subject to 409A. In 2008, the IRS issued a correction program for certain operational failures affecting plans subject to 409A under [Notice 2008-113](#). Because 409A violations can stem from either operational failures and/or by having non-compliant plan documents, the plan document correction program under Notice 2010-6 represents an opportunity to avoid the harsh penalties that could otherwise apply under 409A if there are inadvertent and unintentional plan document failures.

What can be the consequences of failing to comply with 409A?

The negative consequences for failing to comply with 409A can be quite severe and can result in an acceleration of income of amounts intended to be deferred and the imposition of an excise tax of 20%, assessed on the service provider, over and above the income tax owed. In addition, penalties and premium interest charges may also apply and states may impose their own additional tax on the service provider for 409A violations. Employers could also be assessed for failure to properly report and withhold taxes. The Notice 2010-6 correction program encourages employers to voluntarily correct non-conforming provisions that are eligible for correction in order to avoid or mitigate those harsh consequences.

What are some of the general principles of the Notice 2010-6 correction program?

An employer must generally take commercially reasonable steps to identify all other plans subject to 409A that have plan document failures substantially similar to the document failure initially identified, and correct all of the failures in a manner consistent with the program. Generally speaking, Notice 2010-6 is not available if either the service provider or service recipient's tax return is under examination with respect to nonqualified deferred compensation for an tax years in which the document failure occurred. Notice 2010-6 also states, without much elaboration, that relief is not available under the program for document failures involving stock rights (e.g., stock options) or "linked plans" (e.g., excess benefit plans).

The employer must comply with the specific correction procedures outlined in Notice 2010-6 for each type of document failure being corrected. Those procedures may involve including in the affected employee's income a specific percentage of the compensation deferred under the plan that is attributable to the failure and the employee paying the 20% penalty on that includible amount. In addition, the employer must generally prepare and timely provide notices to both the IRS and the service provider reporting information about the failure and its correction under Notice 2010-6.

Is there an incentive to identify and correct plan document failures before 2011?

Yes. Plans that are corrected in accordance with Notice 2010-6 before 2011 may be treated as having been corrected on January 1, 2009 which can mean that any requirement of income inclusion under 409A as a condition of the relief (as mentioned in the preceding paragraph) would generally not apply. However, if there are operational failures with respect to the corrected plan before December 31, 2010, the operational failures must be corrected under Notice 2008-113. More generally, there is time sensitivity to making plan corrections because the level of relief afforded under Notice 2010-6 can be based on whether or not the correction of the failure affects the operation of the plan within one year following the date of correction.

What types of plan document failures are eligible for correction under the program?

Some examples are shown in the following:

- Impermissible definitions of an otherwise permissible 409A-payment event (such as "separation from service", "change in control" or "disability");
- Impermissible discretion with respect to payment schedules following a permissible 409A-payment event (for example, providing for a payment conditioned on the employee tendering a release of

claims in which either the delivery of the release is not time limited or the timing of the release's delivery affects the timing of the payment);

- Impermissible payment periods following a permissible 409A-payment event;
- Impermissible payment events and payment schedules;
- Impermissible discretion to accelerating payment events; and
- Failure to include the six-month delay rule provision for nonqualified deferred compensation payments to "specified employees".

Summary

409A is a wide-ranging law and its [final regulations](#) are complex and intricate. Notice 2010-6 provides one more opportunity to correct nonqualified deferred compensation documents so that they comply with 409A and potentially avoid 409A's harsh treatment for violations. Therefore, implementing any needed corrections should be done sooner rather than later and ideally before 2011.

If you have any questions regarding this information, please contact [Greg Schick](#) at (415) 774-2988 or [Michael Chan](#) at (213) 617-5537.

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