

Client Alert.

December 22, 2010

IRS Expands Section 409A Relief with Notice 2010-80

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On November 30, 2010, the Internal Revenue Service issued [Notice 2010-80](#), which modifies its prior [Notice 2010-6](#) (generally providing transitional relief for documentary corrections under Internal Revenue Code Section 409A ("Section 409A")) and [Notice 2008-113](#) (providing for operational corrections under Section 409A) to expand the relief and reduce the reporting requirements under such Notices. (For detailed background information, please see the Morrison & Foerster client alerts regarding [Notice 2010-6](#) and [Notice 2008-113](#).) In particular, Notice 2010-80 provides for: (i) an expansion of the types of compensation arrangements eligible for correction under Notice 2010-6; (ii) guidance and transitional relief regarding compensation arrangements that require the recipient to execute a release or other agreement to receive payment; and (iii) reduced informational and reporting requirements with respect to certain corrections.

REDUCED INFORMATIONAL AND REPORTING REQUIREMENTS

First, Notice 2010-80 provides relief by reducing the informational and reporting requirements originally set forth in Notice 2010-6 and Notice 2008-113.

Previously, companies wishing to take advantage of documentary corrections under Notice 2010-6 were required to attach information regarding such corrections to their corporate tax returns and to provide statements regarding the corrections to affected employees. In addition, the affected employees were required to attach copies of such statements to their personal income tax returns. While companies are still required to include the information with their corporate tax returns, Notice 2010-80 eliminates the requirements that employees be furnished with statements and that such statements be included with employees' personal income tax returns for corrections made during 2010 under Notice 2010-6.

In addition, companies wishing to make operational corrections pursuant to Notice 2008-113 have been required to provide information on their corporate tax returns regarding the corrections and to provide affected employees with statements regarding the corrections. While these requirements generally remain in effect, Notice 2010-80 eliminates the requirement of providing employee statements when operational corrections are made within the same taxable year that the failure occurs.

COMPENSATION ARRANGEMENTS THAT REQUIRE EXECUTION OF A RELEASE OR OTHER AGREEMENT

Perhaps most significantly, Notice 2010-80 provides valuable guidance and transitional relief pertaining to compensation arrangements in which payment is conditioned upon the employee's execution of an agreement such as a release, noncompetition agreement, or nonsolicitation agreement. Where the payment date depends upon the date on which the employee executes the required release, a Section 409A violation may occur because the employee impermissibly controls the timing of the deferred payment. The IRS highlighted this potential violation in Notice 2010-6, providing strict limits on the manner in which such arrangements could be structured without violating Section 409A. Notice 2010-80 provides more flexibility in this context, as well as transitional relief with respect to such arrangements.

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Notice 2010-80 provides that payments conditioned upon execution of a release (or other agreement) will not violate Section 409A if the employee is prevented from controlling the timing of the payment through certain prescribed means. First, if an arrangement provides for payment (conditioned upon execution of a release) within a specified payment period that is a permissible payment period under Treasury Regulation section 1.409A-3(b), then the arrangement may comply with Section 409A if amended (i) to provide that the payment must be made, if at all, on the last day of the specified period or (ii) if the period covers two taxable years, that the payment must be made, if at all, in the second taxable year (regardless of when the release is executed). Alternatively, if an arrangement does not provide for payment within a specified period, the arrangement may comply with Section 409A by providing that the payment will be made, if at all, (x) on a fixed date either 60 or 90 days following the occurrence of a permissible payment event or (y) during a specified period no more than 90 days following a permissible payment event, provided that if such period covers two taxable years, the payment must be made in the second taxable year.

Notice 2010-80 also offers transitional relief with respect to non-compliant compensation arrangements requiring the execution of a release or other agreement that are in place on or before December 31, 2010. (It is worth noting here that this includes arrangements in which additional employees begin participating after December 31, 2010, so long as the terms of the arrangement – including those allowing participation by the additional employees – were in place as of December 31, 2010.) From an operational perspective, this transitional relief provides that any such payments made on or before March 31, 2011 will not be treated as violating Section 409A. After March 31, 2011, payments must be made in the second taxable year where a payment period covers two taxable years, or else such payments will be treated as operational failures and must be corrected in accordance with Notice 2008-113. From a documentary perspective, such payment arrangements will not be treated as violating Section 409A through December 31, 2012. Where any amounts under such arrangements will remain deferred after December 31, 2012 (other than remaining installments, annuities or other payments of an amount that has already become payable pursuant to the arrangement), the arrangement must be corrected by December 31, 2012 to avoid penalties under Section 409A.

CLARIFICATION AND EXPANSION OF ARRANGEMENTS ELIGIBLE FOR DOCUMENTARY CORRECTIONS UNDER NOTICE 2010-6

Finally, Notice 2010-80 provides clarification regarding the eligibility of linked plans (nonqualified plans linked with qualified plans) for documentary corrections under Notice 2010-6. While linked plans are generally not eligible for relief under Notice 2010-6, Notice 2010-80 clarifies that an arrangement is not disqualified for such relief simply because the amount paid under one arrangement is affected by the amount paid under the other. Thus, such plans may be eligible for documentary corrections under Notice 2010-6 as long as the time and form of payments under one arrangement is not affected by the amount deferred under (or the payment provisions of) the other arrangement.

Notice 2010-80 also expands the scope of Notice 2010-6 to include non-qualified stock options (“NSOs”) and stock appreciation rights (“SARs”) among the compensation arrangements eligible for corrections under Notice 2010-6. Pursuant to Notice 2010-80, NSOs and SARs with documentary failures under Section 409A may be corrected under Notice 2010-6 if they were intended to comply with (and be subject to) the requirements of Section 409A. To qualify, such NSOs or SARs must be structured such that they may be exercised (i) only upon a fixed date or within a period limited to one taxable year or (ii) upon a permissible payment event under Section 409A, as set forth in Treasury Regulation section 1.409A-3(a).

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EFFECTIVE DATES AND ACTION ITEMS

Notice 2010-80 provides that taxpayers may rely on its amendments to Notice 2008-113 for taxable years beginning with January 1, 2010, and on its amendments to Notice 2010-6 for taxable years beginning with January 1, 2009.

Companies would be well advised to review their compensation arrangements in light of this new guidance and transitional relief and to consult counsel as needed. In particular, it should be noted again that the transitional relief under Notice 2010-6 is generally only available for documentary corrections made on or before December 31, 2010.

If you have any questions, contact your Morrison & Foerster attorney or any member of the Employee Benefits and Executive Compensation Group.

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