Section 409A Again? Employers Need to Re-examine Executive Employment Contracts and Other Agreements Conditioning Severence Payments Upon a Release of Claims

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Agreements that provide for payments upon termination of employment, such as employment agreements, retention agreements, severance agreements and change in control agreements, often condition payment upon the return of an executed release of claims. Since Section 409A allows agreements to provide for a payment window of up to 90 days from separation from service, it was widely believed that an agreement could provide for payments to begin upon the return of a release, provided the release was required to be returned within the 90-day window period and the company determined the time of payment. In Notice 2010-6, the IRS stated that this type of provision is not Section 409A compliant. Fortunately, at the end of last year, the IRS came out with relief that will allow companies to correct this problem without employees incurring Section 409A taxation.

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Action Step

Companies should immediately identify all employment agreements, retention agreements, severance agreements and change in control agreements that condition severance payments upon the return of a release. All of these agreements should be reviewed for Section 409A compliance based on the new guidance from the IRS. Companies should not rely on the fact that the agreements were previously reviewed for Section 409A compliance, since the 2010 guidance from the IRS was not anticipated by most practitioners. Companies should pay careful attention to the timing of payments made under impacted agreements during 2011, as payments made after March 31, 2011 must comply with the corrective guidance contained in Notice 2010-80. Further, any impacted agreements that are outstanding or have any payments still due after December 31, 2012, must be amended to correct the agreement provisions in accordance with Notice 2010-80 no later than December 31, 2012.

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