



IRS Provides Section 409A Correction Program for Certain Document Failures

The IRS has issued Notice 2010-6, providing formal guidance on correcting certain document failures under Internal Revenue Code Section 409A. The correction procedures outlined are available for tax years beginning on or after January 1, 2009.

Background

Section 409A provides a complex set of requirements for various nonqualified deferred compensation arrangements that must be complied with in both form and operation. It imposes significant tax penalties on employees for noncompliance, including current income inclusion, an additional 20% income tax, and interest. In late 2008, the IRS issued Notice 2008-113, which provides correction procedures for certain operational failures under Section 409A. (See our May 27, 2009 [For Your Information](#).) The IRS has now issued Notice 2010-6, which primarily addresses errors resulting from noncompliant plan documentation, i.e., document failures.

BUCK COMMENT. *While the notice and Section 409A refer to service recipients and service providers, this For Your Information refers instead to employers and employees, respectively.*

Notice 2010-6

[Notice 2010-6](#) is intended to provide relief to employers who have inadvertently or unintentionally failed to comply with the written document requirements under Section 409A and related regulations. The IRS indicates that the relief is not available when an employer's pattern of interpretation or application of plan provisions would clearly indicate Section 409A violations. Although Notice 2008-113 remains in effect for operational failures, the IRS makes certain modifications to it.

BUCK COMMENT. *Even in the absence of Notice 2010-6, an employer may at any time amend provisions for benefits that have not yet accrued, but the amendment will only protect benefits that accrue after the effective date of the amendment.*

Requirements for Relief

Relief under Notice 2010-6 is only available to employers who meet the specified general requirements, the requirements for a particular failure, and the reporting requirements, all as set forth in the notice.

Generally, the correction procedures are not available for employees and certain employers if a federal income tax return of the employee or employer is under examination with respect to nonqualified deferred compensation for any taxable year in which the failure existed. The IRS clarifies that an individual employee is treated as under examination for this purpose if the employee is under examination with respect to his or her federal income tax return. Employers or other taxpayers are treated as under examination if they have been notified in writing that nonqualified deferred compensation is under examination. Further, the correction procedures are not available for failures directly or indirectly related to participation in any “listed transaction,” i.e., a transaction specifically identified by the IRS as a tax avoidance transaction under regulation section 1.6011-4(b)(2). The notice confirms that the plan aggregation rules otherwise applicable under Section 409A do not apply to the document requirements. However, the relief provided is generally conditioned on the employer’s taking “commercially reasonable steps” to identify and correct all substantially similar document failures in its other nonqualified deferred compensation plans.

An entire section of Notice 2010-6 is devoted to the detailed information and reporting requirements that must be satisfied by both the employer and the employee in connection with the correction of a document failure.

Specific Document Failures and Correction Methods

In the notice, the IRS specifies the following six types of document failures that an employer may correct –

- an ambiguous plan term providing for a payment “as soon as practicable” (or similar language) or a permissible payment event with no definition or an ambiguous definition (e.g., termination of employment)
- an impermissible definition of separation from service, change in control event, or disability
- an impermissible payment period following a permissible payment event
- an impermissible payment event and/or payment schedule
- a failure to include the six-month delay of payment for specified employees
- an impermissible initial or subsequent deferral election provision.

For each type of document failure, applicable correction methods are set forth in detail and generally require an amendment of the impermissible plan provision. The amendments must generally be effective immediately. Penalties vary by the type of error, and in some cases no penalties apply. For example, in many cases, if an event occurs prior to the first anniversary of the corrective amendment that would have required (or prohibited) a payment due to the impermissible pre-correction plan provision, the employee must include in income in the year the event occurs 50 percent (or 25 percent in the case of an impermissible definition of a change in control event) of the amount deferred to which the pre-correction provision applies. In addition the employee will be subject the additional 20 percent tax on that amount, but not the premium interest tax.

BUCK COMMENT. *Importantly, the notice does not generally provide relief for plans linked to other deferred compensation plans for the above document failures except as provided in the transition relief below.*

In specified cases (e.g., certain ambiguous plan terms or an impermissible definition of disability), the plan may be amended at any time. However, if a benefit is paid from the plan based on an ambiguous or impermissible plan provision, the failure is deemed an operational failure (rather than a document failure), which may or may not qualify for correction under Notice 2008-113.

The notice describes specific instances of document failures within each of the six types noted above and the applicable correction procedure, and provides illustrative examples. The guidance and relief is limited to those described failures. The IRS requests comments by April 5, 2010 regarding other common document failures and methods to correct them.

Amendments to New Nonqualified Deferred Compensation Plan

Notice 2010-6 provides a special correction timing rule for a document failure in a newly adopted nonqualified deferred compensation plan that would not be aggregated with any existing nonqualified deferred compensation plan maintained by the employer. For example, an employer that first adopts a nonaccount nonqualified deferred compensation plan with a document failure eligible for correction under Notice 2010-6 could correct it by the later of the end of the calendar year in which a legally binding right to deferred compensation arose under the plan or the 15th day of the third calendar month following the date the first legally binding right to deferred compensation arose under the plan. In this case, Notice 2010-6 could be applied without requiring the employee to include an amount in income if certain events occur prior to the first anniversary of the date of correction. If, however, a payment is made based on the provision before the plan is amended to correct it, the payment would be treated as an operational failure and must be corrected under Notice 2008-113.

Transition Relief

The relief for the six types of document failures described in the notice is available any time, but Notice 2010-6 provides special transition relief if these failures are addressed in 2010. Thus, if a plan is corrected for one of the specified document failures on or before December 31, 2010, the plan may be treated as having been corrected on January 1, 2009, and any required income inclusion as a condition of relief will not apply. Under the transition relief, if a payment made pursuant to a defective plan provision before December 31, 2010 would not have been made under the provision as corrected, the payment must be treated as an operational failure and corrected under Notice 2008-113 on or before December 31, 2010. Similarly, if a payment is not made because of a defective provision before December 31, 2010 but would have been made under the provision as corrected, the

failure to make the payment must be treated as an operational failure and corrected under Notice 2008-113 on or before December 31, 2010.

Linked Plans. The notice provides a limited period ending on December 31, 2011 during which impermissible provisions linking nonqualified deferred compensation plans (which are explicitly excluded from other relief outlined in Notice 2010-6) may be corrected. Impermissible provisions in this context occur when the amount deferred or the time and form of payment under one plan affects the amount deferred or time and form of payment in another plan such that one or both plans fail to satisfy the requirements of Section 409A. If any amounts are paid under one or more of the linked plans in a manner inconsistent with the amended payment provisions, the payments must be treated as operational failures and corrected under Notice 2008-113 on or before December 31, 2011. This extended deadline also applies to the correction of fixed payment schedules, which are not covered by the relief that permits correction at any time.

Modifications to Notice 2008-113

Notice 2010-6 also includes several modifications to Notice 2008-113 relating to operational failures. Specifically, the IRS adds provisions on required repayments by an employee and how to calculate an amount erroneously paid or deferred. It also clarifies that an “excess deferred amount” exists not only when an amount that should not have been deferred is erroneously credited to an employee’s deferral account, but also when an amount that should have been paid to an employee under the plan is not paid.

Conclusion

Notice 2010-6 provides significant relief and correction opportunities to employers and employees who have inadvertent plan document errors under nonqualified deferred compensation arrangements. Although many employers put forth a significant effort to have their plans comply with Section 409A, it is possible that one or more of these defects may exist in one of their nonqualified plans or arrangements. Employers should take advantage of this opportunity and review their arrangements to address any potential document defects that may exist.

Buck’s consultants are available to help you review your nonqualified plans and arrangements and apply, if necessary, the new correction methods, including evaluating correction eligibility and preparing information statements and amended tax reporting forms.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.