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IRS Modifies Section 409A Correction Programs

The IRS has issued Notice 2010-80 which modifies the Section 409A corrections procedures set forth in IRS Notices 2008-113 (addressing operational corrections) and 2010-6 (addressing document correction). Notice 2010-80 expands the Notice 2010-6 document correction program to cover certain linked plans and certain stock rights. For the relief to apply, corrections to the linked plans and for these stock rights must be made by December 31, 2010. However, Notice 2010-80 provides an extension of the relief until December 31, 2012 to correct document errors resulting from a plan tying the date of a distribution on a separation from service to an employee's signing of a waiver of claims.

Background

Section 409A of the Internal Revenue Code of 1986 (Code) generally governs the tax treatment of nonqualified deferred compensation arrangements. Section 409A governs the timing of initial and subsequent deferral elections, when and how distribution elections may be made and changed, what distribution events are permitted, and when payments may be accelerated. Failing to satisfy Section 409A results in the individual providing the services (i.e., a service provider such as an employee) being immediately taxable on the deferred amounts and being subject to an excise tax of 20% and interest on the deferred amount from the date of deferral.

In April 2007, the IRS issued final regulations regarding the application of Section 409A for tax years beginning on or after January 1, 2009. In December 2007, the IRS issued [Notice 2007-100](#) which provided relief for certain operational errors made and corrected during the same tax year, as well as for certain *de minimis* errors that were corrected no later than the end of the second tax year following the year of error.

In December 2008, the IRS issued [Notice 2008-113](#) which provides a correction program for operational failures of Section 409A and supersedes Notice 2007-100 for tax years beginning January 1, 2009. (See our May 27, 2009 [For Your Information](#).) In January 2010, the IRS issued [Notice 2010-6](#), which provides retroactive relief for inadvertent or unintentional failures to comply with the written document requirements of Section 409A if the document correction takes place by December 31, 2010. (See our February 4, 2010 [For Your Information](#).)

Notice 2010-80

On November 30, 2010, the IRS issued [Notice 2010-80](#), which modifies the correction procedures set forth in Notices 2008-113 and 2010-6. Notice 2010-80 expands Notice 2010-6 to cover additional "linked" plans and certain stock rights, provides for an additional method of correction and transition relief under Notice 2010-6 for

payments relating to separations from service where an employee waiver or other action is required before distribution, and modifies the information reporting requirements under Notices 2010-6 and 2008-113.

Relief for Linked Plans and Stock Rights

Notice 2010-6 did not provide general retroactive document correction relief for correction of a nonqualified plan “linked” to a qualified plan or a nonqualified plan “linked” to another nonqualified plan. Plans are linked if the amount, timing, or form of benefit paid by one plan is affected by the other plan. Notice 2010-6 did include a narrow, special correction rule for two linked nonqualified plans if the Section 409A failure was due to the amount deferred or the time or form of payment being affected by another nonqualified plan. Service recipients (e.g., employers) could correct the problem by amending the plan documents to make their terms match.

Notice 2010-80 expands the types of linked plans that service recipients can correct under the general document correction rules to include a nonqualified plan linked with either another nonqualified plan or with a qualified plan. However, relief is provided only if the linkage affects the amount paid but does not affect the time and form of payments. Because the relief under Notice 2010-80 for these linked plans and for these stock rights is an expansion of the relief under Notice 2010-6, the service recipient must correct the document by December 31, 2010.

Notice 2010-6 excluded all stock rights from its coverage. Notice 2010-80 provides that if a stock right that is either a stock option or stock appreciation right was intended at the time of grant or modification to be subject to and compliant with Section 409A, a service recipient can correct the plan document failure under the relief rules of Notice 2010-6. Service recipients must make these document corrections by December 31, 2010.

BUCK COMMENT. *The document relief is conditioned on all legal requirements for adoption being satisfied by December 31, 2010.*

Payments at Separation of Service with Timing Conditioned on Employee Action

Some service recipients conditioned payment as a result of a separation from service on an action of the service provider (e.g., the employee) such as signing a noncompetition agreement, a non-solicitation agreement, or a waiver releasing claims. In Notice 2010-6, the IRS takes the position that by conditioning distribution on this type of service-provider action, the service provider could impermissibly control the timing of the distribution (including in some cases the calendar year of the distribution). Notice 2010-6 provides relief as long as the correction is made before the date an event occurs that is a permissible payment event under Section 409A. If a plan provides for payment within a permissible designated period, Notice 2010-6 requires a corrective amendment that sets the last day of the permissible designated period as the payment date. If the plan does not provide for payment within a permissible designated period, Notice 2010-6 requires the corrective amendment to provide for payment upon a fixed date either 60 or 90 days following the payment event.

Notice 2010-80 provides an additional correction method under which the service recipient may correct the failure in either situation by providing for payment during any specified period not to exceed 90 days from the payment event. However, if the specified period begins in one taxable year (of the service provider) and ends in the subsequent year, the amendment must also provide that payment will be made in the subsequent taxable year.

Transition Relief. If a provision was eligible for correction on or before December 31, 2010, the IRS will not treat the plan as failing to satisfy Section 409A either in form or operation if:

- Any amount deferred is paid on or before March 31, 2011;
- In the case of any deferred amount paid after March 31, 2011, where the potential payment period begins in one year and ends in the subsequent year, the deferred amount –
 - Is paid in the subsequent year, or
 - Is treated as an operational failure and corrected in accordance with Notice 2008-113;
- If any amount remains deferred after December 31, 2012 (other than remaining installments or periodic annuity payments of amounts that have become payable), the service recipient has corrected the plan provision on or before December 31, 2012.

BUCK COMMENT. *The IRS position that Section 409A was violated by conditioning the timing of the distribution on receipt of an employer signed waiver surprised many practitioners because, until the correction program relief, the IRS had never indicated this was a problem. The transition relief provides time to correct these situations.*

Modified Information and Reporting Requirements

Notice 2010-6 generally requires a service recipient who is in the document correction program to provide a statement to all participants in the plan with information regarding the plan document error that is corrected. Participants must then attach the statement to their federal income tax returns. Notice 2010-80 eliminates these requirements with respect to timely document corrections under the transition relief of Notice 2010-6 for corrections made on or before December 31, 2010. Notice 2010-80 also provides the reporting relief for corrections in accordance with the transition rules (discussed above) tied to failures because separation was dependent on the service provider having to complete a waiver or take a similar action the timing of which the service provider could control. In addition, Notice 2010-80 eliminates the requirements that service recipients provide information statements to service providers and service providers attach information statements to their tax returns for operational errors that are corrected in the year of the operational failure.

BUCK COMMENT. *Nothing in this section eliminates the obligation of the service recipient to include the information with its tax return.*

Conclusion

The Treasury Department and IRS continue to analyze the comments to its Section 409A guidance and have said they anticipate issuing further corrections guidance in the future.

Buck's consultants are available to help you with any questions you may have and with any corrections to your deferred compensation programs.

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.