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Navigating the Executive Benefits Landscape
with The Todd Organization

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IRS Opens Window for Fixing Errors in Deferred Compensation Plans; 409A Corrections Due December 31

After much anticipation, the Internal Revenue Service issued rules and regulations on January 5 (IRS Notice 2010-6) for how companies can voluntarily correct unintended errors in deferred compensation plans. This offers an important opportunity for many companies to correct errors that may exist in their plans, while avoiding stiff penalties that would otherwise be assessed.

Background

Section 409A became part of the tax code in conjunction with enactment of the American Jobs Creation Act of 2004. It established a framework by which companies could institute non-qualified deferred compensation plans, which are important for retaining and attracting quality high performing employees. The Act provided a set of rules governing plan design and related issues.

However, there are severe consequences if the 409A requirements are not met. The income deferred that is later determined to be taxable is subject to a 20 percent additional tax and an interest tax penalty.

The Treasury Department and IRS issued regulations under Section 409A on April 17, 2007. On December 3, 2008, the Treasury Department and IRS issued Notice 2008-113, setting forth guidance to correct certain operational failures. Notice 2008-113 also requested comments with respect to potential guidance permitting the correction of "document failures." IRS Notice 2010-6 addresses the concerns raised and remedies put forth.

The New Regulations

In Notice 2010-6 the IRS says:

> "This notice provides methods for taxpayers to voluntarily correct many types of failures to comply with the document requirements applicable under § 409A of the Internal Revenue Code (Code) to non-qualified deferred compensation plans and thereby avoid or reduce the current income inclusion and additional taxes

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> under § 409A. This document correction program is intended to encourage taxpayers to review non-qualified deferred compensation plans to identify provisions that fail to comply with the requirements of § 409A and § 1.409A-1(c) of the Income Tax Regulations (a document failure), and to correct those plan provisions promptly…"

In the 85 page document, the IRS discusses a wide variety of provisions and scenarios where corrections may be needed. These include:

- impermissible payment periods
- impermissible payment events and schedules
- failure to include a six-month payment delay for specified employees
- impermissible initial deferral elections

Regarding the correction of document failures in the Notice, section XI of IRS Notice 2010-6 notes that allowable corrections made by December 31, 2010, will be treated as having been corrected on January 1, 2009, thus negating potential penalties. There are, however, a handful of additional transition rules for certain linked plans and certain fixed payout schedules, where changes can be made until December 31, 2011. The letter and spirit of the Notice send a clear message however: act now.

To view the full document, including many examples of situations that need correction, click here: http://www.irs.gov/irb/2010-03_IRB/ar08.html#d0e618.

Next Steps

Timely action during 2010 will help ensure that many companies' deferred compensation plans are 409A compliant, avoiding potential problems from a cost, administrative, and personnel standpoint. Many companies should use this opportunity to carefully review their non-qualified deferred compensation plans.

The Todd Organization has numerous experts available to help companies address these matters. Please contact your Todd representative.

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