

To: Our Clients and Friends

January 22, 2010

IRS Announces New Section 409A Document Correction Program

Section 409A of the Internal Revenue Code of 1986, as amended (“Code Section 409A”) is spectacular in scope and notoriously difficult for even the most well-intentioned employers to satisfy. Any employer which maintains non-qualified deferred compensation plans for its employees has struggled with Code Section 409A, and may have concerns that some of its plans might not satisfy the attention to minutiae that Code Section 409A demands. Fortunately, the IRS appears to understand the difficulty many employers have had in complying with Code Section 409A.

On January 4, the IRS published its long-awaited program for correcting documentation failures under Code Section 409A. This guidance, set forth in [Notice 2010-6](#), is broad-reaching, and provides helpful relief for a wide variety of documentation errors. Moreover, most of the correction procedures described in the guidance are, unlike most Code Section 409A guidance, relatively easy to understand and implement. In order to minimize the likelihood of correction penalties under the Notice, employers and plan sponsors should actively review their non-qualified deferred compensation programs and take swift, comprehensive action before December 31, 2010 to correct any deficiencies.

Notice 2010-6 is broken into two component sections. First, Notice 2010-6 explains that certain ambiguous plan terms will not be deemed to violate Code Section 409A. Second, Notice 2010-6 lists several specific types of document failures, and describes applicable correction procedures for each.

Ambiguous Plan Terms

Code Section 409A generally permits payment of deferred compensation at a fixed time or on a fixed schedule following a permissible triggering event. Historically, many plans were drafted so that payment occurs “as soon as practicable” following a payment event. Technically, the “as soon as practicable” language could be construed as violating Code Section 409A’s fixed time or fixed schedule payment requirement.

Notice 2010-6 clarifies that if a plan requires payment “as soon as practicable” (or uses similar language) following an otherwise permissible payment event, the fixed date of payment for Code Section 409A purposes will be the date of the payment event. In order to satisfy Code Section 409A,

any such payment due on the date of the payment event will, in operation, be considered timely paid if payments are made or begin by the later of the end of the calendar year in which the payment event occurs or two and one-half months following the payment event.

Notice 2010-6 also clarifies that ambiguous definitions of payment events in plan documents will not result in document failure. For example, a plan provision that calls for payment upon a termination of employment instead of upon a defined Code Section 409A "separation from service" will not result in a document failure. However, if the plan provision or similar provisions in other plans have been interpreted or administered in a manner that would violate Code Section 409A, the plan provision will be treated as causing a document failure. However, any resulting document error may be correctable, as described below.

Correctable Document Failures

Notice 2010-6 provides specific correction procedures for certain types of document failures. A few general principles govern all corrections:

- **Plan Amendment.** Most of the corrections described below require amending the plan to remove the provision that violates Code Section 409A. Generally, such amendment must occur prior to triggering or utilizing the impermissible provision.
- **Income Inclusion.** Certain corrections described below require income inclusion of 25 or 50% of a the amount that is subject to the non-compliant plan provision. With a few exceptions, income inclusion is required only if the non-compliant provisions would have been evoked within one year of the correction. In addition, an individual may not be subject to income tax inclusion if the documentary failure is corrected in accordance with Notice 2010-6 shortly after adoption of the plan with the non-compliant provision if certain conditions are met. While income inclusion requires subjecting affected amounts to the 20% additional income tax under Code Section 409A, the included amounts are generally not subject to interest penalties. Any amounts included as a result of the corrections are subject to special income tax reporting requirements.
- **Transitional Relief.** Any failure corrected on or before December 31, 2010 will be treated as corrected on January 1, 2009, provided that any payments before December 31, 2010 that were either improperly paid or not paid under the plan's post-correction plan terms are treated as an operational failure and corrected under the IRS's Code Section 409A operational failure guidance described in Notice 2008-113 (described in our [previous bulletin](#)). As a result of this transitional rule, many corrections that would otherwise require income inclusion may be corrected during 2010 without significant consequence for plan participants. In addition, many document failures that are not otherwise available for correction may be corrected in 2010.
- **Only Inadvertent Failures.** Intentional failures may not be corrected under the guidance.
- **Correct Similar Document Failures.** Plan sponsors must take all commercially reasonable steps to identify and correct all other document failures that are substantially similar to the failure corrected under the guidance.

- **Not Under Examination.** With a few exceptions, corrections are unavailable if either the plan sponsor or participant is under examination by the IRS with respect to non-qualified deferred compensation.
- **No Linked or Stock Rights Plans.** The correction procedures described below are not available for stock rights plans or plans where the timing or amount of payment are linked to other qualified or non-qualified deferred compensation plans. However, certain linked plans failures may be corrected on or before December 31, 2011.
- **Reporting Requirements.** Plan sponsors that make corrections under Notice 2010-6 are subject to special reporting requirements.

The following plan document failures may be corrected under Notice 2010-6:

- **Impermissible Definitions of Separation from Service, Change in Control, or Disability.** Code Section 409A generally allows for payments upon a separation from service, change in control, or upon disability, each of which is defined under Code Section 409A. The correction for a plan provision that calls for payment upon an impermissibly defined separation from service, change in control, or disability is generally to amend the plan to provide for payment upon a permissibly defined event. A plan provision that calls for payment upon an impermissibly defined disability may also be amended to remove disability as a payment trigger.
- **Payment or Commencement Periods of Longer than 90 Days.** Code Section 409A generally allows a plan sponsor to retain discretion to pay or commence payment of an amount at any time within 90 days following a permissible payment event, provided that the plan participant does not have the right to designate the year of payment if the 90 day period spans two years. The applicable correction for a payment period of longer than 90 days is to either remove the non-compliant payment or commencement period or to set forth a Code Section 409A compliant payment or commencement period.
- **Impermissible Release Provision Delays.** Code Section 409A generally prohibits conditioning the otherwise compliant payment of deferred compensation upon the execution of employment releases, non-competition agreements, or similar employment related agreements when the employee's return of the agreement determines the timing of the payment. Any such non-compliant plan provision may be corrected by removing an employee's discretion to delay or accelerate the timing of the payment by manipulating the timing of the return of the employment related agreement. Correction may also require providing that payment condition upon return of a release will be made only at the end of a specified period of time following the Code Section 409A payment triggering event.
- **Plans with Both Permissible and Impermissible Payment Events.** A plan provision that calls for the payment of an amount upon both compliant and non-compliant Code Section 409A triggering events can be corrected by removing the impermissible payment events. This correction is unavailable for impermissible payment events that occur at the discretion of the plan sponsor (e.g. non-compliant plan termination and liquidation) or plan participant (e.g. a "haircut" withdrawal).
- **Plans with Only Impermissible Payment Events.** A provision that calls for the payment of an amount only upon non-compliant Code Section 409A triggering events can be corrected by replacing

the non-compliant provisions with a provision providing for payment upon the later of separation from service or the sixth anniversary of the correction.

- **Alternative Payment Schedules.** With certain exceptions, Code Section 409A prohibits different times and forms of payment for a single type of triggering event. A failure related to this rule can be corrected by removing all forms of payment other than the form with the latest final payment date. However, if payments are made in different forms following voluntary and involuntary separation from service, the corrected form of payment must be in the form provided following an involuntary separation from service.
- **Discretion to Modify a Payment Schedule.** Code Section 409A generally prohibits allowing either a plan sponsor or plan participant discretion to change the form of payment of deferred compensation once the form is fixed. A plan provision that provides for this impermissible discretion can be corrected by removing discretion to modify the form of payment and either reverting to the default form of payment or, if no default form exists, reverting to the form with the latest final payment date.
- **Discretion to Accelerate Payment Events.** Code Section 409A generally prohibits a plan sponsor from retaining discretion to accelerate an otherwise Code Section 409A-compliant payment. A plan provision that provides for such acceleration discretion can be corrected by removing the discretion to accelerate the payment.
- **Impermissible Reimbursements or In-Kind Benefits.** Generally, certain reimbursements and in-kind employee benefits are subject to Code Section 409A. Code Section 409A prohibits the payment or provision of these reimbursements or in-kind benefits unless certain conditions are met. A plan provision that does not satisfy Code Section 409A's reimbursement rules can be amended to comply with Code Section 409A.
- **Failure to Include Six Month Delay for Certain Public Corporation Employees.** Code Section 409A generally requires that payments to certain public corporation employees be delayed six months following separation from service. Failure to include a provision that implements this delay may be corrected by adding a provision that delays payments to specified employees upon separation from service until the later of 18 months following the correction or six months following the separation from service.
- **Impermissible Initial Deferral Elections.** Code Section 409A contains a number of rules that restrict the timing of initial participant elections as to either the amount of compensation deferred or the time and form of payment of the compensation. Under Notice 2010-6, a plan is not considered to violate Code Section 409A if an impermissible initial deferral election provision has never been applied with respect to the plan participant. However, if the impermissible initial deferral election provision has been applied with respect to a plan participant, the provision can be corrected by removing the ability to make the impermissible initial deferral election and correcting any resulting operational failures under Notice 2008-113.
- **Improper Commission Payments.** Code Section 409A generally prohibits conditioning the timing of plan payments upon the plan sponsor's receipt of an amount from a third party (e.g., commission payments) unless certain requirements are met. A non-compliant plan commission provision may be amended to satisfy these requirements, but only if the plan is amended on or before December 31,

2011 and any payments under the non-compliant plan term that would not have been paid if the plan term was corrected on January 1, 2009 are corrected using Notice 2008-113.

Notice 2010-6 is welcome news for companies that have struggled with Code Section 409A compliance. For many non-qualified deferred compensation plan sponsors, Notice 2010-6 presents a path to documentary compliance with few, if any, significant consequences for plan participants. In order to take full advantage of the documentary compliance program, plan sponsors should take swift action to review their non-qualified deferred compensation offerings and correct any deficiencies they uncover.

Please feel free to contact any member of the Bryan Cave LLP Employee Benefits and Executive Compensation Group listed below if you require assistance or have any questions regarding the information contained in this Bulletin.

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