Proskauer

IRS Relief and Voluntary Correction Program for Certain??Section 409A Document Failures

January 14, 2010

On January 5, 2010, the Internal Revenue Service issued Notice 2010-6, which permits employers[1] to correct certain plan document failures of a nonqualified deferred compensation plan[2] to comply with Section 409A of the Internal Revenue Code (hereinafter, "409A") and provides certain substantive guidance on 409A compliance. Taxpayers may rely on Notice 2010-6 for taxable years beginning after January 1, 2009. Unlike Notice 2008-113, which addresses the correction of certain operational failures under 409A and remains in effect, Notice 2010-6 primarily addresses the correction of inadvertent and unintentional plan document failures and provides relief limiting the amount currently includible in income and the additional taxes (*i.e.*, 20% tax plus premium interest) under 409A for certain document failures that are properly corrected. Notice 2010-6 also clarifies certain aspects of Notice 2008-113 regarding certain operational failures.

Importantly, Notice 2010-6 includes a transition rule whereby certain 409A plan document failures may be corrected by December 31, 2010 without having to pay any 409A tax or penalty. Therefore, employers should review Notice 2010-6 carefully and determine whether any plan document correction is necessary. Employers are also well-advised to review operational compliance. Often, 409A plan document failures result in operational errors correctible under Notice 2008-113. Additionally, employers should remember that Notice 2010-6 does not limit the availability of alternative correction techniques set forth under existing guidance. For example, as permitted under currently proposed Internal Revenue Service regulations, noncompliant arrangements can be amended to comply with 409A before the year in which amounts deferred under the arrangement vest without including amounts in income or being subject to a penalty under 409A. Through a comprehensive 409A compliance review, both plan document and operational failures can be found and corrected in order to minimize penalties as much as possible.

General Conditions to Relief

Notice 2010-6 relief is not available for a plan document failure unless, in addition to properly correcting the failure, the employer takes commercially reasonable steps to (1) identify all other nonqualified deferred compensation plans that have a substantially similar document failure, and (2) correct these failures as described in the notice. Relief is conditioned upon, where applicable, the employee properly including all amounts in income and paying all applicable federal taxes, including the additional 20% tax under 409A but not including the additional premium interest tax. In addition, relief under Notice 2010-6 is not available if: (1) the federal income tax return of an employee or employer is under examination with respect to nonqualified deferred compensation for any taxable year in which the document failure existed (subject to transition relief described below); (2) the failure is intentional; or (3) the failure is part of a listed transaction.

If plan document failures are fully corrected under the requirements of Notice 2010-6, the employer will not be required to report, and the employee will not be required to include as income under 409A, any amount for any taxable year prior to the taxable year in which the document failure is corrected.

Clarification Regarding Certain Ambiguous Plan Terms

Importantly, Notice 2010-6 clarifies that certain ambiguous language often included in plan documents will not automatically cause a document failure.

- ???*Payment "As Soon as Practicable."* Plans that contain 409A-compliant payment events but require payment "as soon as reasonably practicable" (or under substantially similar conditions) after those events will not be considered to have failed to set forth a permissible payment date as long as the employer does not have a pattern or practice of making payments after the later of (1) the end of the employee's taxable year in which the permissible payment event occurs or (2) the 15th day of the third calendar month following the permissible payment event. However, if the employer fails to make payment by this date, there will be an operational failure (unless the delay satisfies the timeliness exception under the 409A regulations). In this regard, plan administrators should closely monitor distributions to be made "as soon as practicable" after an employee's death to

ensure that the amounts are paid within this time frame.

- *Absent or Ambiguous Definition of Permissible Payment Date.* If a plan designates a payment event in a way that could reasonably be interpreted to comply with 409A but could also be reasonably interpreted to include an impermissible payment event, the plan will not be considered to have a document failure, provided that the employer does not have a pattern or practice of interpreting the payment event in a manner that does not comply with 409A. Notably, if the plan contains "catch-all" 409A compliance language requiring the term to be interpreted to comply with the requirements of 409A, the provision is not considered ambiguous.

Correction of Certain Document Failures

As explained below, in certain cases, Notice 2010-6 permits employers to correct plan document failures, without current income inclusion or additional taxes under 409A, provided that the corrected plan provision does not affect the operation of the plan within one year following the date of correction. If the corrected plan provision *does* affect the operation of the plan within one year following the correction, Notice 2010-6 provides relief limiting the amount currently includible in income and the additional taxes under 409A. In other cases, correction may be made without specific limits on post-correction operation (other than compliance with 409A-compliant plan terms). Therefore, it is important to be sure to understand which type of correction applies in a given case and what conditions apply.

For purposes of Notice 2010-6, the date of correction of a document failure is the latest of: (1) the date on which the correction is adopted; (2) the date on which the correction is effective; or (3) the date on which the correction is set forth in writing in one or more documents.

The failures that may be eligible to be corrected under Notice 2010-6, assuming the requirements of the notice are met, are described briefly below. The correction methods and relief provided, if any, are described in more detail in Appendix A.

- *Impermissible Definitions of 409A-Compliant Payment Events*. An employer may amend a plan to provide for 409A-compliant definitions of the following payment events: (1) separation from service;(2) change in control event; and (3)disability.

???*Impermissible Payment Periods Following a 409A-Compliant Payment Event*. An employer may correct the following impermissible payment periods, provided they follow a 409A-compliant payment event:

???Payment Period Longer Than 90 Days. A plan that provides that payment will be made following a 409A-compliant payment event, but designates the period immediately following the payment event during which payment may be made or commence as later than 90 days and earlier than 366 days following the event, may be amended to comply with 409A.

???Payment Period Dependent on Completion of Certain Employment-Related Actions. A plan provision that provides that payment will be made following a 409A-compliant event, but conditions payment upon an employment-related action (*e.g.*, execution of a release of claims or a noncompetition or nonsolicitation agreement) which would provide the employee with control over the time of payment, may be amended to comply with 409A.

???*Certain Impermissible Payment Events and Payment Schedules.* An employer may correct the following impermissible payment events and payment schedules:

???Permissible and Impermissible Payment Events. A plan that provides for both 409A-compliant and impermissible payment events with respect to a deferred amount may be amended to comply with 409A (This does not apply to a payment event the occurrence of which is in the discretion of the employee or employer.)

???Impermissible Payment Events. A plan that includes only impermissible payment events may be amended to comply with 409A.

???Certain Impermissible Alternative Payment Schedules. A plan that includes, with respect to a deferred amount, more than one time or form of payment upon the occurrence of a single type of 409A-compliant payment event (commonly referred to as an impermissible “toggle”) may be amended to comply with 409A.

???Impermissible Discretion Regarding Payment Schedules. A plan that provides the employee or employer with discretion to change the time or form of payment following a 409A-compliant payment event may be amended to comply with 409A.

- *Impermissible Employer Discretion to Accelerate Payment.* A plan that gives the employer discretion to accelerate payment regardless of whether a payment event has occurred may be amended to comply with 409A.

- *Impermissible Reimbursement or In-Kind Benefit Provisions.* A plan that provides for a reimbursement or in-kind benefits subject to 409A may be amended to comply with 409A.

- *Failure to Include Six-Month Delay.* An employer may amend a plan that fails to include a provision providing for a six-month delay of payment for specified employees to comply with 409A.

- *Impermissible Initial Deferral Elections.* An employer may amend a plan that provides for a non-compliant initial election to defer compensation to comply with 409A.

As explained in Appendix A to this summary, Notice 2010-6 includes mitigated 409A penalty amounts, depending on the error being corrected. If two or more document failures apply to the same deferred amount and two or more of the corrections require as a condition of correction that the employee include a percentage of the amount deferred in income under 409A, Notice 2010-6 clarifies that the employee is only required to include in income the *largest* percentage of the deferred amount otherwise required to be included in income.

Notice 2010-6 also includes a special rule for initially adopted plans under which correction may be made without regard to the otherwise applicable one-year rule on post-correction payment events. This rule applies if a document failure is corrected no later than the later of the end of the calendar year in which, or the 15th day of the third calendar month following, the date of the initial adoption of the plan, and any amounts paid or not paid in violation of 409A as a result of the document failure are treated as operational failures and corrected under Notice 2008-113 by the end of the calendar year in which the document failure is corrected.

Transition Relief

- *Document Failures Eligible for Correction under Notice 2010-6.* Document failures eligible for correction under Notice 2010-6 that are properly corrected on or before December 31, 2010 are eligible for the following transition relief:

  - The plan may be treated as having been corrected on January 1, 2009 for purposes of applying the relief set forth in the notice.

  - Any requirement of an income inclusion under 409A as a condition of relief will not apply so long as any payment made before December 31, 2010 that would not have been made under the amended provision, or any payment not made before December 31, 2010 that would have been made under the amended provision, is treated as an operational failure and corrected under Notice 2008-113 on or before December 31, 2010.

- *Other Transition Relief for "Linked Plans."* Plans containing certain impermissible provisions linking nonqualified deferred compensation plans or payment schedules for payments to employees that are determined by the timing of payments received by the employer that are corrected on or before December 31, 2011 will not be treated as violating 409A provided that (1) the provisions are corrected in accordance with the requirements set forth in Notice 2010-6 and (2) any payments made in violation of 409A under the plan since January 1, 2009 (or any payments that should have been made under 409A but were not) are treated as operational failures and corrected under Notice 2008-113 on or before December 31, 2011. In addition, for corrections made on or before December 31, 2011, an employer that is under examination for periods beginning on or before December 31, 2011 (and would otherwise be ineligible to correct under Notice 2010-6) will only be treated as under examination with respect to any specific document failure (and thus ineligible to correct under Notice 2010-6) that has been identified as an issue in the examination.

Information and Reporting Requirements

To correct a document failure under Notice 2010-6, including through the use of the transition relief, the employer must attach a statement to its timely-filed (including extensions) federal income tax return for its taxable year in which it corrects the failure. The statement must include, among other things, (1) the name and TIN for each employee affected by the document failure, (2) the name of the affected plan, (3) a statement that the document failure is eligible for correction and the section of the notice under which the document failure is corrected, and (4) the amount involved in each failure. In addition, if an employee is required to include an amount in income during the taxable year subsequent to the taxable year in which the failure was corrected, the employer must attach this statement to its timely-filed (including extensions) federal income tax return for the subsequent taxable year.

The employer must also provide a statement to each affected employee no later than the January 31st following the calendar year in which it corrects the failure (and for the subsequent calendar year to the extent an affected employee is required to include an amount in income during that subsequent year). This statement must explain that the employee is entitled to relief under Notice 2010-6 and include all information described in the preceding paragraph that is related to the employee's deferred amount.

The employee must attach to his or her federal income tax return a copy of the statement he or she received from the employer with respect to each failure. Similar to the reporting applicable to employers, if an employee included an amount in income during the taxable year subsequent to the year of correction, the employee must attach the statement to his or her federal income tax return for the year of correction as well as for the year of income inclusion.

Clarification of Certain Aspects of Notice 2008-113

Notice 2010-6 modifies and clarifies certain provisions of Notice 2008-113. In particular, Notice 2010-6 clarifies that a failure to pay an amount owed until the calendar year immediately following the year in which it is owed should be treated as an excess deferred amount corrected in the taxable year immediately following the year of the failure and corrected pursuant to Section V.D. of Notice 2008-113.

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The Internal Revenue Service has indicated that the document correction program is intended to encourage employers to review their plans to identify noncompliant provisions promptly (but without providing an advantage to those employers over those whose plans were drafted on a timely basis in compliance with 409A). In light of the relief available under Notices 2010-6 and 2008-113, particularly the transition relief granted for document failures corrected on or before December 31, 2010, employers should consider a review of their plans for documentary and operational compliance with 409A. Additionally, as the Internal Revenue Service has solicited comments regarding other common 409A failures and methods of correction, further guidance may provide more examples of correctable failures.

[1] Internal Revenue Code Section 409A and the provisions of Notice 2010-6 apply to a variety of different service providers (including outside directors, independent contractors, and personal service corporations) and service recipients. We use the terms "employer" and "employee" throughout this summary for the sake of simplicity.

[2] The term "nonqualified deferred compensation plan" is defined broadly to include, for example, voluntary deferred compensation, SERPs, stock options granted with a below-market exercise price ("discount options"), certain bonus programs, certain severance plans, and certain benefits and severance included under individual employment and other agreements. However, the relief in this notice is not available to "stock rights" such as discount stock options and, subject to an exception, linked plans.

Appendix A

Document Failures, Corrections, and Relief

Click here to access a pdf version of the Document Failures, Corrections, and Relief

FAILURE	CORRECTION	RELATED EVENTS BEFORE FIRST ANNIVERSARY OF CORRECTION [3]

Impermissible Definitions of 409A-Compliant Payment Events		
Separation from Service (Applies to plan provision that provides for payment on change in service relationship that is not a 409A-defined separation from service or a failure to pay on a 409A-defined separation from service)	Amendment must be adopted before occurrence of separation of service under pre-correction plan that does not comply with 409A or on the date an event occurs that is a separation from service under 409A but not a payment event under pre-correction plan. Amendment may not expand or narrow the definition of separation from service except as necessary to comply with 409A. Amendment must be effective immediately.	Upon occurrence of an event that constitutes a separation from service under ***either*** the pre-correction plan or the post-correction plan within one year following the correction: ??? Employee must include in taxable income for the year in which the event occurs, 50% of the amount deferred under the pre-correction plan and pay all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ??? Employer must report amount on Form W-2, Box 1 and Box 12, using Code Z.

Change in Control Event (Applies to plan provision that provides for payment on a change in control event of the applicable service provider that is not a 409A-defined change in control event)	Amendment must be adopted before occurrence of change in control event under pre-correction plan that does not comply with 409A but is a payment event under the pre-correction plan. Amendment may not add new payment event. Amendment must be effective immediately.	Upon occurrence of change in control event under pre-correction plan that does not comply with 409A within one year following the correction: ??? Employee must include in taxable income for the year in which the event occurs, 25% of the amount deferred under the pre-correction plan and pay all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ??? Employer must report amount on Form W-2, Box 1 and Box 12, using Code Z.

Disability (Applies to plan provision that provides for a payment event related to a service provider's illness or other incapacity and resulting inability to perform services but is not a 409A-defined disability)	Amendment must be adopted before occurrence of disability under pre-correction plan that does not comply with 409A but is a payment event under the pre-correction plan. Amendment must be effective immediately. If impermissible disability occurs before correction, amendment to correct definition of disability may still be adopted if: ???The entire amount, if any, paid out due to the impermissible disability would be eligible for correction under Notice 2008-113 if the plan were treated as having a 409A-compliant definition of disability. ???The payment is treated as an operational failure and corrected under Notice 2008-113.	Related events occurring before first anniversary of correction do not adversely affect correction and do not cause additional amounts to be included in income.
Impermissible Payment Periods Following a 409A-Compliant Payment Event		

Payment Period Longer Than 90 Days (Applies to plan provision that provides for payment following a permissible payment event under 409A but designates the period of payment to be made or commence no later than 90 days and earlier than 365 days following the payment event)	Amendment to payment period may be made either before or within a reasonable time after occurrence of a 409A-compliant payment event provided that, if the amendment is made after the occurrence of the event: ??? Payment is actually made within 90 days following the event. ??? Employee includes in taxable income for the year in which the payment event occurs, 50% of the amount deferred under the pre-correction plan and pays all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ??? Employer reports amount on Form W-2, Box 1 and Box 12, using Code Z.	Related events occurring before first anniversary of correction do not adversely affect correction and do not cause additional amounts to be included in income, but see "Correction" column.

Payment Period Dependent on Completion of Certain Employment-Related Actions (Applies to plan provision that provides for payment on a permissible payment event but conditions payment on employment-related action of the employee such as execution of a noncompetition agreement or release)	Amendment must be adopted before occurrence of 409A-compliant payment event to which the employment-related action relates. If plan provides for payment (subject to employee's action) within a 409A-compliant designated period following a payment event, the amendment must provide that payment will be made on the last day of the designated period. If the plan does not provide for payment (subject to employee's action) within a 409A-compliant designated period following a payment event, the amendment must provide that payment may be made only upon a fixed date either 60 or 90 days after the payment event. Amendment may not otherwise change the time and form of payment.	Related events occurring before first anniversary of correction do not adversely affect correction and do not cause additional amounts to be included in income.
Impermissible Payment Events and Payment Schedules		

Plan Includes Permissible and Impermissible Payment Events (Applies to plan provision that provides for both one or more permissible payment events under 409A and one or more impermissible payment events under 409A with respect to a deferred amount)	Amendment may be adopted either before or after an impermissible payment event has been irrevocably elected or otherwise applies to an amount deferred by an employee, provided that, if the amendment is adopted after one or more impermissible payment events have been elected by the employee or otherwise become applicable to the deferred amounts, the plan must be corrected before the date any of the impermissible payment events occur and must be effective immediately.	If amendment is adopted before the employee's irrevocable election of an impermissible payment event or other application of the event to an amount deferred, related events occurring before first anniversary of correction do not adversely affect correction and do not cause additional amounts to be included in income. If amendment is adopted after the employee's irrevocable election of an impermissible payment event or other application of the event to an amount deferred, upon the occurrence of the impermissible payment event within one year following the correction: ??? Employee must include in taxable income for the year in which the event occurs, 50% of the amount deferred under the pre-correction plan and pay all applicable taxes on the

Plan Includes Only Impermissible Payment Events (Applies to plan provision that provides for only one or more impermissible payment events with respect to a deferred amount)	Amendment must be adopted before the impermissible payment event occurs. Amendment must provide for payment upon the later of (1) the employee's separation from service within the meaning of 409A and (2) the sixth anniversary of the date of correction. For the year in which the correction is made: ??? Employee must include in taxable income in the year in which correction occurs, 50% of the amount deferred under the pre-correction plan and pay all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ??? Employer must report amount on Form W-2, Box 1 and Box 12, using Code Z.	Related events occurring before first anniversary of correction do not adversely affect correction and do not cause additional amounts to be included in income, but see "Correction" column.

Plan Includes Impermissible Alternative Payment Schedules (Applies to plan provision that provides for a deferred amount to be payable in more than one time and form of payment upon the occurrence of a single permissible payment event in violation of 409A)	If the plan provides for multiple forms of payment relating to the occurrence of an employee's voluntary or involuntary separation from service: ???Plan must be amended before the date a separation from service occurs that could result in impermissible multiple forms of payment to provide that the form of payment upon voluntary separation from service will be the same as form of payment upon involuntary separation from service provided for under pre-correction plan. ???Amendment must be effective immediately. If the plan provides for multiple forms of payment resulting from an alternative payment schedule relating to factor other than whether separation from service is voluntary or involuntary: ???Amendment must be adopted before occurrence of event that could result in the impermissible multiple forms of payment. ???Amendment must remove forms of payment until the remaining forms are permissible. The remaining form of payment must be the	Upon occurrence of voluntary separation from service within one year following the correction: ???Employee must include in taxable income for the year in which the event occurs, 50% of the amount deferred under the pre-correction plan and pay all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ???Employer must report amount on Form W-2, Box 1 and Box 12, using Code Z. Upon occurrence of corrected payment event within one year following the correction: ???Employee must include in taxable income for the year in which the event occurs, 50% of the amount deferred under the pre-correction plan and

Impermissible Discretion Related to Payment Schedule (Applies to plan provision that allows the employer or employee with impermissible discretion to change time and form of payment following a permissible payment event)	If plan has a default time or form of payment that would be in effect if employee or employer did not exercise its discretion to change time and form of payment, amendment must remove employee's and/or employer's discretion to change time and form of payment. If plan does not have default time or form of payment that would be in effect if employee or employer did not exercise its discretion to change time and form of payment, amendment must: ??? Remove employee's and/or employer's discretion to change time and form of payment. ??? Provide that time and form of payment will be the potential time and form of payment under the pre-correction plan terms that would result in the latest final payment date. If two forms of payment result in, or potentially result in, the same latest final payment date, the remaining form must be that commencing, or potentially commencing, at the latest possible date. If those two dates are the same, the remaining form must be the form generally anticipated to result in the amount deferred being paid at later dates	Upon occurrence of payment event to which correction applies within one year following correction: ??? Employee must include in taxable income for the year in which the event occurs, 50% of the amount deferred under the pre-correction plan and pay all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ??? Employer must report amount on Form W-2, Box 1 and Box 12, using Code Z.

Impermissible Employer Discretion to Accelerate Payment (Applies to plan provision providing an employer with impermissible discretion to accelerate payment regardless of whether a payment event has occurred)	Amendment must be adopted before the earlier of (1) the date the employer exercises discretion to accelerate payment under the plan and the discretion is irrevocable, or (2) the date a payment has been made under the plan pursuant to the exercise of discretion. Amendment must either remove employer's discretion to accelerate payment or make the acceleration permissible under 409A.	Related events occurring before first anniversary of correction do not adversely affect correction and do not cause additional amounts to be included in income.

Impermissible Reimbursement or In-Kind Benefit Provisions (Applies to plan provision providing for reimbursements or in-kind benefits in a manner that does not comply with 409A)	Amendment must be adopted before occurrence of event that would result in employee becoming eligible to receive a reimbursement or in-kind benefits subject to 409A. Amendment must provide for reimbursements or in-kind benefits that comply with 409A, including, where applicable, the proration requirement. Amendment must be effective immediately.	Upon occurrence event that would have made employee eligible for payment of reimbursement or in-kind benefits under the pre-correction plan within one year following correction: ??? Employee must include in taxable income for the year in which the event occurs, 50% of the amount deferred under the pre-correction plan and pay all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ??? Employer must report amount on Form W-2, Box 1 and Box 12, using Code Z.
Other Failures		

Failure to Include Six-Month Delay of Payment for Specified Employee	Amendment must be adopted before occurrence of event that would be subject to six-month delay. Amendment must add the six-month delay and further provide that any amounts payable under the plan that are subject to the six-month delay may not be paid before the later of (1) 18 months following the date of correction, or (2) six months following the date of the payment event. Amendment must be effective immediately.	Upon occurrence of separation from service within one year following date of correction that results in the six-month delay rule being applied: ??? Employee must include in taxable income for the year in which the separation from service occurs, 50% of the amount deferred under the pre-correction plan and pay all applicable taxes on the amount, **including** the additional 20% tax under 409A but not including the additional premium interest tax. ??? Employer must report amount on Form W-2, Box 1 and Box 12, using Code Z.

Impermissible Initial Deferral Elections	Amendment must be adopted no later than the end of the employee's second taxable year immediately following the taxable year during which the applicable deadline for making an initial deferral election under 409A occurs. Amendment must remove ability to make the impermissible deferral election. Any amounts not paid due to the impermissible initial deferral election must be corrected in accordance with Notice 2008-113.	Related events occurring before first anniversary of correction do not adversely affect correction and do not cause additional amounts to be included in income.

[3] Related events occurring after the first anniversary of the correction do not adversely affect the correction and do not cause additional amounts to be included in income.

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