# IRS Issues Section 409A Plan Document Correction Procedures with Potential Advantages to Correction by December 31, 2010

Earlier this month, the IRS issued a set of correction procedures permitting the amendment of noncompliant plans, agreements and policies subject to Section 409A of the Internal Revenue Code. Notably, while the correction procedures require partial income inclusion and payment of the Section 409A excise taxes under certain circumstances, it might be possible to avoid such adverse tax consequences if correction is completed by December 31, 2010.

By way of background, Section 409A restricts how and when compensation may be deferred, and the time and manner in which it may be paid (e.g., upon separation from service, death, disability, hardship, change in control or a set future schedule, etc.). Failure to comply with Section 409A generally results in taxation upon vesting, along with a 20 percent excise tax and interest. While Section 409A was originally intended to cover "traditional" deferred compensation arrangements, its scope has been dramatically widened by IRS regulations, so that it can reach provisions and arrangements which are not commonly thought of as deferred compensation, such as severance provisions, expense reimbursements, and equity compensation arrangements. Due to this broad scope, some employers did not timely identify and update their covered arrangements by the deadline of December 31, 2008. These new IRS correction procedures provide an opportunity to revisit, and potentially correct, noncompliant arrangement documentation.

Examples of potentially permissible corrections include the following, subject to certain conditions of the correction procedures:

- Interpreting certain ambiguous terms in a manner to comply with Section 409A.
- Conforming definitions of permissible payment events (such as separation from service, disability and change in control) to meet Section 409A requirements.
- Correcting provisions allowing improper delay of payment beyond the occurrence of the payment event.
- Correcting impermissible payment events and schedules.
- Correcting impermissible discretion as to acceleration of payments or alternative payment schedules.
- Adding the requirement for a 6-month delay for payment to a “specified employee” of a public company following separation from service.
- Correcting improper deferral elections.

In addition to amending the arrangement documentation, the following might be required, among other things, under the correction procedures:

- In certain circumstances, if payment is made within a year after correction, half of the 20% additional tax under Section 409A must be paid by the employee.
- In that case, the respective form W-2 must be coded to reflect such taxes are due.
- Certain information must be reported on the tax returns of the employer and employee reflecting the use of the correction procedures.
- In some situations, improper deferrals or payments made prior to correction must be corrected under the separate Section 409A operational correction procedures issued earlier by the IRS.

There are some circumstances under which documents cannot be fixed under the correction procedures:

- If commercially reasonable steps are not taken to correct all substantially similar document failures.
- If an IRS audit has started.
- For intentional failures or “listed transactions” (e.g. abusive tax transactions).
- For stock rights or, after December 31, 2011, for “linked” plans.

**Please contact any of the attorneys in our Employee Benefits & Executive Compensation group if you have any questions regarding this alert.**

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In light of the availability of the new document correction procedures, and the potential ability to avoid adverse tax consequences if corrections are completed by December 31, 2010, you may wish to discuss with one of the members of our Employee Benefits and Executive Compensation Group whether any of your arrangements are in need of corrective action.

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