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## IRS Establishes Section 409A Relief Program for Plan Document Failures

On January 5, 2010, the Internal Revenue Service issued Notice 2010-6 (“Notice”), which provides long-awaited guidance on correcting plan document failures in nonqualified deferred compensation arrangements subject to Internal Revenue Code §409A. In addition to providing specific correction methods and broad relief for plan document failures, the Notice also provides helpful insight as to whether the IRS considers certain common plan provisions to be sufficient under §409A. These insights are critical because they show that the IRS’s view of certain plan provisions, in some instances, is not necessarily consistent with the view that has been held by many plan sponsors and practitioners. It is clear from the Notice, for example, that particular attention should be given to executive severance arrangements and to arrangements that require an executive to sign a release of claims in order to receive benefits following a separation from service.

The Notice provides welcome relief for plan sponsors who did not timely amend their nonqualified deferred compensation arrangements to comply, in form, with §409A. However, even sponsors who timely amended their §409A plans may now wish to consider their plan documents in light of this IRS guidance.

### Section 409A Background

Section 409A, which became effective on January 1, 2005, significantly changed the landscape with respect to nonqualified deferred compensation. As a general matter, §409A governs how and when compensation is deferred and ultimately distributed. Distributions can only be made at times, or upon events, specified in §409A. Accelerations of distributions and redeferrals are generally prohibited, subject to limited exceptions. Additionally, §409A requires that nonqualified deferred compensation arrangements be in writing, and the written plan documents satisfy §409A’s requirements. Although a series of transition relief guidance issued during 2005–2008 postponed the date upon which nonqualified deferred compensation arrangements had to comply in form with the rules, all covered arrangements had to be amended by January 1, 2009.

A failure to satisfy §409A in form (i.e., a plan document failure) or in operation, results in taxation to the individual covered by the arrangement retroactive to the inception of the arrangement (or the date of vesting, if later), plus interest, plus a 20 percent additional tax. Generally, a simple failure taints all deferrals.

In December 2008, the IRS issued Notice 2008-113, which provided correction methods for a number of different types of operational errors (e.g., failing to distribute an amount of deferred compensation at the time required under the arrangement, or distributing an amount that should have been deferred). Notice 2010-6 provides correction methods and relief for plan document failures.

#### **Notice 2010-6**

As noted above, Notice 2010-6 provides correction methods and relief for a broad range of plan document failures, including:

- Use of certain ambiguous terms, such as providing that a distribution will be made “as soon as

reasonably practicable” following a specified date or event;

- Use of defined terms that do not comply with §409A (e.g., using an incorrect definition of “separation from service” or “disability”);
- Providing a payment event or payment period that is not permissible under §409A;
- Failure to require an automatic six-month payment deferral following a separation from service for key employees; and
- Provisions dealing with initial and/or deferral elections that do not meet the §409A requirements.

Some of the permitted corrections involve simply amending the relevant

plan documentation. In certain circumstances, correction may require that the individual include a portion of the deferred compensation as income under §409A (and pay the 20 percent additional tax). Importantly, however, Notice 2010-6 provides broad relief in allowing deficient provisions to be corrected without any taxation or penalties if the plan documentation is amended in accordance with the Notice on or before December 31, 2010. Thus, plan sponsors may now wish to review their plan documents in light of Notice 2010-6 and to take advantage of this broad relief as needed.

Please let us know how we can help in assessing the compliance of your nonqualified deferred compensation arrangements to assure you take full advantage of Notice 2010-6.