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Employee Benefits &
Executive Compensation Alert
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IRS Provides Additional Relief Under its Section 409A Correction Program

The Internal Revenue Service has issued Notice 2010-80, modifying previous guidance on correction procedures for non-qualified deferred compensation plans covered by Internal Revenue Code Section 409A.

Background. Section 409A, which was enacted in 2004, imposes a variety of rules and requirements on non-qualified deferred compensation arrangements. Section 409A defines deferred compensation broadly and, in addition to traditional deferred compensation agreements, includes severance arrangements and equity-based plans. Generally, the Section 409A rules govern the timing of deferral elections, distribution requirements and changes in distribution elections.

In previous guidance, the IRS established methods for employers to voluntarily correct many types of failures to comply with the Section 409A requirements in order to reduce or avoid penalties that would otherwise apply under Section 409A. In Notice 2008-113, the IRS addressed corrections of certain plan operational failures and in Notice 2010-6, the IRS established a program providing employers the opportunity to correct certain plan documentation failures.

Notice 2010-80 expands the types of plans eligible for relief under Notice 2010-6 and provides an additional method of correction for certain plan document failures relating to payments at separation of service. It also provides some relief from certain of the correction reporting requirements under Notice 2008-113 and Notice 2010-6.

Expansion of Plans Eligible for Relief.

- **Linked Plans**. The documentary correction relief provided under Notice 2010-6 generally does not extend to a non-qualified deferred compensation plan that is linked to another plan - meaning the amount contributed to the non-qualified plan is dependent on the amount contributed to either a qualified plan or another non-qualified plan. Notice 2010-80 clarifies that the plan document correction procedures are available to a linked plan but only in the event that the linkage does not affect the time and form of payment of the benefits under the plans.

> **Stock Plans.** As originally issued, Notice 2010-6 provided that a stock option issued at less than fair market value (*i.e.*, a discounted option) that did not comply with the Section 409A rules was not eligible for correction. Notice 2010-80 expands the document correction procedures under Notice 2010-6 to discounted stock options that were intended at the time of grant to comply with the Section 409A rules (*i.e.*, the option was either exercisable at a fixed date or period, or upon a permissible payment event).

Additional Correction Method for Severance Payments Subject to a Release of Claims. A common feature of severance arrangements is to condition the severance payments on an employee executing a general release of claims or similar document in favor of the employer. The employee's ability to control when the release is signed causes a 409A violation because the employee may be able to determine which taxable year the payment will be made. Notice 2010-6 provided a correction method for this type of violation by allowing the severance arrangement to be amended to provide that the payment must be made on a fixed date, generally the 60th or 90th day following termination. Notice 2010-80 allows payment to be made during a specified period, generally not longer than 90 days following termination, provided that if the specified period spans two taxable years, the payment will be made in the later taxable year. An extended transition period for this rule gives employers until December 31, 2012, to bring their severance arrangements into compliance.

Relief from Employee Tax Reporting Requirements for Some Corrections. As originally issued, IRS Notice 2010-6 required employers and employees to attach a statement to their respective tax returns notifying the IRS of their reliance on the 409A correction procedures. Notice 2010-80 provides that employees are not required to attach a statement to their tax returns for corrections made during 2010 or for corrections made by December 31, 2012, with respect to severance payments subject to a release. Employers are still required to report any reliance on the correction procedures.

Relief from Employer Reporting Requirements to Employees for Same Year Corrections. Under Notice 2008-113, employers were required to notify affected employees of operational failures corrected within the same plan year. Notice 2010-80 eliminates this requirement. Employers are still required, however, to report same year corrections to the IRS.

Effective Date. The additional relief granted under Notice 2010-80 that modifies Notice 2010-6 can be relied upon for tax years beginning on or after January 1, 2009, and the additional relief that modifies Notice 2008-113 can be relied upon for tax years beginning on or after January 1, 2010.

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