

## **A LITTLE GIFT IN TIME FOR THE HOLIDAYS: THE IRS MODIFIES ITS § 409A CORRECTIONS PROGRAM—AGAIN**

December 6, 2010

To Our Clients and Friends:

The IRS has again modified its § 409A corrections program for nonqualified deferred compensation plans with last week's issuance of Notice 2010-80. The Notice, among other things, (i) provides an additional method of correction and transition relief with respect to certain failures involving termination payments conditioned upon the employee's signing a release or noncompetition agreement; (ii) modifies the reporting requirements for certain corrections imposed by Notice 2008-113 and Notice 2010-6; and (iii) expands the program's coverage to additional types of § 409A plans.

While these modifications are generally beneficial to both employers and employees, the transitional nature of the relief makes **December 31, 2010** an important deadline. Companies wishing to take advantage of many of these changes should therefore ensure that their plan documents are reviewed and corrected by that date.

### **CORRECTION OF TERMINATION PAYMENT PROVISIONS CONTINGENT UPON AN EMPLOYEE'S SIGNING A RELEASE**

Provisions that provide for a payment within 90 days of an employee's separation from service where the payment is contingent upon the employee's signing of a release of claims, noncompetition, or other agreement are considered problematic by the IRS because the IRS believes that these contingencies may allow an employee to control when the payment will be made, based on the timing of the employee's execution of the release or other agreement.

**Additional Method of Correction.** The earlier Notice 2010-6 provides a method of correcting this sort of plan failure that requires payment to be made on a fixed date after the release delivery period has ended. Notice 2010-80 adds additional payment flexibility. The failure may now also be corrected by providing for a payment during a specified period that does not exceed 90 days, but under the condition that, if the period spans two of the employee's taxable years, the payment must be made in the second taxable year.

**Additional Retroactive Transitional Relief.** Notice 2010-80 also provides extended retroactive transitional relief for plans containing these types of provisions through December 31, 2012, but only for plans eligible for correction on or before December 31, 2010. The transition relief effectively deems such provisions to be in compliance with § 409A with respect to deferred amounts that are paid out on or before March 31, 2011. For

amounts deferred under such plans that are payable after March 31, 2011, the plan will not be deemed to fail to comply in form, and the payments triggered will be treated as not failing to comply in operation, with § 409A if two additional conditions are satisfied. First, for any amounts paid under the plan where the potential payment period spans two of the employee's taxable years, the payment must be made in the second year. Second, to the extent that any amounts subject to the plan remain deferred after December 31, 2012, the plan must be corrected on or before December 31, 2012. If the provisions are not corrected by the end of 2012, however, the IRS may consider the plan noncompliant going forward, and potentially, during prior periods as well. The transition relief also appears to be available to service providers who commence participation in a substantially similar arrangement after December 31, 2010, in accordance with the terms that are in effect on December 31, 2010.

### **RELIEF FROM CERTAIN REPORTING REQUIREMENTS**

Notice 2010-6 requires employers to provide certain information relating to the corrected plan and the employees who were affected by plan failures to both the IRS and the affected employees. Affected employees are required to attach a statement to their tax returns documenting the plan corrections made by the employer. Notice 2010-80 eliminates the requirement to provide notice to employees as well as the requirement that employees attach statements to their tax returns for corrections made under the corrections program in 2010. The employer, however, is still required to provide notice to the IRS with its tax return for the year of correction. The employee notice and IRS filing requirements, moreover, remain in effect for post-2010 plan corrections.

Notice 2010-80 also alters the reporting requirement under the operational failure corrections program (contained in Notice 2008-113) with respect to corrections of operational failures in the same taxable year as the failure. In particular, if the same or substantially similar operational failure occurs with respect to multiple employees and is corrected in the same taxable year, the information about the nature of the failure may be supplied only once. To take advantage of this relief, however, the employer must still identify each employee who is affected by the failure and the amount by which the employee is affected.

### **SOME STOCK RIGHTS AND LINKED PLANS ARE NOW (OR WERE ALWAYS) ELIGIBLE FOR CORRECTIONS RELIEF**

Notice 2010-80 both clarifies and expands upon the guidance in Notice 2010-6 regarding the eligibility of certain types of plans for relief. First, it clarifies that a nonqualified plan that is linked to either a qualified or nonqualified plan is not ineligible for relief merely due to such linkage. For linked plans to be eligible, however, the time and form of payment under the first plan must not be affected by the amount deferred under, or the payment provisions of, the second plan.

Second, the Notice expands the eligibility provisions of Notice 2010-6 with respect to stock rights. Under the expanded provision, stock rights that were intended, either at the time of grant or upon modification pursuant to transitional relief, to be subject to and compliant with § 409A but nonetheless contained a plan document failure, are now eligible for relief. Note, however, that stock rights intended to be exempt from the requirements of § 409A remain ineligible.

### **LESS THAN ONE MONTH LEFT TO TAKE FULL ADVANTAGE OF TRANSITIONAL RELIEF**

The IRS is continuing to analyze comments that it has received regarding its § 409A corrections program, and expects to issue additional guidance in the future. The full benefit of the program, however, may only be realized if a plan failure is corrected by December 31, 2010. Implementation of any necessary changes should therefore be undertaken before the end of this year. That leaves less than a month to complete the amendment process.

This memorandum was not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. Federal tax law.

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