ALERT
NOVEMBER 10, 2010

EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION
News Concerning Recent Employee Benefits & Executive Compensation Issues

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# LAST CHANCE TO CORRECT 409A VIOLATIONS WITHOUT HAVING TO PAY A PENALTY

The IRS issued Notice 2010-6 (Notice) earlier this year, providing taxpayers with a mechanism to correct certain IRC Section 409A document errors. Under the Notice's transition rules, if certain document compliance errors are corrected by December 31, 2010, the affected employee may avoid incurring any income tax or penalties (other than income tax on amounts actually received). If a correction under the Notice is made after December 31, 2010, it may cost the taxpayer a penalty and the early recognition of income.

## Availability of the Program

To be eligible to use the document correction program, several requirements must be satisfied. The employee has to pay all taxes related to the correction. The employer must correct all other similar errors in its other plans. The employer's income tax return cannot be under audit for its deferred compensation plans, and the employee's tax return must not be under audit. The error has to be unintentional and inadvertent, and certain reporting and disclosure requirements must be satisfied.

## IRC Section 409A

Section 409A established a new set of requirements which nonqualified deferred compensation must satisfy. Employees are liable for a 20 percent excise tax, the early recognition of taxable income, and interest from the time compensation is vested, if their nonqualified deferred compensation does not satisfy Section 409A's requirements. Section 409A applies whenever a right to compensation becomes vested in one year and the compensation is actually paid in a future year. This broad definition expanded the type of compensation previously thought to be "deferred" compensation, and now can include, (but is not limited to) items such as severance pay, incentive compensation, bonuses, reimbursement arrangements, SERPS, and certain types of equity arrangements. Violations of Section 409A may occur through both the terms of the document and actual operation of the plan.

## Correctable Document Errors:

The Notice covers document errors, including, but not limited to:

- public company plans that do not include the specified employee six-month delay in payment rule
- noncompliant reimbursement arrangements
- impermissible deferral elections
- noncompliant payment events and payment periods
- impermissible alternative payment schedules and forms of payment for a single event
- employer discretion to accelerate payments
- required employee releases or other actions which permit the employee to determine what year a payment will be made
- noncompliant definitions of certain terms such as "separation from service" or "change in control."

Certain types of corrections are not permitted to impact the operation of the deferred compensation arrangement for at least one year from the date the correction is made. Under the transition rule, however, if the correction is made by December 31, 2010 the correction will be treated as if it was made on January 1, 2009, thereby automatically satisfying the one year look back requirement.

## What Employers Should Be Doing Now

With the transition rule expiring at the end of the year, employers should consider reviewing their deferred compensation plans to identify any Section 409A errors that may need to be corrected, taking into account the additional guidance provided by the Notice and recent IRS comments on how Section 409A is to be applied.

*If you have any questions on the information presented in this alert, please contact Jay Dorsch at 215.665.4685 or jdorsch@cozen.com, Kathleen Drapeau at 212.908.1286 or kdrapeau@cozen.com, Stephen Bowers at 215.665.7283 or sbowers@cozen.com, or Arthur Zatz at 215.665.2194 or azatz@cozen.com.*