

Employee Benefits E-news

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Last Chance to Correct Nonqualified Deferred Compensation Plan to Comply With Section 409A Violations

Internal Revenue Code Section 409A dramatically changed the landscape of nonqualified deferred compensation programs and certain equity compensation arrangements by imposing restrictions on the timing and distribution of deferrals and other payments. Although Section 409A was enacted in late 2004, employers could comply with various good faith compliance standards for plan operation through December 31, 2007 when plans were required to satisfy Section 409A in both form and operation. Penalties for Section 409A violations include immediate taxation and interest plus a 20% excise tax imposed on affected participants (generally executives or directors).

IRS Correction Program

The IRS offers a limited correction program to report and correct Section 409A violations. **The correction program expires December 31, 2010.** The program allows employers to identify and correct nonqualified plan errors prior to an IRS executive compensation, corporate or employment audit. This is significant given the IRS's prior announcement that it would initiate new employment tax audits for 6000 companies in 2010 alone. Under the IRS program, certain corrections can be made with reduced penalties or no penalties at all. If corrections are made under the IRS program, the employer and the affected employee must attach a statement containing information relating to the Section 409A failures to their tax returns.

Section 409A Violations Eligible For Correction

The following compliance failures are eligible for correction under the IRS program:

- **Impermissible payment dates or events.** For example, a plan permits payment of benefits upon a change of control that does not satisfy Section 409A definition.
- **Failure to satisfy 6 month payment commencement delay for specified employees of publicly traded companies.** For example, a publicly traded company's deferred compensation plan permits immediate payment to the chief executive officer upon separation from service.
- **Failure to establish or enforce employee deferral deadlines.** For example, employees are permitted to make, change or revoke deferral elections after the beginning of the year (absent a qualified exception).

- **Clarify ambiguous terms such as “termination of employment” or “as soon as practicable”.** A plan amendment may not be required if the plan is operated in compliance with Section 409A.

Action Items

Even if a company’s nonqualified plans and employment agreements have been reviewed in the past for Section 409A, we recommend re-assessment to ensure compliance and to take advantage of what may likely be the last opportunity to correct defects while avoiding or minimizing income tax inclusion and penalties.

Additional Information

For more information about Section 409A compliance, or for questions regarding any employee benefits issue, contact your regular Butzel Long attorney, a member of the Butzel Long Employee Benefits Practice Group, or the author of this e-news bulletin.

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