

December 31, 2010 Deadline Offers Maximum Corrective Relief for Plans Subject to 409A

On November 30, 2010, the IRS issued Notice 2010-80 (Modification to the Relief and Guidance on Corrections of Certain Failures of a Nonqualified Deferred Compensation Plan to Comply with § 409A(a)). This NolanWIRE discusses the ameliorative relief, offering the most generous provisions, available only until December 31, 2010. Subsequently, less generous provisions will apply. In order to take advantage of the most generous provisions of the corrective relief available, the corrections must be made by December 31, 2010.

In 2008, the IRS issued Notice 2008-113 – Operational Correction Program, providing a means to address operational failures occurring in arrangements subject to Section 409A of the Internal Revenue Code. In 2010, the IRS issued Notice 2010-6 – Document Correction Program, to allow for the correction of inadvertent document failures to avoid or limit adverse tax consequences. However, with the recently issued Notice 2010-80, the IRS has modified some of the requirements of the prior two Corrections Programs.

Non-compliance with Section 409A provisions results in taxation of amounts subject to the plan, a 20% penalty tax, state tax, as well as interest charges on the service provider (employee). However, inadvertent failures may be remedied under the Corrections Programs to avoid adverse consequences.

If some of the failures are corrected in 2010, the benefits are more favorable than if corrected in 2011 or 2012. At present only the Document Correction Program and Notice 2010-80 are available as the transition period for the Operational Correction Program has ended.

Under Notice 2010-80, if document corrections are made and completed in the year 2010, there will be no future adverse tax consequences. If the corrections are not completed in 2010, there may be future tax consequences under certain circumstances. The Document Correction Program allows for corrections to be made in 2010 without subjecting any income to inclusion as part of the relief granted. However, to the extent that such document corrections result in operational failures, due to the retroactive application of the document correction to January 1, 2009, those failures must also be corrected under the Operational Correction Program by December 31, 2010.

One of the more generous provisions of Notice 2010-80 provides that if document corrections are made and generally completed by December 31, 2010, a service provider (employee) is no longer required to file an information statement to the IRS. In addition, if operational corrections are made in a year, an employer does not have to provide an employee with an information statement for the errors corrected in the same year. Nonetheless, the employer is still required to complete and file an information statement with its applicable income tax return.

In addition to the specific provisions applicable for corrections made in the year 2010, Notice 2010-80 modified provisions relating to linked plans, stock rights and issues pertaining to payments made “within” a set number of days following a separation from service that was contingent upon the employee’s execution of a release. Please review IRS Notice 2010-80 for more details.