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Notice 2010-80: Relief for Section 409A Correction Programs And for Payments Conditioned on Executing Releases



By CHARLES C. SHULMAN

Notice 2010-80, issued by the Internal Revenue Service on Nov. 30, 2010, provides certain relief with respect to Internal Revenue Code Section 409A¹ correction methods described below, as well as with respect to payments conditioned on employment-related

¹ Section 409A, effective Jan. 1, 2005, among other things, restricts the timing of elections to defer compensation and regulates permitted payment events and schedules of covered nonqualified deferred compensation plans. Final regulations took effect Jan. 1, 2009.

Charles C. Shulman has over 20 years of experience in employee benefits and executive compensation. He may be reached at Law Offices of Charles C. Shulman, Esq., cshulman@ebeclaw.com, (201) 357-0577, or (212) 380-3834.

action of the employee, such as executing a release, as summarized below.

Background: Existing Correction Procedures

Notice 2008-113² provides for certain self-correction methods for Section 409A *operational failures*, provided the corrections are made in the year of failure or in certain cases in the first or second year following the year of failure. The errors must be unintentional and reasonable steps must be taken to avoid recurrence. Depending on the year of correction and whether the employee is a § 16 insider,³ all 409A taxes⁴ may be avoided or only the premium interest tax may be avoided. The notice also provided certain transitional relief for operational failures occurring before 2008 with corrections made before 2010. Certain information and reporting requirements apply to the corrections, as described below.

Notice 2010-6⁵ allows taxpayers to voluntarily correct many *documentary failures* under Section 409A, including (i) impermissible definitions of separation from service or change in control, (ii) impermissible payment periods, payment events or payment schedules, (iii)

² 2008-51 I.R.B. 1305 (Dec. 22, 2008).

³ Section 16(a) of the Securities Exchange Act of 1934 defines insiders as officers, directors, and greater-than-10-percent shareholders of an issuer.

⁴ Section 409A penalties are imposed on the employee if a covered plan violates Section 409A. Penalties include immediate taxation of the amounts deferred under the plan and all similar plans, an additional 20 percent tax on the amount of compensation included in income, and possibly, premium interest penalties.

⁵ 2010-3 I.R.B. 275 (Jan. 19, 2010).

lack of six-month delay for public company, (iv) impermissible initial deferrals, etc. The corrections must be made by the employer for all similar errors in all of its plans, and the employee may not be under audit. In certain cases, the income tax and 20 percent additional tax (but not the premium interest tax) must be paid for a portion of the amount deferred if a violation (if not for the correction) would occur within one year. This notice also provides certain transition rules for corrections on or prior to Dec. 31, 2010, or for certain corrections on or prior to Dec. 31, 2011. Certain information and reporting requirements apply to the corrections, as described below.

Notice 2010-6 also provides relief for payments conditioned on employment-related action of the employee such as executing a release, a nonsolicitation agreement, or a noncompete agreement. Correction can be made before the permissible payment event occurs by removing the ability of the employee to delay or accelerate the timing of the payment as a result of his or her actions, and by fixing the payment date at 60 (or 90) days after the payment event (with certain other conditions, as outlined below).

Severance Conditioned on Executing Release: Expanded Relief Under Notice 2010-80

When payment of severance is conditioned on the employee's signing a release of claims (e.g., for age discrimination), and the employee can sign the release at any time, this could cause the severance to fail to be a short-term deferral,⁶ and therefore exempt from Section 409A, or to not have a fixed payment date as required by Section 409A.⁷

One solution that practitioners have used is to provide a fixed deadline in which time to execute the release— e.g., the release must be executed and not revoked by the 60th (or 90th) day following termination—and the terms of the release would be agreed upon in advance. This way, the Age Discrimination in Employment Act's 21-day period to consider the release, or the 45-day period in connection with an exit incentive program or other employment termination program, and the seven days to revoke can be satisfied before the expiration of that period. The payment would then be made after the execution and nonrevocation of the release, and such payment would be within 60 (or 90) days after termination. In addition, in order to avoid an employee being able to control the year of payment by delaying the execution of the release until the next taxable year,⁸ a provision would also need to be added that if the 60 (or 90) day period begins in one taxable year and ends in the next taxable year the payment will automatically be pushed to the next taxable year.

The IRS has indicated informally and in Notice 2010-6 that such a solution to the problem of payment within a 60 (or 90) day period would not work, because there would be an impermissible toggle if the employee

were able to execute the release prior to or after November 1.⁹ The solution the IRS proposed is that regardless of whether the release is executed right away, the severance payment will only be made on the 60th (or 90th) day following termination, provided that an irrevocable release is in place by then. This solution is supported by Notice 2010-6, § VI.B, which provides a documentary correction for a payment that is conditioned on the employee executing a release. In this case, a correction can be made before the permissible payment event occurs by removing the ability of the employee to delay or accelerate the timing of the payment as a result of his or her actions, and fixing the payment date at 60 (or 90) days after the termination.

(Note that the above only applies if the severance arrangement is subject to Section 409A. If the severance can be paid within the short-term deferral period (e.g., the arrangement has a safe harbor Section 409A good reason definition) or within the two years/two times pay exception for involuntary terminations, this would avoid application of Section 409A and therefore the arrangement would not be subject to the toggle rule relating to Section 409A payment events or the straddling of two taxable years. The release would have a fixed deadline for execution and revocation, and the severance would have to be paid in all events no later than 2½ months after the year of separation (to ensure that it is a short-term deferral), or within two years if relying on the two years/two times pay exception.))

More recently, however, the IRS has retreated from its position requiring a fixed date, and has determined that the first solution described above would also work, namely to set a 60 day (or 90 day) time period within which to execute the release and receive payment, and to push the payment date to the next year if this 60 (or 90) day period begins in one calendar year and ends in the next year. This position is set forth in Notice 2010-80, modifying Notice 2010-6, § VI.B, to allow for correction of impermissible release provisions. Under Notice 2010-80, severance amounts can be set as payable within a 60 (or 90) day time period following the termination (the permissible payment event), assuming execution of the release and nonrevocation have occurred, provided that if such 60 (or 90) day period begins in the employee's first taxable year and extends into the employee's second taxable year, the payment must be made in the second taxable year (or alternatively, the payment can be set for the last day of the period).¹⁰

Transition Relief Under Notice 2010-80 for Severance Dependent Upon a Release Through Dec. 31, 2012.

Notice 2010-80 modifies Notice 2010-6 by providing additional transition relief through Dec. 31, 2012, for plans that contain documentary failures involving payments dependent upon the employee executing a release (and the plan is eligible for correction by Dec. 31, 2010), provided that any payments made after March 31, 2011, that could be paid during a period that begins

⁶ See Treas. Reg. § 1.409A-1(b)(4). Payments made no later than the 15th day of the third month following the close of the employee's taxable year in which employee first has a vested right to the payment are exempt from Section 409A.

⁷ I.R.C. § 409A(a)(2)(A)(iv).

⁸ Being able to pick year of payment would violate Treas. Reg. § 1.409A-3(b), which prohibits having multiple times or form of payment for a distributable event.

⁹ A specific date in each year would, according to this view, not fit within the "toggle" rule exception of Treas. Reg. § 1.409A-3(c).

¹⁰ Notice 2010-80 at § III.B, modifying § VI.B.2 of Notice 2010-6.

in one taxable year and ends in the subsequent taxable year must be paid during the subsequent taxable year, and provided further that to the extent any amounts remain deferred under the plan, the plan is amended to be compliant by no later than Dec. 31, 2012.¹¹

Certain Linked Plans and Stock Rights Are Included in Documentary Corrections Under Notice 2010-80

Notice 2010-80 amends Notice 2010-6 to provide that the documentary corrections procedure can be utilized: (i) by linked plans (nonqualified plans linked with qualified plans) with document failures if the linkage does not affect the time and form of payment of amounts under the plans, and (ii) by stock rights (stock options and stock appreciation rights) that were intended at the time of grant (or upon a modification pursuant to applicable transition relief) to be subject to and compliant with Section 409A but that have a plan document failure.¹²

Relief Under Notice 2010-80 Regarding Information and Reporting Requirements for Operational Corrections

Notice 2008-113 requires information and reporting by the employee and employer in order to make use of the operational corrections program. For example, with respect to same year corrections, Notice 2008-113 provides that the employer must attach to its federal income tax return for its taxable year in which the failure occurred a statement titled "Section 409A Relief under Section [IV] of Notice 2008-113," with specific information about the correction, and the employer must provide to each affected employee a similar statement by the W-2 due date.¹³ Notice 2010-80 amends this provision so that notice to the employee is not required for corrections made in the same year of error.¹⁴

¹¹ Notice 2010-80 at § III.C, adding § VI.B.3 to Notice 2010-6.

¹² Notice 2010-80 at § III.A.

¹³ Notice 2008-113 at § IX.

¹⁴ Notice 2010-80 at § III.H, amending Notice 2008-113 at § IX.

Relief Under Notice 2010-80 Regarding Information and Reporting Requirements for Documentary Corrections

Notice 2010-6 provides that an employer with respect to any of the corrections in the notice must attach to its corporate tax returns and to Forms W-2 and 1099 for the year of failure an exhibit titled "§ 409A Document Correction Under § ___ of Notice 2010-6," which must include certain information about the correction.¹⁵ The affected employees must also be provided with a statement that the employee is entitled to the relief provided in the applicable provision in Notice 2010-6 with respect to a failure to comply with Section 409A. The statement must also contain the above information about the correction, and state that the employee must attach a copy of the statement to his or her income tax return for the taxable year in which the failure was corrected.¹⁶ The employee must attach to his or her tax return a copy of the above statement regarding the failure. Notice 2010-80 modifies Notice 2010-6 to provide that this statement is not required to be furnished by the employer to affected employees and the statement is not required to be attached by the employees to their tax returns with respect to transition relief corrections that may be made prior to Dec. 31, 2010, Dec. 31, 2011, or Dec. 31, 2012, as applicable,¹⁷ although the employer is still required to attach the statement to its return.¹⁸

Prompt Attention

For employers, prompt attention to documents and operating procedures is advisable, as some of the transition rules for corrections end on Dec. 31, 2010.¹⁹

¹⁵ Notice 2010-6 § XII.A. The attachment describing the documentary correction should set forth the name and tax identification number for each service provider affected by the failure, identification of the plan with the failure, a statement that the document failure is eligible for correction (and identifying the specific section of the notice with such correction) and stating the amount involved in the documentary error. Notice 2010-6 § XII.B.

¹⁶ Notice 2010-6 § XII.C.

¹⁷ The transition relief corrections are in Notice 2010-6 at § XI and in Notice 2010-6 at § VI.B.3 (as added by Notice 2010-80).

¹⁸ Sections III.E, F, and G of Notice 2010-80 amending § XII of Notice 2010-6.

¹⁹ For example, under Notice 2010-6, if a documentary error arises in 2008 and is corrected in 2010, the error may be considered cured within the following year.