

December 7, 2009

## There's Still Time! Correct Code Section 409A Violations By December 31, 2009

Employers have until December 31, 2009 to take advantage of opportunities to avoid the 20% and other penalty taxes that otherwise would be imposed by Section 409A of the Internal Revenue Code. We recommend employers review all their plans and agreements that are subject to Section 409A, including nonqualified deferred compensation, severance, change of control plans and agreements, and employment agreements.

**Operational Failures.** Companies that have not operated their nonqualified deferred compensation plans and arrangements in accordance with Section 409A of the Internal Revenue Code between 2005 and 2007 have until December 31, 2009 to correct certain "operational failures" and avoid the Section 409A penalties that otherwise would be imposed on the affected employees or other service providers. I.R.S. Notice 2008-113 (the "Notice") provides companies with an opportunity to correct operational failures to comply with Section 409A. Under the Notice, if a company corrects such failures in either the year the failure occurs or the immediately following year, and takes other steps as outlined in the Notice, it can avoid Section 409A's penalties. The Notice offers transition relief to correct certain operational failures that occurred between 2005 and 2007. If those failures are corrected by December 31, 2009, they will be treated as properly corrected, and the 20% and other penalty taxes will not be imposed on the employee or other service provider. Such relief is not available for operational failures involving insiders (generally, directors, officers, or 10% shareholders).

The types of operational failures that may be corrected under the transition rule by December 31, 2009 are the early payment of deferred amounts, the failure to delay payments to non-insider "specified employees" of a public company for six months following a separation from service, and the deferral of amounts that should otherwise have been paid as compensation from a nonqualified plan.

**Document Failures.** In addition, companies may correct plan documents and agreements to comply with Section 409A. An employer may amend provisions for non-vested benefits at any time, but such amendment will only protect benefits that vest in a future year. Therefore, if benefits will or may vest in 2010 (such as severance benefits), plan document failures must be corrected before December 31, 2009, to avoid Section 409A penalties for amounts under such plans that vest in 2010. Waiting until 2010 to correct a document failure would mean benefits vesting in 2010 would be subject to Section 409A's penalties.

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