

January 13, 2010

IRS Issues 409A Document Correction Program Immediate Action May Be Needed

The IRS has issued a Notice that describes a document correction program covering certain failures to comply with Section 409A of the Internal Revenue Code ("409A"). 409A contains tax rules for nonqualified deferred compensation arrangements. While this IRS program offers employers welcome relief from inadvertent drafting mistakes and other failures to conform applicable documents to the requirements of 409A, it also raises some additional concerns.

This Alert addresses one of those concerns—a subtle distinction in the way a plan or agreement subject to 409A provides for payment of amounts contingent on the employee's (or other service provider's) execution of a release, confidentiality, noncompete or other type of agreement.

The Notice states that an agreement subject to 409A cannot provide for a payment to an employee within a specified number of days (such as within 60 days) following employment termination, so long as the employee signs a release or other agreement within that time period. Leaving the timing of the payment to the employee's decision regarding when to sign the agreement is a violation of 409A, according to the IRS.

Rather, the agreement must provide that the employee will be paid on a specified date (such as on the 60th day) after employment termination, provided the employee signs the agreement by that date. Thus, timing of the payment is fixed and cannot be paid earlier, even if the release or other agreement is signed sooner.

This problem can be corrected without penalty, so long as the correction occurs before the employee terminates employment. Therefore, employers should review all employment and other agreements that are or may be subject to 409A for this and other potential violations in order to take advantage of available correction opportunities.

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