Deadline to Correct 409A-Covered Documents Involving Employee Releases Is December 31, 2012

Insights
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Internal Revenue Code Section 409A governs deferred compensation, which includes, with some exceptions, practically all agreements or plans in which an agreement is made in one year to pay an amount in a later year. Its most common form is a non-qualified deferred compensation plan in which the employer makes an unfunded promise to pay a dollar amount to the employee at a later time (termination of employment, specific age, etc.)

Section 409A is a relatively new Code provision, and after the regulations were finalized, the IRS issued some further guidance which provided tax relief for those deferred-compensation arrangements that were out of compliance with the final regulations.

One such publication is IRS Notice 2010-80, which modified the relief for correction of certain failures of a deferred compensation plan or agreement covered by Internal Revenue Code Section 409A. One of the changes was an expansion of the correction program for payments at employee separation from service, subject to the requirement that the departing employee sign a release of claims or similar document (such as a non-compete agreement or non-solicitation agreement).

If your 409A-covered employment agreements, separation agreements, deferred compensation plans, or arrangements include a requirement that the employee sign a release of claims in order to receive the benefit, you must act before December 31, 2012, to amend this language to comply with the provisions of IRS Notice 2010-80 or risk application of 409A's excise taxes upon later separation payments.

Many separation plans and agreements include a provision that require the departing employee to sign a release of claims to be eligible for the separation benefit. The IRS has stated that this release requirement gives the employee too much flexibility with regard to receipt of taxable income and could allow an employee to affect the year in which the separation benefit is received and taxed, which violates IRC 409A. As such the IRS has put restrictions on these provisions to try to eliminate employee flexibility. The correction of this 409A violation is relatively simple, requiring a plan amendment to establish less-flexible payment dates.

If your 409A-covered plan or agreement includes a release requirement, we recommend you have it reviewed by one of the attorneys in our Employee Benefits Practice Group as soon as possible so that any necessary amendments can be completed by December 31, 2012.

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