IRS Establishes Voluntary Correction Program

Insights
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Section 409A of the Internal Revenue Code generally provides that nonqualified deferred compensation plans must comply with certain complex rules regarding the timing of deferrals and distributions. Compliance must be in both form and operation. Failure to abide by section 409A's requirements will result in all amounts deferred under the plan for the current year and all previous years becoming immediately taxable to the employee, plus an additional 20% excise tax and interest penalty. As a result, a failure to comply with the requirements of section 409A can have severe adverse tax consequences to the executive.

The IRS recently issued a Notice which will provide methods for employers to voluntarily correct many types of failures to comply with the plan document requirements. By taking advantage of this correction program, you may be able to avoid or reduce the current income inclusion and additional tax penalties under section 409A.

General Requirements
The correction program is intended to encourage taxpayers to review nonqualified deferred compensation plans to identify provisions that fail to comply with the requirements of section 409A and to promptly correct those plan provisions in order to be in compliance and avoid tax penalty assessments. The Notice provides:

- clarification that certain language commonly included in plan documents will not cause a document failure;
- relief permitting correction of certain document failures without current income inclusion or additional taxes under section 409A, provided that the corrected plan provision does not affect the operation of the plan within one year following the date of correction;
- relief limiting the amount currently includible in income and the additional taxes under section 409A for certain document failures if correction of the failure affects the operation of the plan within one year following the date of correction;
- relief permitting correction of certain document failures without current income inclusion or additional taxes under section 409A if the plan is the employer's first plan of that type (disregarding any plans not subject to section 409A or any plans under which all deferred

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amounts have previously been paid or forfeited) and the failure is corrected within a limited period following adoption of the plan;

- transition relief permitting corrections of certain document failures without current income inclusion or additional taxes under section 409A if the document failure is corrected by December 31, 2010, and any operational failures resulting from the document are also corrected; and
- clarification of prior IRS guidance concerning correction of certain section 409A operational failures.

Recommendations

Take some time now to review your deferred compensation arrangements for compliance with Section 409A. If you identify errors, carefully consider correction alternatives to help reduce or avoid the significant section 409A penalties. If you'd like us to help, give us a call.

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