

IRS Embarks on 409A Audits: Staying in Shallow Waters?

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The IRS recently launched a limited audit initiative to gauge how well nonqualified deferred compensation plans are complying with Code Section 409A. The IRS has stated it will send Information Document Requests to a limited number of companies, purportedly fewer than 50, from a group of large employers that have been selected already for employment tax audits. The IRS hopes this initiative will help the Service refine its audit techniques and test compliance in three particular areas: (i) initial elections to defer compensation; (ii) subsequent elections to redefer deferred compensation; and (iii) plan distributions in compliance with Section 409A, including the requirement that distributions to “specified employees” of public companies be delayed for at least six months.

By focusing on those three areas, it appears the initiative is targeted primarily at traditional nonqualified deferred compensation plans, or “top hat” plans, which are common among large employers. If so, the scope of these audits would be relatively comfortable for both the Service and the employers because Section 409A, to the extent it is ever straightforward, applies most understandably and objectively to traditional top hat plans. The IRS presumably would review plan documents, election forms, and conduct participant sampling to tick-and-tie the plan’s compliance with the basic provisions of Section 409A.

Even if these audits do not venture into Section 409A’s deeper waters, such as the various gray areas that can frustrate incentive compensation and employment agreements, now is a good time for employers of all sizes to self-audit their various compensation agreements to gauge their level of Section 409A compliance. The IRS has made available correction programs for certain 409A failures, but those corrections generally are no longer available once the plans are subject to an IRS audit.

This Benefits Blast is brought to you by Michael Falk, author of the book, “Practical Guide to Code Section 409A” (CCH, 2012).

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