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Another Trap for Employers Under the IRS' Notice on 409A Correction Procedures

This is my third Blog on significant new issues raised by IRS issued Notice 2010-6, Relief and Guidance on Corrections of Certain Failures of a Nonqualified Deferred Compensation Plan to Comply with § 409A(a) (the "Notice"). As I noted in the first two Blogs, the Notice does much more than just offer correction methods. It contains examples of situations that the 409A final regulations do not clearly address – and provides for significant penalties for many plan provisions that a normal person might view as a foot fault.

The Notice includes this example relating to the everyday situation where the employer requires the employee to sign a release of claims before it pays him/her severance.

Employee's employment agreement entitles Employee to \$100x severance upon a separation from service. The severance is payable upon Employee executing and submitting a release of claims and after any period during which Employee may revoke the release pursuant to applicable law has expired, but the agreement does not include any time limit for payment. On April 1, 2011, Employer and Employee amend the employment agreement to provide for payment of \$100x on the 60th day following Employee's separation from service, provided that Employee has executed and submitted a release of claims and the statutory period during which Employee is entitled to revoke the release of claims has expired on or before that 60th day. Employee has a separation from service with Employer on June 16, 2011. Employee executes and submits a release of claims on July 1, 2011. Employer pays Employee \$100x on August 15, 2011.

Because Employer and Employee N corrected the provision *before* Employee's separation from service, Employee is not required to include any amount in income under 409A solely due to the pre-correction plan provision.

The good news is that the Notice allows the employer and employee to amend the employment agreement to set a hard deadline for execution (and failure to revoke) the Release. The bad news is that the example implies that, without that amendment, the employment agreement was in violation of 409A.

I guess we should look on the bright side: IRS may be preparing to whack us for minor document deficiencies, but it is giving us warning now, and the opportunity to correct the deficiencies.

For many employers, that means 409A reviews all over again, as we endeavor to ensure that plans and agreements comply with the IRS' new stricter standards.

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