

# ClientAlert

November 20, 2009

## Section 409A: Certain Violations May be Corrected by Year End

It is not too late to correct certain violations of Internal Revenue Code Section 409A. Although the deadline for bringing non-qualified deferred compensation arrangements into compliance with Section 409A has passed, it is still possible to correct certain operational violations of Section 409A and to correct certain plan documentation deficiencies. The deadline for such corrections is generally December 31, 2009.

**Section 409A Generally.** Section 409A imposes strict rules for non-qualified deferred compensation arrangements and strict penalties and other adverse tax consequences on participants if the rules are not followed. These penalties include a 20% penalty tax, interest at the federal underpayment rate plus 1% and immediate taxation upon vesting. These adverse tax consequences apply both to the non-compliant arrangement as well as any similar arrangement that must be aggregated with the non-compliant arrangement for purposes of Section 409A, regardless of whether the similar arrangement complies with Section 409A.

Section 409A applies to both public and private companies and to a broad range of arrangements, including traditional deferred compensation plans, excess retirement and savings plans, bonus plans and employment-related agreements.

Section 409A became effective in 2005. Companies have been required to operate their non-qualified deferred compensation arrangements in accordance with (or under an exemption from) Section 409A since January 1, 2005. Companies were given until the end of 2008 to amend non-qualified deferred compensation plan documents to comply with (or be exempt from) Section 409A.

**New Audit Initiative.** The IRS has begun auditing companies for compliance with Section 409A. A number of companies have received Information Document Requests from the IRS requesting information about compensation arrangements subject to Section 409A. If your company has not already done so, now would be a good time to review your company's non-qualified deferred compensation arrangements to ensure that they have been operated and documented in accordance with Section 409A. Although the deadline for bringing plans into compliance with Section 409A has passed, it is not too late to correct certain Section 409A violations under one of the correction methods described below.

**Operational Violations.** Late last year, the IRS announced a correction program where companies could correct certain **operational** violations of Section 409A, such as certain early and late payments, payments made to specified employees of public companies before the end of the six-month waiting period and discounted stock options. The correction program is set forth in [IRS Notice 2008-113](#) and is summarized in our [previous client alert](#). Under the operational violations correction program, it may be possible to correct operational violations that occurred in 2008 (and, in certain cases, earlier years) with respect to "non-insiders" and to correct operational violations that occurred in 2009 with respect to "insiders." "Insiders" generally include directors, officers and 10% or more owners of the company. The deadline for making such corrections is December 31, 2009. Such corrections generally may be made without substantial penalties.

**Documentary Violations.** The Treasury Department and the IRS are expected to announce in the very near future a new program that would permit companies to correct certain plan document deficiencies. Although details of the new program are not yet available, the new program is expected to provide some relief to companies that may have missed the documentary compliance deadline. Finally, it may be possible to amend certain documents that do not comply with Section 409A if amounts under the non-compliant non-qualified deferred compensation arrangements (and any similar arrangements that are required to be aggregated with such non-compliant arrangements) are not yet vested. This exception may be *used in very limited cases* and is subject to the IRS's policy against "anti-abuse."

**Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:**

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