
employee benefits lawflash

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Section 409A Transitional Relief Deadline Approaching

Deferred compensation arrangements under which payments subject to Section 409A are contingent on a release must be brought into compliance with documentation requirements by December 31.

The December 31, 2012, deadline is quickly approaching for amending affected deferred compensation arrangements to comply with the Code Section 409A documentation requirements that apply for payments that are contingent on execution (and, where applicable, nonrevocation) of a release of claims. The affected arrangements could potentially include equity, nonqualified retirement, and severance or employment arrangements. Employers need to identify and revise any noncompliant agreements before the December 31 deadline.

Background

On November 30, 2010, the Internal Revenue Service (IRS) issued Notice 2010-80, which provided guidance for correcting nonqualified deferred compensation plans under Section 409A of the Internal Revenue Code. Notice 2010-80 modified provisions in Notice 2008-113 (regarding 409A operational failures) and Notice 2010-6 (regarding 409A documentary failures).¹

IRS Notice 2010-80 provides transitional relief through December 31, 2012, for Section 409A documentary failures involving payment arrangements that are contingent on the execution of a release (such as a severance payment that is subject to Section 409A and is contingent on execution of a release of claims). The IRS takes the position that an arrangement providing for payments of Section 409A deferred compensation to be made subject to execution of a release may allow for the possibility that an employee could manipulate the year in which payment is made by accelerating or delaying the execution and delivery of the release. Where the employee can thereby exercise control over the year of payment, the IRS has indicated that such a provision would violate the prohibition on an employee directly or indirectly designating the calendar year of payment for a payment of deferred compensation subject to Section 409A, thus triggering an automatic Section 409A violation.

IRS Notices 2010-6 and 2010-80 offer corrective relief by providing that such documentary failures can be corrected by either of the following methods:

- Providing for payment on a fixed date (such as on the 60th day following separation) so that delivery of the release does not affect payment timing.
- Providing that any payment that could be paid over a release consideration and revocation period beginning in one taxable year and ending in the subsequent taxable year will be paid in the subsequent taxable year

1. For a more detailed discussion of IRS Notices 2008-113, 2010-6, and 2010-80, see the following LawFlashes: "2009 Offers Section 409A Correction Opportunities" (Feb. 11, 2009), available at http://www.morganlewis.com/pubs/EB_409ACorrectionOpportunities_11feb09.pdf; "IRS Issues Document Corrections Program for Deferred Compensation Plans Under Code Section 409A" (Jan. 11, 2010), available at http://www.morganlewis.com/pubs/EB_409ADocCorrections_LF_11jan10.pdf; and "Executive Compensation and Equity Compensation Plan Issues for Consideration as 2011 Approaches" (Dec. 6, 2010), available at http://www.morganlewis.com/pubs/EB_LF_ExecutiveCompensationEquityCompensationPlanIssues_06dec10.pdf.

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(again, so that release delivery does not affect payment timing).

Applicable transition relief under IRS Notice 2010-80 requires that payments under an arrangement with a nonconforming release provision triggered between March 31, 2011, and December 31, 2012, must be administered by paying in the later taxable year where an applicable release period spans two taxable years.

Any deferred compensation arrangement under which payments of deferred compensation subject to Section 409A are contingent on a release must be amended by December 31, 2012, to comply with the requirements of Section 409A, generally using one of the two methods described above. Only arrangements that are subject to Section 409A (and for which no exemption is applicable) are affected by these requirements. Accordingly, exempt short-term deferral (vest and pay) amounts, or exempt separation pay, generally do not involve this compliance issue because the rule regarding employee influence over year of payment applies only to payments of Section 409A deferred compensation (and not to exempt amounts).

Actions Needed

Employers should review compensation arrangements that provide payments that are contingent on execution of a release, if they have not done so already, in order to identify and correct any noncompliant provisions as necessary in advance of the December 31, 2012, deadline for amendment.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Chicago

Brian D. Hector	312.324.1160	bhector@morganlewis.com
Louis L. Joseph	312.324.1726	louis.joseph@morganlewis.com

New York

Craig A. Bitman	212.309.7190	cbitman@morganlewis.com
Gary S. Rothstein	212.309.6360	grothstein@morganlewis.com

Palo Alto

S. James DiBernardo	650.843.7560	jdibernardo@morganlewis.com
Zaitun Poonja	650.843.7540	zpoonja@morganlewis.com

Philadelphia

Robert L. Abramowitz	215.963.4811	rabramowitz@morganlewis.com
Brian J. Dougherty	215.963.4812	bdougherty@morganlewis.com
I. Lee Falk	215.963.5616	ilfalk@morganlewis.com
Amy Pocino Kelly	215.963.5042	akelly@morganlewis.com
Robert J. Lichtenstein	215.963.5726	rlichtenstein@morganlewis.com
Vivian S. McCardell	215.963.5810	vmccardell@morganlewis.com
Joseph E. Ronan	215.963.5793	jronan@morganlewis.com
Steven D. Spencer	215.963.5714	sspencer@morganlewis.com
Mims Maynard Zabriskie	215.963.5036	mzabriskie@morganlewis.com
David B. Zelikoff	215.963.5360	dzelikoff@morganlewis.com

Pittsburgh

Lisa H. Barton	412.560.3375	lbarton@morganlewis.com
John G. Ferreira	412.560.3350	jferreira@morganlewis.com
R. Randall Tracht	412.560.3352	rtracht@morganlewis.com

Washington, D.C.

Althea R. Day	202.739.5366	aday@morganlewis.com
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Morgan Lewis

David R. Fuller
Mary B. (Handy) Hevener
Daniel L. Hogans
Gregory L. Needles

202.739.5990
202.739.5982
202.739.5510
202.739.5448

dfuller@morganlewis.com
mhevener@morganlewis.com
dhogans@morganlewis.com
gneedles@morganlewis.com

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