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April 30, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Relief and Guidance on Corrections of Certain Failures of a Nonqualified
Deferred Compensation Plan to Comply with Section 409A(a)

Dear Commissioner Shulman:

Enclosed are comments on relief and guidance on corrections of certain failures of a nonqualified deferred compensation plan to comply with section 409A(a). These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stuart M. Lewis
Chair, Section of Taxation

Enclosure

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
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ABA SECTION OF TAXATION

COMMENTS ON RELIEF AND GUIDANCE ON CORRECTIONS OF CERTAIN FAILURES OF A NONQUALIFIED DEFERRED COMPENSATION PLAN TO COMPLY WITH SECTION 409A(a)

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Althea R. Day, Chair of the Executive Compensation Subcommittee of the Employee Benefits Committee of the Section of Taxation. Substantive contributions were made by Pamela Baker, Brian Benko, Adam Cohen, Dennis Drapkin, Elizabeth Drigotas, Maureen Gorman, Andrew Oringer, James Raborn, Priscilla Ryan, Susan Serota, Steven Sholk, Charmaine Slack, Douglas A. Smith and Martin Tierney. The Comments were reviewed by Joni Andrioff, Vice Chair of the Committee, and by Eleanor Banister, Chair of the Committee. The Comments were further reviewed by Bruce D. Pingree of the Section’s Committee on Government Submissions, and by Thomas R. Hoecker, Council Director for the Employee Benefits Committee.

Although the members of the Section who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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Date: April 30, 2010

EXECUTIVE SUMMARY

These Comments relate to the relief and guidance on corrections of certain failures of a nonqualified deferred compensation plan to comply with section 409A(a),¹ as set forth in Notice 2010-6, issued on January 5, 2010 (the “Notice”),² and also respond to the request by the Internal Revenue Service (the “Service”) and the Department of Treasury (“Treasury”) in the Notice for public comments³ regarding other document failures that commonly occur and methods to correct those other document failures.

We commend the Service and Treasury for providing this guidance, and appreciate the substantial efforts that went into the Notice, especially in the absence of any Congressional or statutory direction to create such a program.

Following is a summary of our recommendations with respect to the Notice:

A. We recommend that (a) an individual service provider be considered “under examination” for purposes of the Notice only after the individual has received written notice specifically indicating that his or her federal tax return is under examination for a nonqualified deferred compensation plan issue for the year in which the deferred compensation plan document failure exists; (b) the application of the transition relief provided in Section XI.D of the Notice be expanded to individual service recipients; and (c) the transition relief provided in Section XI.D of the Notice be made permanent, without regard to whether the transition relief is expanded to individual service recipients.

B. We recommend that Section III of the Notice be revised to clarify that document failures resulting from a reasonable, good faith effort to comply with section 409A are eligible for relief under the Notice, even if such failures could be characterized under certain circumstances as other than “inadvertent and unintentional.”

C. We recommend that the Notice be revised to provide relief for stock rights that are not otherwise eligible for correction under Notice 2008-113⁴ and that are not intended to come within the exception under Regulation section 1.409A-1(b)(5).

D. We recommend that Section III of the Notice be modified to eliminate the exclusion for linked plans and that the relief in Section XI.B of the Notice be made permanent.

¹ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

² 2010-3 I.R.B. 275.

³ Notice § XV.

⁴ 2008-51 I.R.B. 1305.

E. We recommend that:

a. When neither income inclusion nor penalty is required for document correction under the Notice, (i) a service recipient not be required to provide a service provider with the information statement described in Section XII.B of the Notice (a “Section 409A Document Correction Statement”), and (ii) a service provider not be required to attach a Section 409A Document Correction Statement to his or her tax return.

b. Alternatively, under the transitional relief in Section XI of the Notice, (i) a service recipient not be required (A) to attach a Section 409A Document Correction Statement to its return or (B) to provide a service provider a Section 409A Document Correction Statement, and (ii) a service provider not be required to attach a Section 409A Document Correction Statement to his or her tax return.

F. We recommend that the relief provided for certain documentary compliance failures under the Notice, including the transition relief set forth under Section XI.A of the Notice, be expanded to allow for the correction of plan documents that are intended to satisfy the short-term deferral exception to section 409A.

G. We recommend that, with respect to correction of impermissible payment periods following a permissible payment event, (a) Section VI.C, Example 3, of the Notice be modified to provide facts clearly indicating that the service provider’s consent to a release results in the acceleration of the payment; and (b) the Notice be modified to treat release contingencies in the same manner as treatment of failures under Section IV.A of the Notice or, alternatively, the Notice be modified to permit payment within the 90-day period described in Regulation section 1.409A-3(b) instead of requiring that a qualifying correction state as a payment date only the 60th or 90th day after the payment event.

H. We recommend that Section X of the Notice be revised to clarify that, in general, no document failure can occur until the written plan deadline (determined in accordance with Regulation section 1.409A-1(c)(3)(i)) has expired.

I. We recommend that (a) Treasury and the Service issue guidance addressing documentary corrections made on or after January 1, 2009, and prior to the release of the Notice, providing that when it is evident from the nonqualified deferred compensation plan document that a good faith effort was made prior to January 1, 2009, to bring the plan document into compliance with section 409A, neither the uncorrected plan provision nor the correction should be treated as a violation of section 409A; and (b) in such a case, (i) a service recipient would not be required to provide a Section 409A Document Correction Statement to a service provider and (ii) a service provider would not be required to attach a copy of a Section 409A Document Correction Statement to the service provider’s tax return.

COMMENTS

I. BACKGROUND

These Comments address the documentary correction program provided under the Notice. Regulations under section 409A require a nonqualified deferred compensation plan to be written and to satisfy certain other requirements, effective as of January 1, 2009.⁵ Failure by service recipients to comply with these rules results in significant adverse tax consequences for service providers, including immediate income inclusion by the service providers of all applicable vested deferred compensation, as well as a 20% additional tax and the application of a premium interest tax.⁶

Given the complexity of the statutory and regulatory requirements of section 409A and the significant penalties associated with a failure to be in documentary compliance, a documentary correction program is most welcome, and the substantial efforts of the Service and Treasury evidenced in the Notice are greatly appreciated.

These Comments provide recommendations on aspects of the Notice that we believe support and are consistent with the purpose of encouraging service recipients to review and correct their nonqualified deferred compensation plans promptly and to ensure that they satisfy the documentary requirements of section 409A.

II. DISCUSSION

A. Relief not Available to Service Providers and Certain Service Recipients Under Examination.

1. Summary

Section III.C of the Notice prohibits relief under Sections V-XI of the Notice if the federal income tax return of the service provider or service recipient is under examination with respect to nonqualified deferred compensation for any taxable year during which a document failure existed in the deferred compensation plan at issue. Under the Notice, an individual service provider or service recipient is considered to be “under examination” if the individual is under examination with respect to any issue regarding the individual’s federal income tax return for the taxable year. If the service provider or service recipient is not an individual, the entity is considered to be “under examination” with respect to nonqualified deferred compensation only if the service provider or service recipient receives written notice specifically citing nonqualified deferred compensation as an issue under examination. According to the Notice, such written notice may take the form of an examination plan, an information document request or notification of proposed adjustments or income tax examination changes.

⁵ Reg. § 1.409A-1(c)(3).

⁶ See I.R.C. § 409A(a)(1).

Additionally, Section XI.D of the Notice provides limited transition relief with respect to the “under examination” requirement for corrections made on or before December 31, 2011. Under the transition relief, for periods beginning on or before December 31, 2011, a non-individual service recipient is considered to be under examination with respect to nonqualified deferred compensation only with respect to any specific document failure identified as an issue in the examination (including any other plan of the service recipient with a substantially similar document failure). No similar transition relief is provided with respect to service providers or individual service recipients.

2. **Recommendations**

We recommend that (a) an individual service provider be considered “under examination” for purposes of the Notice only after the individual has received written notice specifically indicating that his or her federal tax return is under examination for a nonqualified deferred compensation plan issue for the year in which the deferred compensation plan document failure exists; (b) the application of the transition relief provided in Section XI.D of the Notice be expanded to individual service recipients; and (c) the transition relief provided in Section XI.D of the Notice be made permanent, without regard to whether the transition relief is expanded to individual service recipients.

3. **Explanation**

Sections III.C and XI.D of the Notice distinguish between individuals and persons that are not individuals in defining when a person is “under examination.” For example, if an individual service provider’s return is examined for a mathematical error, the individual would not be eligible for relief under the Notice. However, if the examiner finds the same errors on the return of a non-individual, relief would be available under the Notice unless the examiner also identifies nonqualified deferred compensation as an issue. We believe that an individual service provider or service recipient should not be treated as “under examination” until he or she receives written notification that his or her tax return is being examined specifically for a nonqualified deferred compensation issue. Thus, mere consideration or selection of a return for examination by an office of the Service, without more, would not constitute an “examination” of the return for purposes of the Notice.

An individual is less likely to be familiar with the documentary requirements of section 409A and, in the case of a service provider, the specific provisions of the deferred compensation arrangement in which he or she participates. Accordingly, it seems unlikely that an individual would conclude from a general notice of examination that he or she would not be eligible for relief under Sections V through XI of the Notice.

Similarly, we recommend that the transition relief in Section XI.D of the Notice be extended to individual service recipients as well as non-individual service recipients.

Further, we recommend that the transition relief in Section XI.D of the Notice be extended to periods after 2011, limiting “under examination” to those specific document failures identified to the service recipient to be at issue in the examination. If the rationale for the transition rule is that many large companies are continually under audit and therefore need a more limited definition of being “under examination,” the same rationale would apply for all periods, not just periods before 2012. The more limited definition of the transition rule (requiring a notice to identify a specific document failure as an issue) provides more certainty to service recipients in identifying which nonqualified deferred compensation plans are eligible for correction. Moreover, it does not appear that the broader definition of “under examination” in Section III.C of the Notice (requiring a notice that simply cites nonqualified deferred compensation as an issue under consideration) would better curb any abusive practices or provide an additional incentive for prompt correction than the financial penalties under the Notice, regardless of whether the service recipient is an individual or a small or large company.

B. No Relief for Intentional Failures.

1. Summary

The Notice provides that a document failure must be “inadvertent and unintentional” to be eligible for any of the permissible correction methods.

2. Recommendation

We recommend that Section III of the Notice be revised to clarify that document failures resulting from a reasonable, good faith effort to comply with section 409A are eligible for relief under the Notice, even if such failures could be characterized under certain circumstances as other than “inadvertent and unintentional.”

3. Explanation

Preparation of documents entails some measure of deliberation and intent and we respectfully submit that, without further development, the standard set forth in the Notice is difficult to apply and potentially overly broad.⁷

For example, an experienced practitioner preparing or reviewing a plan document might make reasonable, good faith efforts to comply with section 409A, or to meet the requirements for an exception to section 409A, but, for one reason or another, fail to do so (*e.g.*, there may be a “good reason” definition for an involuntary separation from

⁷ This point was made in an earlier comment to the Service regarding a potential documentary relief program by a third-party administrator of numerous nonqualified deferred compensation plans:

[A]s opposed to an operational failure which can occur due to an error in payroll or bookkeeping software or the like, a plan document failure does not occur without the preparation of documents by the Service Recipient or legal counsel, review of those documents by the Service Recipient and Provider, and subsequent execution of those documents by the parties involved.

Letter dated March 6, 2009, from Renaissance Bank Advisors, at 13.

service payment that fails to meet the requirements of Regulation section 1.409A-1(n)(2)). Such an error could be said to be “intentional” in that the provisions were deliberately drafted. The requirement that the error be both “inadvertent and unintentional” could be interpreted to exclude any such document failures from relief under the Notice. Further, we do not believe the word “inadvertent” to be helpful in these situations, as it suggests an unconscious error, something akin to a typographical error, which would not address document errors resulting from a reasonable, good faith application of the law.

Accordingly, we recommend that Section III of the Notice be revised to clarify that document failures that result from a reasonable, good faith effort to comply with section 409A are eligible for relief under the Notice.

C. **Stock Rights not Eligible for Relief.**

1. **Summary**

Section III.G of the Notice provides that relief provided in the Notice generally is not available for stock rights. Stock rights instead are eligible for correction only under Sections IV.D and V.E of Notice 2008-113,⁸ which limits correction to those stock options and stock appreciation rights that otherwise satisfy the requirements of Regulation section 1.409A-1(b)(5)(i)(A) or (B), except that the exercise price of the stock right is erroneously established at less than the fair market value of the underlying stock on the date of grant.

2. **Recommendations**

We recommend that the Notice be revised to provide relief for stock rights that are not otherwise eligible for correction under Notice 2008-113 and that are not intended to come within the exception under Regulation section 1.409A-1(b)(5).

3. **Explanation**

A stock right is defined in Regulation section 1.409A-1(l) as “a stock option (other than an incentive stock option described in section 422 or an option granted pursuant to an employee stock purchase plan described in section 423) or a stock appreciation right.” A “stock appreciation right” means “[a] right to compensation based on the appreciation in value of a specified number of shares of service recipient stock.”⁹ Thus, the limitation on eligibility for relief could be interpreted as applying to any nonqualified deferred compensation arrangement that determines the amount payable by reference to increases in the value of underlying equity, and not just to an option or appreciation right that was intended to come within the exception from section 409A under Regulation section 1.409A-1(b)(5)(i)(A) or (B).

⁸ 2008-51 I.R.B. 1305, 1311, 1314.

⁹ Reg. § 1.409A-1(b)(5)(i)(B).

Many deferred compensation plans may be characterized as stock rights, but are not designed to and do not need to comply with the exception under Regulation section 1.409A-1(b)(5)(i)(A) or (B). For example, plans that provide a benefit based on stock that would not qualify as service recipient stock or provide economic benefits in addition to the appreciation permitted by the exception could be ineligible for relief under Notice 2008-113. Such plans are subject to section 409A on the same terms as any other deferred compensation plan, and carry the same potential for documentary failures. The mere fact that the benefit formula references equity appreciation does not seem a sufficient basis to exclude such plans from generally applicable relief.

We are not certain that the intent of the Notice is to exclude relief in all cases involving stock rights. In any event, we suggest that the Notice be clarified to address certain stock rights. In particular, we recommend that the eligibility exclusion only apply to stock rights that are eligible for correction under Notice 2008-113 (*i.e.*, stock rights that comply with all requirements of the stock rights exception under Regulation section 1.409-1(b)(5)(i)(A) or (B) except that the exercise price was erroneously established at less than fair market value of the underlying stock on the date of grant). The effect of this revision would be that the eligibility exclusion would not apply (and relief would therefore be available) when the only aspects of the plan that are noncompliant are otherwise eligible for correction under the Notice. Our recommendation would permit correction of plans that are stock rights plans because the plan formula is based on appreciation of an equity interest, but are not designed to satisfy, or otherwise do not need to comply with, the stock rights exception.

D. Linked Plans not Eligible for Relief.

1. Summary

With limited exceptions, Section III.G of the Notice excludes linked plans from relief under the Notice.

2. Recommendations

We recommend that Section III of the Notice be modified to eliminate the exclusion for linked plans and that the relief in Section XI.B of the Notice be made permanent.

3. Explanation

When the amount deferred or the time or form of payment in a nonqualified deferred compensation plan is determined by the amount deferred or the time or form of payment under another plan (whether qualified or nonqualified), the plans are referred to as “linked” plans.¹⁰ While there are compliance issues that may arise because of the linkage between the amount of benefits or the time and form of payment among linked plans, these plans also may experience the same documentary failures addressed in the

¹⁰ See Notice, § III.G.

Notice. Those errors (*e.g.*, errors with respect to definitions) bear no relation to the linked status of the plan. Accordingly, to the extent that Treasury and the Service are concerned that the documentary noncompliance arises from the linked structure of the plan, we respectfully suggest that relief could be tailored to apply only in cases in which the compliance failure does not relate to the linkage.

The correction permitted in Section XI.B provides a method for correcting failures that arise because of the relation between two nonqualified deferred compensation plans. In a sense, this failure is not dissimilar from other failures that are eligible for correction, such as impermissible distribution alternatives or impermissible discretion to change timing of distributions. The reasons for benefits to be provided under two plans that are linked, rather than under one plan, are often historical, related to the evolution of plan design, internal promotions or corporate transactions. Such issues will continue to arise after 2011. As a result, we recommend that this relief be permanent.

In the case of a nonqualified deferred compensation plan that is linked to a qualified plan, the time and form of distributions cannot be aligned because of the qualification requirements. Such a nonqualified deferred compensation plan is completely excluded from relief under the Notice, even though documentary failures of such plan may be unrelated to any issue associated with the link to the qualified plan benefit. We recommend that nonqualified deferred compensation plans that are linked to qualified plans be eligible for correction of failures that are otherwise covered by the Notice.

E. **Information and Reporting Requirements.**

1. **Summary**

Section XII of the Notice describes the information and reporting required for an effective correction of a documentary failure. Those requirements include, generally, that information be attached to the service recipient's tax return in the year of the correction (and the subsequent year if a service provider is required to include an amount in income in the subsequent year);¹¹ information be provided to the service provider;¹² and information be attached to the service provider's tax return for the year of the correction and, if applicable, the subsequent year.¹³ These information and reporting requirements apply to documentary failures described in Sections V to XI of the Notice.

¹¹ Notice § XII.B.

¹² Notice § XII.C.

¹³ Notice § XII.D.

2. **Recommendations**

We recommend that:

a. *When neither income inclusion nor penalty is required for document correction under the Notice, (i) a service recipient not be required to provide a service provider with a Section 409A Document Correction Statement, and (ii) a service provider not be required to attach a Section 409A Document Correction Statement to his or her tax return.*

b. *Alternatively, under the transitional relief in Section XI of the Notice (i) a service recipient not be required (A) to attach a Section 409A Document Correction Statement to its return or (B) to provide to a service provider a Section 409A Document Correction Statement, and (ii) a service provider not be required to attach a Section 409A Document Correction Statement to his or her tax return.*

3. **Explanation**

We believe that the information and reporting requirements of the Notice will be burdensome for service recipients and service providers alike. In our view, significant difficulties in preparing the Section 409A Document Correction Statement include communicating with outsourced payroll providers and determining the value of an instrument, such as an option or contingent interest, and determining the value of common performance-based awards when there is a broad range of possible outcomes (including zero) for the amount of the eventual payout (which might not occur for several years). Further, requiring service recipients to prepare, file and provide to service providers a Section 409A Document Correction Statement could have a chilling effect on service recipients' willingness to correct nonqualified deferred compensation plan documents, particularly because the penalty for noncompliance falls almost entirely on the service provider. Additionally, a Section 409A Document Correction Statement may confuse service providers, who may assume, erroneously, that the correction is adverse to their interests and being made for a business reason unknown to them, such as an imminent change in control or a reduction in force.

Requiring a service provider to include a Section 409A Document Correction Statement with his or her tax return as a condition to relief does not serve a useful enforcement objective. In almost all cases, the service provider will have had no control over the documents governing his or her nonqualified deferred compensation. The Section 409A Document Correction Statement will not necessarily educate the service provider or his or her tax advisors because the statement is not required to describe the error corrected (it merely indicates the relevant section of the Notice that is being relied upon) or state whether a penalty is involved. Further, the plan document is not required to be attached to either the service recipient's return or the service provider's return. Thus, the service provider cannot determine whether an error exists or has been properly corrected. Finally, the relevant information needed for audit purposes is in the hands of the service recipient; requiring an additional filing by the service provider does not provide new or additional information to the Service.

When no income inclusion or penalty is required as a condition to the correction, we believe the burdens of preparing, providing and filing the Section 409A Document Correction Statement outweigh the benefit of the information provided in that statement. In addition, we are concerned that many service providers may fail to attach the Section 409A Document Correction Statement to their returns through inadvertence or oversight, with the harsh result that those service providers would be ineligible for relief under the Notice and, therefore, subject to the full array of section 409A penalties.

On the other hand, it is possible, especially in 2010, that service recipients might file a Section 409A Document Correction Statement as a precaution for each of many plans maintained by the service recipient in a good faith attempt to comply with the Notice, when changes made to the plans are minimal and, perhaps, not required. For example, a service recipient might enter into such a correction merely to remove ambiguities even though no filing is required, nor would any income inclusion be required. Such a response to the Notice would not only be burdensome to taxpayers but also to the Service.

Section XI of the Notice sets out transition relief for corrections made by December 31, 2010 (and in the case of linked plans, by December 31, 2011). For service recipients that are attentive to the details of section 409A and who wish their documents to be compliant, we believe the burden of notifying dozens, or in some cases thousands, of service providers that the service recipient has corrected a “document failure” (when in many cases the “failure” will involve inoffensive terms such as “termination of employment,” or the failure to define “change in control” or “disability,” or to include a procedure for obtaining a waiver and release on separation from service that conforms to the Notice) frequently may outweigh the perceived risk of not modifying the documents. The Section 409A Document Correction Statement requirements seem particularly burdensome when there is no penalty involved. In those circumstances when correction under the transition relief in Section XI may involve a penalty, the Notice provides that correction is achieved by following Notice 2008-113, which has its own information and reporting requirements.¹⁴ We believe the information and reporting requirements under Section IX of Notice 2008-113 should be a sufficient aid to enforcement, and no Section 409A Document Correction Statements should be necessary.

F. **Short-Term Deferral Failures.**

1. **Summary**

The Notice provides no relief for document failures resulting from payments that are intended, but fail, to qualify for the short-term deferral exception. Given the complexity and broad scope of section 409A and the Regulations, as well as the varied interpretive issues that continue to exist, there are a number of circumstances in which the parties may have intended for payments to qualify for the short-term deferral exception, but due to drafting errors or some unforeseen or uncontrollable event, the payments in fact do not meet the short-term deferral exception.

¹⁴ 2008-51 I.R.B. 1305, 1320-1321.

2. Recommendation

We recommend that the relief provided for certain documentary compliance failures under the Notice, including the transition relief set forth under Section XI.A, be expanded to allow for the correction of plan documents that are intended to satisfy the short-term deferral exception to section 409A.

3. Explanation

The short-term deferral rule represents an important exception to section 409A. Nonetheless, the exception reflects a decision by Congress that unvested deferred compensation paid shortly after the close of the taxable year in which it becomes vested should not be subject to the detailed compliance requirements imposed on vested deferred compensation.¹⁵ Further, we understand that Treasury and the Service concurred that taxpayers should not be provided with relief if no efforts were made to comply with section 409A. However, an important purpose of the Notice is to encourage taxpayers to review their nonqualified deferred compensation plans for compliance with section 409A and promptly correct certain types of failures. We believe that this purpose applies to plans intended to qualify for the short-term deferral exception.

Payments that are intended to qualify for the short-term deferral exception are technically nonqualified deferred compensation that would be subject to the requirements of section 409A and Regulation section 1.409A-1(c) but for the short-term deferral exception. Many plan drafting challenges and pitfalls exist that could result in a failure of a plan to qualify for the short-term deferral exception. Section 409A and the Regulations contain a highly complex set of rules governing document and operational compliance that are still developing. In many cases, it may be difficult to distinguish short-term deferral drafting problems that create section 409A failures from those enumerated in Sections V-X of the Notice. For example, there is considerable uncertainty regarding the meaning of a “substantial risk of forfeiture” with respect to the entitlement to an amount that is “conditioned on the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial.”¹⁶ It remains unclear whether, and to what extent, certain types of compensation and long-standing compensation practices (*e.g.*, various forms of contingent payments) in certain industries ultimately would qualify as payments of short-term deferrals.

The following discussion provides a few examples of circumstances in which relief permitting correction of plan provisions providing for certain short-term deferral failures would be justified. We recognize that such relief generally should be consistent with the conditions for relief set forth in the Notice. We believe that our recommendations would encourage review of plans, prompt correction, and compliance with section 409A and Regulation section 1.409A-1(c) without creating the potential for abuse or providing unwarranted advantages to noncompliant taxpayers.

¹⁵ See Staff of the Joint Comm. on Taxation, General Explanation of Tax Legislation Enacted in the 108th Congress 476 (2005); Notice 2005-1, 2005-1 C.B. 274, 277-278, § IV.A, Q&A-4(c).

¹⁶ Reg. § 1.409A-1(d).

a. A plan provides that a payment is to occur on the day following filing of corporate financials (or another event related to the service recipient's business). It is possible that due to unexpected circumstances, the filing of the financials (or other event) could be delayed beyond the short-term deferral period. A helpful correction would permit a service recipient to amend the plan to provide for a specified payment date that is the last day of the short-term deferral period, provided such amendment occurs prior to the last day of the short-term deferral period and is immediately effective. The relief would be similar to the relief for correction of impermissible payment periods following a permissible payment event under Section VI of the Notice.

b. A plan provides for payment of severance in installments to a service provider who is a specified employee. The payments are intended to qualify for the short-term deferral exception. However, the plan does not include the provision that each payment will be regarded as a separate payment and, due to the facts at the time of separation, payment cannot be completed within the applicable short-term deferral period. A helpful correction would permit the service recipient to amend the plan to add the provision that each payment will be regarded as a separate payment thereby allowing for payments made during the short-term deferral period to qualify as short-term deferral payments. The relief would be similar to relief for correction of impermissible payment periods following a permissible payment event under Section VI of the Notice.

c. Assume the same facts as in b., except that the service provider was not a specified employee at the time the legally binding right was created, the plan does not include a six-month delay provision, and the service provider through a series of promotions becomes a specified employee. The plan, however, was not modified to add the separate payment provision or a six-month delay provision on or before the specified employee effective date applicable to the service provider. A helpful correction would allow the service recipient to amend the plan to add the separate payment and six-month delay provisions, with relief similar to Section VIII of the Notice.

d. A plan provides for a six-month delay for all payments made on separation from service, and does not distinguish between payments that would qualify for short-term deferral and those that are nonqualified deferred compensation; as a result, the six-month delay could be applicable to the short-term deferral payments. A helpful correction would allow the service recipient to amend the plan to clarify that the six-month delay provision applies only to payments that constitute nonqualified deferred compensation, with relief similar to that in Section VIII of the Notice.

e. A plan is intended to include a good reason definition that satisfies the safe harbor provision under Regulation section 1.409A-1(n)(2)(ii). However, the plan fails to specify the number of days for the notice or cure period or incorrectly specifies the number of days for the notice or cure period; or alternatively, includes a cure period but fails to specify a notice period. A helpful correction would permit the service recipient to amend the plan to specify a notice or cure period that complies with the safe harbor provision of the Regulations, with relief similar to Section V.A of the Notice.

G. Payment Periods Following a Permissible Payment Event Dependent Upon the Service Provider Completing Certain Employment-Related Actions (i.e., Release Provisions).

1. Summary

The Regulations provide that deferred compensation may be paid within certain periods after the occurrence of an event designated in section 409A as a permissible payment event. A plan provides for timely payment if the plan provides that the date of the event is the payment date or specifies another payment date that is objectively determinable and nondiscretionary at the time the event occurs.¹⁷ The plan also may use taxable years as the basis for payment.¹⁸ A payment made on account of a permissible payment event will not violate section 409A merely because the payment is made during a designated period that is objectively determinable and nondiscretionary at the time the payment event occurs, if (i) the designated period begins and ends within one taxable year of the service provider, or (ii) the designated period is not more than 90 days and the service provider does not otherwise have a right to designate the taxable year of the payment other than pursuant to a deferral election that satisfies Regulation section 1.409A-2.¹⁹ (The rule in the foregoing clause (ii) is referred to below as the “90-Day Rule,” and the provision therein generally proscribing service provider discretion to designate the taxable year of payment is referred to below as the “No-Discretion Requirement.”)

2. Recommendations

We recommend that, with respect to correction of impermissible payment periods following a permissible payment event, (a) Section VI.C, Example 3, of the Notice be modified to provide facts clearly indicating that the service provider’s consent to a release results in the acceleration of the payment; (b) the Notice be modified to treat release contingencies in the same manner as treatment of failures under Section IV.A of the Notice; and (c) alternatively, the Notice be modified to permit payment within the 90-day period described in Regulation section 1.409A-3(b) instead of requiring that a qualifying correction state as a payment date only the 60th or 90th day after the payment event.

3. Explanation

The Regulations provide for flexibility as to when payments can be made over short periods of time after a designated permissible payment date, not to exceed 90 days and subject to the No-Discretion Requirement, without violating the requirements of section 409A. The Regulations, therefore, may be viewed as reflecting a policy decision that permitting a distribution to be moved from one taxable year to the following year, or

¹⁷ Reg. § 1.409A-3(b) (first sentence).

¹⁸ Reg. § 1.409A-3(b) (third sentence).

¹⁹ Reg. § 1.409A-3(b) (fourth sentence).

vice versa, in the context of a short period at the exclusive discretion of the service recipient constitutes an acceptable balance between administrability and the potential for manipulation of the timing of income.

Section 409A does not allow the timing of a payment to be determined by the service provider's decision as to when to execute a release. Treasury and the Service declined to provide for any release-specific relief for the period of time after a payment event and execution of a release during which a distribution may be made.²⁰ As a result, many customary release provisions in severance and other agreements that make payments contingent upon the execution and non-revocation of employment-related actions (*e.g.*, execution and submission of a release of claims, noncompetition or nonsolicitation agreement) present compliance challenges under section 409A.

Section VI.B of the Notice provides that if a compliance failure arises by virtue of the inclusion of a contingency for an employment-related action by the service provider, the plan may be amended prior to the occurrence of a permissible payment event to correct the failure. The amendment must change the payment date to the last date of the designated period. If the nonqualified deferred compensation plan does not provide for a designated payment period, then the amendment must set the payment date at 60 or 90 days from the permissible payment event.

We recommend that the relief in Section VI.B of the Notice be expanded. In certain respects, the Notice may have the effect of further tightening the substantive rules, rather than providing relief. For example, Example 3 in Section VI.C of the Notice assumes that the employment agreement at issue "provides that the amount is payable within 90 days of [the service provider's] separation from service, but not until [the service provider] executes and submits a release of claims . . . before the end of the 90-day period. If [the service provider] fails to execute the release the amount is forfeited." This example purports to describe a situation that provides a service provider with an impermissible "right to designate the taxable year of the payment."²¹ Under the facts, however, it is not clear that the service provider possesses such a right, because providing the release does not compel prompt payment.²² It would be helpful if Example 3 were modified to provide a situation that is more clearly problematic, such as a provision for which giving the release requires the acceleration of the payment.

More broadly, given the nature of a release and its use in commercial practice, we do not believe the potential income timing contingency presented by the use of a release (based on the practices prior to the enactment of section 409A) justifies the substantive interpretation presented in Section VI of the Notice. In our experience, release requirements are not used even to a minor extent to manipulate income timing, but rather are used to expeditiously terminate an employment relationship while addressing actual

²⁰ See T.D. 9321, 2007-1 C.B. 1123, 1142; *see also* Reg. § 1.409A-3(j)(4)(xiv); T.D. 9321, 2007-1 C.B. 1123, 1161.

²¹ Reg. § 1.409A-3(b), fourth sentence.

²² *See infra* note 23.

and potential residual liabilities of the service recipient. In our view, neither party to the release, but most especially the service provider, has any incentive to use the release to defer the receipt of payments or benefits. Furthermore, in our experience, practitioners and advisors who prepare releases frequently are not tax or benefits experts and may not be familiar with the nuances of section 409A, thereby creating a trap for the unwary. Consequently, the timing consequences attributable to release requirements, viewed in a section 409A context, closely resemble the effect of the common commercial practice of using phrases such as requiring payment “as soon as practicable” or substantially similar language, which has been approved without penalty in Section IV.A of the Notice. Accordingly, we recommend that the Service treat release contingencies in the same manner as Section IV.A of the Notice, with the same or similar qualifications as are set forth in that Section IV.A.

Alternatively, we request reconsideration of the requirement that a qualifying correction provide for a payment date only upon the 60th or 90th day after the payment event. We believe that the specificity of this requirement is not necessary to achieve its intended purpose and, as explained below, will have the unfortunate effect of failing to cure a large number of highly technical but harmless documentary errors. One possible approach would be to have payments commence no later than 90 days (or some shorter period) after separation from service, together with a requirement that the release be delivered and become irrevocable on or before the expiration of the 90-day (or shorter) period. This approach relies upon the flexibility provided by the 90-Day Rule to pay within a multiple tax year period, so long as the service provider does not otherwise have discretion to determine the taxable year of payment.²³

Another area of correction involves the situation in which, notwithstanding documentary compliance, the parties, due to a bona fide dispute, cannot agree within 90 days after the separation from service or other permissible payment event on the terms of

²³ There are a number of arguments to support the position that permitting the payment to be made within a 90-day (or shorter) period of time after separation from service, while requiring that the release be delivered and become irrevocable on or before the expiration of the relevant period, does not give the service provider impermissible discretion under the No-Discretion Requirement. One argument relies on the principle that the service recipient may always choose to make the payment, without waiting for the release. Viewed from this vantage point, the service provider has no control over timing. It also may be argued that the 90-Day Rule itself acknowledges that a service recipient may have a limited amount of discretion to waive a right to delay payment, in that any payment made before the final day of the period reflects an implicit waiver of the right to defer the payment until the end of the period. Essentially, the service recipient remains in control of payment within the 90-day (or shorter) period, as it is always free to waive the release requirement, just as it is free to commence payments before the expiration of the full 90-day or shorter period.

Another argument that a provision that restricts payment until the service provider returns an executed release does not run afoul of the No-Discretion Requirement is the service provider’s inability to compel payment in the earlier year even if the release is given early. Since the service recipient is only required to make the payment no later than the end of the applicable period, the service provider is never left in control of the year of payment. The ability to withhold the release and cause a deferral of the commencement of payment to the next year does not amount to an election within the service provider’s control, since the service provider cannot compel earlier-year payment in any event.

the release or whether it should be given at all.²⁴ This situation may occur when a claim surfaces during release negotiations. Our concern is that if additional relief is not provided, in the context of a bona fide dispute over the terms of release, section 409A may become a means by which service recipients apply pressure to service providers to agree to the terms of a release to avoid application of section 409A penalties.

This issue may arise in the context of nonqualified deferred compensation payment, and also in the context of a short-term deferral that, by virtue of the delay, becomes noncompliant nonqualified deferred compensation. We believe that correction, including correction that would allow status as a short-term deferral to be maintained, should be permitted if payments are made as soon as practicable after agreement in principle is reached regarding the release. To address concerns regarding manipulation and abuse in light of the peculiarly fact-sensitive nature of the inquiry, we recommend that Treasury and the Service consider a provision under which the conduct of the parties would be expressly subject to close scrutiny.

Finally, we also believe that many release provisions that the Service may now consider as providing impermissible discretion will in fact be rewritten, following common commercial practice, as a part of a definitive termination agreement prior to and in connection with the actual separation from service so as to specify payment dates or payment periods that follow or conclude shortly after the service provider's termination date; such provisions, however, may not happen to specify the 60th or 90th day after termination as the payment date. For example, the final separation agreement may simply state that payment will be made only if the release has become effective and all revocation periods have expired within 30 days after termination of employment. We, therefore, recommend that the Service accept as a sufficient correction under Section VI.B of the Notice any similar definitive language as long as it states a payment provision that would reasonably satisfy the requirements of Regulation section 1.409A-3(b). We urge the Service to take this approach to avoid a multitude of harmless violations of section 409A that are not intended to manipulate the timing of income.

H. Amendment Period Following Initial Adoption of a Plan.

1. Summary

Under Section X of the Notice, a plan provision that would violate section 409A on its face and that has been adopted prior to the regulatory deadline for satisfying the written plan requirement of section 409A will be treated as a document failure. This treatment appears to be inconsistent with regulatory guidance on the timing for establishing a written plan.²⁵

²⁴ This issue is distinguished from the issue that arises when payment times are changed by virtue of the settlement itself. See Reg. § 1.409A-3(j)(4)(xiv).

²⁵ See Reg. § 1.409A-1(c)(3)(i).

2. Recommendation

We recommend that Section X of the Notice be revised to clarify that, in general, no document failure can occur until the written plan deadline (determined in accordance with Regulation section 1.409A-1(c)(3)(i)) has expired.

3. Explanation

A plan may be established in writing at any time up and until the written plan deadline set forth under Regulation section 1.409A-1(c)(3)(i) without violating section 409A. This Regulation prescribes the requirements for when a plan is considered to be “established” for purposes of section 409A. A plan is considered established on the latest of the date it is adopted, the date it is effective, and the date on which the material terms are set forth in writing. A plan also is considered to be established when the service provider obtains a legally binding right to the deferral of compensation as long as, among other events, the material terms of the plan are set forth in writing by the later of (a) the end of the service provider’s taxable year in which the legally binding right arises, or with respect to an amount that is not payable in the year (the “subsequent year”) immediately following the service provider’s taxable year in which the legally binding right arises, the 15th day of the third month of the subsequent year.²⁶ For convenience, we will refer to this rule as the “written plan deadline.”

In our experience, many have interpreted the written plan deadline to permit the written terms of a nonqualified deferred compensation plan to be identified or revised without violating section 409A at any time until the expiration of the written plan deadline. We are concerned about a rule under which taxpayers that reduced their plan terms to writing at an earlier time could be penalized.²⁷ To avoid risk of penalty, a cautious taxpayer might wait until the written plan deadline to set forth the terms of the plan in writing, which seems counterproductive.

We respectfully suggest that no document failure can occur until the written plan deadline has expired. Consequently, we believe that a plan provision may be revised without penalty (rather than “corrected”) at any time up and until the applicable written plan deadline. In our view, any other interpretation would be inconsistent with the appropriate application of the requirements of Regulation section 1.409-1(c)(3)(i) and would deter, rather than encourage, taxpayers to comply promptly with the written plan requirements of section 409A. In addition, declaring a plan provision to be in violation of section 409A as soon as it is written rather than at the end of the written plan deadline

²⁶ Reg. § 1.409A-1(c)(3)(i).

²⁷ Similar proposals were made prior to the publication of the Notice. We do not perceive any policy articulated in the Notice that would rebut the rationales expressed in comments on these earlier proposals. See New York State Bar Association Tax Section, Employee Benefits Committee Report on a Program to Remedy Documentary Noncompliance by Section 409A Plans in Response to Notice 2008-113, March 25, 2009, at 8-10; letter dated September 17, 2009, from Michael Francese and Seth Safra of Covington & Burling LLP, at 3-4.

appears to be inconsistent with the policy underlying the rules applicable to same-year corrections established under Notice 2008-113.²⁸

We recognize two instances in which this suggestion could run counter to the policies underlying section 409A. First, the plan may have been operated inconsistently with the later-adopted documents. Second, the adoption of the plan could amount to the making of an untimely late election that is not consistent with section 409A. We acknowledge that relief should not apply in those situations.

I. **Document Corrections Made Prior to Publication of the Notice.**

1. **Summary**

Documentary compliance under section 409A became effective on January 1, 2009. The Notice was released on January 5, 2010, and published in the Internal Revenue Bulletin on January 19, 2010. In the interim, taxpayers who identified potential documentary failures may have corrected noncompliant plan provisions. The Notice does not address the status under section 409A of such corrections.

2. **Recommendation**

We recommend that (a) Treasury and the Service issue guidance addressing documentary corrections made on or after January 1, 2009, and prior to the release of the Notice, providing that when it is evident from the nonqualified deferred compensation plan document that a good faith effort was made prior to January 1, 2009, to bring the plan document into compliance with section 409A, neither the uncorrected plan provision nor the correction should be treated as a violation of section 409A; and (b) in such case, (i) a service recipient would not be required to provide a Section 409A Document Correction Statement to a service provider and (ii) a service provider would not be required to attach a copy of a Section 409A Document Correction Statement to his or her tax return.

3. **Explanation**

The appropriate treatment of corrections made after December 31, 2008, and prior to issuance of the Notice in 2010 is uncertain. On the one hand, the applicable deadline had been extended several times and remained at January 1, 2009, notwithstanding further requests to extend the deadline, with no mandate on the Service at that time to publish a corrections program. On the other hand, the Service eventually did publish a corrections program, thereby leaving the status of interim corrections in doubt. We therefore recommend that taxpayers who implemented a correction during the interim period not be penalized relative to taxpayers who did not act until after publication of the Notice. Further, we recommend that in such instances, (a) a service recipient not be required to provide a Section 409A Document Correction Statement to a service provider and (b) a service provider not be required to attach a copy of a Section 409A Document

²⁸ 2008-51 I.R.B. 1305.

Correction Statement to his or her tax return. In order not to inappropriately benefit taxpayers who failed to abide by the January 1, 2009, deadline, we suggest limiting relief for corrections made during the interim period to those nonqualified deferred compensation plans that were previously documented in a manner that evidences a good faith timely effort to comply, generally, with the requirements of section 409A.