April 19, 2010

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

Re: Comments on Notice 2008-115 Reporting and Wage Withholding Requirements with Respect to Amounts Includible in Income Under Section 409A

Dear Commissioner Shulman:

Enclosed are comments on Notice 2008-115 reporting and wage withholding requirements with respect to amounts includible in income under section 409A. 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  
William Wilkins, Chief Counsel, Internal Revenue Service  
Joshua Odintz, Acting Tax Legislative Counsel, Department of the Treasury  
George H. Bostick, Benefits Tax Counsel, Office of Benefits Tax Counsel, Office of Tax Policy, Department of the Treasury  
Alan N. Tawshunsky, Deputy Division Counsel/Deputy Associate Chief Counsel (Employee Benefits) Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), Internal Revenue Service  
J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy, Department of the Treasury
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, the Comments should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Dennis Drapkin, Ryan Liebl, and Wayne Luepker of the Employee Benefits Committee of the Section of Taxation. The Comments were reviewed by John L. Utz, Vice Chair of the Committee and by Eleanor Banister, Chair of the Committee. The Comments were further reviewed by Pamela Baker on behalf of the Quality Assurance Group of the Committee, James R. Raborn on behalf of the Section’s Committee on Government Submissions and Thomas R. Hoecker, Council Director for the Employee Benefits Committee.

Although the members of the Section of Taxation 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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April 19, 2010
EXECUTIVE SUMMARY

These Comments are submitted in response to the request by the Internal Revenue Service (the “Service”) and the Department of the Treasury (“Treasury”) in Notice 2008-115, issued on December 10, 2008 (the “Notice”),¹ for public comments regarding certain issues arising with respect to reporting and wage withholding requirements under section 409A ² that are addressed on an interim basis by the Notice.

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

1. We recommend that the rules set forth in the Notice be modified to provide that, when the requirements set forth in the Notice are inconsistent with the requirements set forth in Proposed Regulation section 1.409A-4 (the “Proposed Regulations”),³ or when an issue is addressed in the Notice or the Proposed Regulations but not both, (i) the determination of whether a taxpayer has satisfied the requirements of the Notice will not be adversely affected by reason of the taxpayer’s choice of whichever requirement of the Notice or the Proposed Regulations is applicable, and (ii) the failure to comply with some of the terms of the Proposed Regulations and the Notice will not, in itself, adversely affect a taxpayer’s ability to comply with other portions of the Notice.

2. We recommend that the Notice establish a reasonable, good faith standard of compliance for reporting and withholding issues that are within the general scope of the Notice but not specifically addressed by the Notice.

3. We recommend that if a service provider relies in good faith on information furnished by a service recipient or relies in good faith on the absence of any information from a service recipient, penalties (and to the extent permissible, interest) be waived.

² References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.
COMMENTS

The Notice is effective for taxable years beginning on or after January 1, 2008, and will remain effective until subsequent guidance is issued. Consequently, the Notice may serve as relevant guidance for a significant period. In view of the importance of the issues discussed below, we believe that certain aspects of the Notice should be reconsidered.

1. Relationship Between the Notice and the Proposed Regulations.

Summary.

The Preamble to the Proposed Regulations provides:

The Treasury Department and the IRS anticipate issuing interim guidance during 2008 addressing the extent to which taxpayers may rely on the proposed regulations with respect to the calculation of the amounts includible in income under §409A(a) and the calculation of the additional taxes under §409A(a). . . . The Treasury Department and the IRS anticipate that such interim guidance will provide that taxpayers may rely upon the proposed regulations in their entirety (but that taxpayers may not rely on part, but not all, of the proposed regulations).4

The Notice was published two days later. Section V of the Notice provides that:

Until the Treasury Department and the IRS issue further guidance, compliance with the provisions of the proposed regulations with respect to the calculation of the amount includible in income under §409A(a) and the calculation of the additional taxes under §409A will be treated as compliance with the requirements of this notice, provided that the taxpayer complies with all the provisions of the proposed regulations.

This language could imply that a taxpayer must choose to rely on either the Notice entirely or the Proposed Regulations entirely. The language also could mean that compliance with all of the provisions of the Proposed Regulations is one method of complying with the Notice, but not the exclusive method. Representatives of the Service have said that taxpayers need not follow the Proposed Regulations, but if they do, taxpayers must follow all of the provisions of the Proposed Regulations, not just those that are favorable to the taxpayer, and that this requirement is intended to prevent “cherry picking” of taxpayer-favorable provisions from the Notice or the Proposed Regulations. In practice, unfortunately, it is not clear how to reconcile this policy with the provisions in the Notice and section 409A.

Recommendation.

We recommend that the rules set forth in the Notice be modified to provide that, when the requirements set forth in the Notice are inconsistent with the requirements set forth in the Proposed Regulations, or when an issue is addressed in the Notice or the Proposed Regulations but not in both, (i) the determination of whether a taxpayer has satisfied the requirements of the

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Notice will not be adversely affected by reason of the taxpayer’s choice of whichever requirement of the Notice or the Proposed Regulations is applicable, and (ii) the failure to comply with some of the terms of the Proposed Regulations and the Notice will not, in itself, adversely affect a taxpayer’s ability to comply with other portions of the Notice.

Explanation.

The Notice is not comprehensive. Moreover, as noted in the following examples, some of the issues that are not addressed by the Notice are covered by the Proposed Regulations.

As an example of potential inconsistency, Section III.B.3.d of the Notice provides guidance in computing the amount includible in income under section 409A(a) for only a limited number of types of deferred compensation plans. For other types, the amount must be determined under the Notice using “a reasonable, good faith application of a reasonable, good faith method,” whereas specific rules are provided in the Proposed Regulations. The reasonable, good faith method, as established by the taxpayer and consistent with the foregoing language of the Notice, may be inconsistent with the methodology set forth in the Proposed Regulations.

As examples of items that are covered in the Proposed Regulations but not the Notice, the Notice does not provide guidance on (i) the computation of the premium interest tax or (ii) the treatment of amounts included in income that are subsequently reduced or forfeited.

Taxpayers inevitably will consult the Proposed Regulations for guidance to resolve issues that are not covered by the Notice. Thus, for this purpose and within the constraints stated in Section III.B.3.d of the Notice, reliance on provisions of the Proposed Regulations should be permissible without precluding reliance on the Notice for issues addressed therein. Otherwise, given the limited scope of the Notice and the broader coverage of the Proposed Regulations, the likelihood that taxpayers would need to consult the Proposed Regulations for certain purposes could result in widespread unavailability of the Notice.

The integration of the Notice and the Proposed Regulations is further complicated by the following statement in Section III.B.3.d of the Notice: “For the ability to rely on the assumptions concerning the time and form of payment set forth in the proposed regulations, see Section V of this Notice.” Section V of the Notice provides that if a taxpayer “complies with all of the provisions of the proposed regulations,” the taxpayer is deemed to have complied with the Notice. This sequence of references suggests the possibility that the intended priority of the Proposed Regulations is or could be limited in the following manner. If taxpayers choose to rely on the assumptions concerning the time and form of payment that are set forth in the Proposed Regulations, taxpayers must also rely on all of the rules in the Proposed Regulations that are related to such assumptions. Otherwise, some flexibility in choice is acceptable. If the intent is that taxpayers may choose to rely on the assumptions in the Proposed Regulations concerning the time and form of payment without being required to rely on all of the rules in the Proposed Regulations related to such assumptions, it would be helpful to have confirmation of this ability.

Finally, the apparent priority of the Proposed Regulations over the Notice seems unnecessary in the light of high probability that parts of the Proposed Regulations will be revised
as a result of the comment process and further consideration by the Treasury and the Service, including the possibility that other compliance alternatives may be developed.

2. **Compliance for Subjects Not Covered by Notice.**

**Summary.**

The Notice does not address certain reporting or withholding issues.

**Recommendation.**

We recommend that the Notice establish a reasonable, good faith standard of compliance for reporting and withholding issues that are within the general scope of the Notice but not specifically addressed by the Notice.

**Explanation.**

The rules governing reporting and withholding for section 409A are complex, and their application in certain circumstances remains unclear. For example, the computation of the section 409A premium interest tax is not covered by the Notice. We recommend that the Notice state generally (as it does specifically in Section III.B.3.d for “other deferred amounts” not addressed in Section III.B.3) that for any section 409A reporting or withholding subject not covered by the Notice, a “reasonable, good faith application of a reasonable, good faith method” will be treated as compliance with the Notice until such time as applicable guidance is published, including final regulations.

A similar approach was permitted in Notice 2005-1.

Section II of that notice provided that because it did not “provide comprehensive guidance with respect to the application of §409A”:

> Until additional guidance is issued, to comply with the requirements of §409A with respect to issues not addressed in this notice, taxpayers should base their positions upon a good faith, reasonable interpretation of the statute and its purpose, which includes consideration of the legislative history. Whether a taxpayer position constitutes a good faith, reasonable interpretation of the statutory language generally will be determined based upon all of the relevant facts and circumstances, including whether the taxpayer has applied the position consistently and the extent to which the taxpayer has resolved unclear issues in the taxpayer’s favor.

In addition, a good faith compliance operational standard was initially set forth in Q&A-19 of Notice 2005-1, and subsequently extended through December 31, 2008.

We believe that because of uncertainty as to the application of the reporting and withholding requirements, it is appropriate for the Service to provide that with respect to

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reporting and withholding, compliance with a good faith, reasonable interpretation of applicable statutory and administrative rules will be deemed to satisfy the requirements of the Notice.

3. **Coordination of Calculation between Employer and Employee.**

**Summary.**

Section IV.A of the Notice provides that service providers and service recipients must calculate the amounts includible under section 409A under the same methods and standards. Service provider compliance with the Notice is to be determined independently of service recipient compliance. Consequently, service providers may be subject to penalties and additional taxes even if they follow the information furnished by service recipients.

**Recommendation.**

We recommend that if a service provider relies in good faith on information furnished by a service recipient or relies in good faith on the absence of any information from a service recipient, penalties (and to the extent permissible, interest) be waived.

**Explanation.**

A system of compliance with section 409A that is based on independent determinations by service providers is unrealistic and impractical. Service providers will often lack information needed to prepare such a determination, such as whether a documentary or operational failure under section 409A has occurred or data necessary to compute the section 409A consequences. Further, a service provider will rarely have the resources necessary to make the determinations required under section 409A.

It also is possible that during the period that the Notice is in effect, a service provider and a service recipient might compute different amounts to be included in income under section 409A, and that both computations would correctly follow the applicable guidance. For example, a service recipient might choose to rely on the Proposed Regulations, while a service provider might rely exclusively on the Notice.\(^6\) We recommend that in such circumstances the Service accept both determinations. As to the calculation of taxes due, because the service provider is the taxpayer for purposes of section 409A tax liabilities, we believe that only the service provider’s computation, if correct under the Notice, would be controlling.

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\(^6\) See the example in item 1 above, relating to the provisions of the Notice relating to a good faith method of determining the amount as compared to the specific method of determination in the Proposed Regulations.