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IRS Issues 409A Document Correction Program: The Six Month Payment Delay for Key Employees (second in a series)

As described in an [earlier alert](#), the IRS has announced a document correction program covering certain failures to comply with Section 409A of the Internal Revenue Code ("Section 409A"), which contains tax rules for nonqualified deferred compensation arrangements. This Alert focuses on a common error that can now be corrected, and the importance of finding and correcting this and other errors as quickly as possible.

Generally, if a payment to a key employee of a public company is (i) subject to Section 409A and (ii) triggered by the employee's "separation from service," that payment must be delayed by at least six months after the employee's separation. If the relevant agreement or plan document does not explicitly provide for this delay, it violates Section 409A, potentially triggering immediate taxation, an additional 20 percent tax, and other penalty taxes.

Under the IRS correction program, this error can be corrected at any time prior to the employee's separation from service by amending the relevant document to incorporate the six-month delay requirement and to provide that any payment subject to that requirement will not be paid before the later of (i) 18 months after the date of the correction or (ii) six months after separation from service. Certain reporting requirements also apply.

While this error can be corrected at any time prior to the employee's separation from service, a transition rule makes correction during 2010 particularly desirable. There will be no adverse tax consequence for documents that are corrected by December 31, 2010, so long as the amendment is completed before the separation from service occurs. For corrections made after 2010, if the employee separates from service within 12 months of the correction date, 50 percent of the relevant amount will be includible in income for the year of separation (even if payment is not made until a later year) and will be subject to Section 409A's additional 20 percent tax (but not otherwise applicable penalty taxes). Similar rules apply for other types of errors. Consequently, it is important to identify and correct document errors during 2010.

Employers should review all plans, employment and other agreements that are or may be subject to Section 409A for this and other potential violations in order to take advantage of available correction opportunities. For more information, please feel free to contact any [lawyer](#) in the [Employee Benefits Group](#).