

Strafford

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*Presenting a live 110-minute teleconference with interactive Q&A*

# Employee Fringe Benefits and Sect. 409A Deferred Compensation: Tax Issues

Evaluating Exclusions or Potential Federal Taxability

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WEDNESDAY, JUNE 12, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Tara Silver-Malyska, Tax Principal, UHY Advisors, Dallas

James Davis, Shareholder and Chairman, Tax Practice Group, Gunster, Fort Lauderdale, Fla.

Stefan Smith, Partner, Locke Lord, Dallas

Cynthia A. Moore, Member, Dickinson Wright, Troy, Mich.

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**For this program, attendees must listen to the audio over the telephone.**

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Please refer to the instructions emailed to the registrant for the dial-in information. Attendees can still view the presentation slides online. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

# IRS CORRECTION PROGRAMS

- **Internal Revenue Service notices with correction methods**
  - Notice 2008-113
  - Notice 2010-3
  - Notice 2010-6
- **Types of failures/non-compliance**
  - Operational failure (OF)
  - Plan document failure (PDF)
- **Notice 2008-113** (incorporates Notice 2007-100)
  - Purposes of Notice 2008-113
    - Methods for correction of certain *operational failures* occurring during the SP's taxable year
    - Limited transition relief limiting amount includable in income from operational failures
    - Special transitional relief for operational failures occurring before Jan. 1, 2008
    - Requested comments as to potential guidance for correction of document failures

# CORRECTION PROGRAMS (CONT.)

- Features of Notice 2008-113
  - Eligibility
  - Required payment by SP to SR
    - SP must repay gross payment amounts back to SR, or SR may reduce SP compensation before applicable deadline.
  - Correction of OFs in same taxable year of occurrence
    - Must be repaid on or before end of SP's taxable year in which amount was paid
  - Correction of OFs in immediately following taxable year of occurrence
    - Must be repaid on or before end of SP's taxable year in which amount was paid
    - Correction method is not available to "insiders" – officer, director or 10% shareholder of SR.
    - Payment is reported on W-2 or 1099.

# CORRECTION PROGRAMS (CONT.)

- Amounts that should have been treated as deferred but were actually paid prematurely.
  - Amount is limited to the §402(g)(1)(B) limitation.
  - SP receives W-2 or 1099 for such payment.
  - 20% excise tax applies, but premium interest is not assessed.
- Amounts of deferred compensation that should have been paid, or amounts that were treated as deferred compensation but should have been paid
  - Amount is limited to the §402(g)(1)(B) limitation.
  - Amount is paid by SR to SP by end of SP's following taxable year.
  - SP receives W-2 or 1099 for such payment.
  - 20% excise tax applies.

# CORRECTION PROGRAMS (CONT.)

- Relief for certain other operational failures discovered in a subsequent taxable year of SR
  - Generally requires repayment, reporting of income, payment of 20% excise tax - but not the premium interest
- Transitional rule for non-insiders for OFs occurring prior to Jan. 1, 2008
  - For OFs occurring prior to Jan. 1, 2008, 2009 will be treated as the SP's next taxable year.
- Information and reporting requirements:
  - SR must attach a statement for “§409A Relief” to federal income tax return with required information.
  - SR must provide each SP the above statement with required information.
  - SP must attach a statement for “§409A Relief” to federal income tax return with required information.
  - “Required information” is set forth in notice and is “disclosure data.”

# CORRECTION PROGRAMS (CONT.)

## ■ Notice 2010-06

### ○ Purposes of Notice 2010-06

- Contains methods to voluntarily correct PDFs
- Clarifies that certain, commonly used language will not cause PDFs
- Relief permitting correction without income inclusion or 20% excise tax
- Correction must not affect the operation of the plan within one (1) year following correction; otherwise, income inclusion and 20% excise tax apply.
- Relief permitting PDF correction for initial plan adoptions within limited period after plan adoption
- Transition relief if PDF is corrected by Dec. 31, 2010
- Clarifies aspects of Notice 2008-113

# CORRECTION PROGRAMS (CONT.)

- PDF correction features of Notice 2010-6
  - Ambiguous plan terms – generally amend *before* event occurs
  - Plan provides payment to be made “as soon as reasonably practicable” -- payment must occur by end of the year or the 15<sup>th</sup> day of third calendar month following event.
  - Permissible payment event but no definition or ambiguous definition, e.g., “termination of employment” and not SFS
    - Amend to define
    - §409A “savings” clause will suffice.
  - Impermissible definitions of otherwise permissible payment events, e.g., improper definition of SFS, CICE, disability
    - Amend plan to properly define event before payment occurs
    - 25% or 50% income inclusion if “bad” CICE or SFS occurs within one year after correction, respectively
  - Impermissible payment periods following a permissible payment event, e.g., payment periods longer than 90 days after event occurs

# CORRECTION PROGRAMS (CONT.)

- 50% inclusion if “bad” event occurs within 12 months
- Payments requiring SP to complete post-SFS actions, e.g., a *general release* or non-competition agreement
  - Amendment must provide for either a fixed date, e.g., on 60<sup>th</sup> or 90<sup>th</sup> day or if “within 90 days” then payment must be in following year if period straddles SP’s taxable year-end
- Impermissible payment events and schedules if there is *at least one* permissible payment event
  - 50% income inclusion if event occurs within 12 months
- Impermissible payment events and schedules if there is *no permissible payment event*
  - 50% income inclusion if event occurs within 12 months
- Impermissible discretion in SP or SR to payment schedule after a permissible payment event
  - Amendment (i) before discretion exercised and (ii) at least one year before event occurs; otherwise, 50% income inclusion

# CORRECTION PROGRAMS (CONT.)

- Impermissible reimbursement
  - Amendment one year before reimbursement event; otherwise, 50% income inclusion
- Failure to include six-month delay of payment for “specified employee”
  - Amend before event to provide payment at *later* of 18 months after correction or six months after event; otherwise, 50% income inclusion
- Impermissible initial deferral elections
  - SP or SR may revoke initial election and correct before applicable deadline
  - If corrected after deadline, correction applies as of date made
- Amendment of plan by SR
  - Amend by end of calendar year or 15<sup>th</sup> day of third month in which legally binding obligation arose
- Transition relief: A correction prior to Dec. 31, 2010, will be deemed corrected as of Jan. 1, 2009, and no income inclusion.

# CORRECTION PROGRAMS (CONT.)

- Impermissible provisions linking non-qualified plans
    - Correction was required prior to Dec. 31, 2011 and made before payment event occurred.
  - Failure to include objective payment schedule for timing of payments to SP when received by the SR
    - Correction before payments are made to SP
  - Non-individual SRs under audit for pre-Jan. 1, 2012 years
    - Will only be treated as “under examination” for specific DFs that have been identified, i.e., correction may still be available
  - Information and reporting
  - SR and SP must report on federal income tax returns similar to Notice 2008-113
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- **Notice 2010-80**
    - Clarifies certain parts of Notice 2010-06
    - Extended correction deadline for SP discretion, e.g., general releases, noncompetition agreements to Dec. 31, 2012

# CORRECTION PROGRAMS (CONT.)

## ▪ IRS information document requests

- See Strafford Publications presentation “Section 409A Audits on the Rise” held Thursday, Feb. 11, 2010
- Sample IDR questions:

For all tax years beginning after Dec. 31, 2006:

- List all plans and arrangements that provide a service provider with a legally binding right to compensation in one year, with payment to be made in a later year
- Indicate why the deferral is not subject to Sect. 409A
- List the terms of the non-qualified deferred compensation plan’s elections, including deadlines
- List payments that were deferred beyond the originally scheduled payment date including terms, payment date and rescheduled payment date
- Names of “specified employees” and list of deferred compensation payments with dates made to them

# CORRECTION PROGRAMS (CONT.)

- Indicate the original payment date and actual payment date of any deferred compensation payments
- Indicate if there were any acceleration of payments
- Summarize terms of each nonqualified deferred compensation plan and each modification made after adoption
- Identify and describe Sect. 409A violations and if such amounts were reported on a W-2 or Form 1099
- Identify participation in any correction programs and provide copies of federal income tax returns and 409A informational statements
- Provide information on all stock rights that may be subject to Sect. 409A and how they were valued
- Provide a description of any non-qualified deferred compensation funding resulting from a decline in the company's financial condition
- Provide dates of initial deferral elections and any subsequent modifications
- Indicate any funding of deferred compensation and dates