



presents

Section 409A Audits on the Rise

Prevailing in an IRS Audit and Navigating the New and Ongoing Challenges in 409A Compliance

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

Gail W. Stewart, Partner, **Baker Botts**, Houston
Michael S. Melbinger, Partner, **Winston Strawn**, Chicago
Steven Friedman, Partner, **Little Mendelson**, New York

Thursday, February 11, 2010

The conference begins at:

1 pm Eastern

12 pm Central

11 am Mountain

10 am Pacific

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Scope of IRS Audits and Information Document Requests (IDRs)

*** * * ***

No Rest for the 409A Weary

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Overlapping IRS Audits

- **409A audits**
 - Started in 2009, covering 2006 tax years
 - Comprehensive audit of NQDC arrangements
- **National Research Project (“NRP”) audits**
 - Announced in Fall of 2009 to begin in early 2010
 - Massive audit initiative
 - Comprehensive employment tax audits
 - Executive compensation (including 409A) one area of review

409A IDRs - NQDC Arrangements

- **IDRs for periods under examination cover:**
 - Arrangement details
 - Documents, in some cases
 - Legal conclusions
 - Participant/service provider information

409A IDR's - NQDC Arrangements (cont.)

- **Identify plans/arrangements that provided service provider a legally binding right in one year to payment of compensation in a subsequent year that is not a non-qualified deferred compensation plan subject to § 409A**
 - Identify corresponding service providers
 - Provide basis for position that such plan/arrangement is not a non-qualified deferred compensation plan subject to 409A
 - Where such basis is that the plan/arrangement provides short-term deferral, describe terms of arrangement including terms of any relevant substantial risk of forfeiture

409A IDRs - NQDC Arrangements (cont.)

- **Did the company maintain any plan/arrangement under which a service provider elected to defer the receipt of compensation that would otherwise have been paid during 2006 or a later year, as to which there was no previous deferral election?**
 - Identify terms under which all such elections were made, including any relevant deadline for making an election

409A IDR's - NQDC Arrangements (cont.)

- **Did the company defer a payment beyond the originally scheduled payment date, for example, by amending the arrangement providing for the payment?**
 - Identify terms of each subsequent deferral, including original payment date and rescheduled payment date
 - Were any subsequent deferrals made with respect to amounts that would otherwise have been payable in 2006?

409A IDR's - NQDC Arrangements (cont.)

- **Did the company permit any service provider to elect to receive a payment under a non-qualified deferred compensation arrangement before the originally scheduled payment date?**
 - Identify the terms under which all such elections were made, including any relevant deadline for making election
 - Did such election cause amounts to be paid during 2006 that would not otherwise have been payable in 2006?

409A IDR's - NQDC Arrangements (cont.)

- **Did the company make any payments of non-qualified deferred compensation during 2006 that were scheduled to be paid in a subsequent year?**
 - Identify the terms of the payment, including the original scheduled payment date and actual payment date
- **Did the company identify the specified employees for all or part of 2006?**

409A IDR's - NQDC Arrangements (cont.)

- **Did the company make any payments of non-qualified deferred compensation during 2006 to any specified employee upon separation from service?**
 - Identify the service provider, date of separation from service, and date payments were made
 - If any payment was made within six months after the date of separation from service, were payments reported on Form W-2, Box 12 using Code Z or Form 1099, Box 15b

409A IDR's - NQDC Arrangements (cont.)

- **At any time during 2006, did any service provider hold an outstanding stock right (whether vested or unvested) with all of the following characteristics:**
 - Exercise right below FMV as of date of grant, or contained a deferral feature
 - Granted in connection with performance of services for company
 - Granted on or after 1/1/05, was not earned and vested before 1/1/05 or was materially modified on or after 1/1/05

409A IDRs - NQDC Arrangements (cont.)

- **Was any previously described stock right exercised, transferred or otherwise liquidated or cashed out during 2006?**
- **Did any assets become restricted to the payment of deferred compensation, or did any amount of deferred compensation become funded or payable during 2006, as a result of any event that may relate to a decline in the company's financial condition?**
 - Describe each deferred compensation amount and service provider to whom amount was paid or owed

409A IDR's - NQDC Arrangements (cont.)

- **Did the company modify any arrangement under which amounts deferred are subject to 409A to comply with the rules under 409A?**
 - Describe plan/arrangement, and each modification
- **To date, has the company identified any violations of the requirements of 409A?**
 - Explain nature of violation(s)
 - State whether the company has reported amounts to affected service providers on Form W-2, Box 12 using Code Z or Form 1099, Box 15b

409A IDRs - NQDC Arrangements (cont.)

- **In 2007, did company notify IRS that it was participating in Compliance Resolution Program described in Announcement 2007-18?**
 - Describe status of company's participation in the Compliance Resolution Program
- **Has the company participated under the 409A Correction Program announced in Notice 2007-100, which provides relief for certain operational failures?**
 - Years corrections were made

409A IDR's - NQDC Arrangements

Some 409A IDR requests include:

- **Actions taken to comply with 409A**
- **Copies of all non-qualified deferred compensation arrangements**
- **Detailed information regarding funding vehicles**

409A IDRs - NQDC Arrangements (cont.)

- **List of current and former participants by name, title, social security number, and their current employer**
 - Account activity, including account balances (beginning and ending)
 - Deferral election dates
 - Distribution amounts
 - Distribution deferral dates
 - Loans, swaps, and conversions

409A IDRs - NQDC Arrangements (cont.)

- **Copies of deferral election forms for the top ten corporate officers**
- **Timing of federal employment tax withholding**
- **Details regarding participants' receipt of (or request for) payment of an amount not yet payable under terms of arrangement**

409A IDRs - NQDC Arrangements (cont.)

- **Detailed description of hardship or unforeseeable emergency payments, including circumstances and procedures followed**
- **Employee loans**
 - Nature of loan (term, interest rate, terms of repayment, evidence of repayment, whether recourse/nonrecourse)
 - Extent to which timely amortized

409A IDR's - NQDC Arrangements (cont.)

- **Participant distributions**
 - Form of distribution and how determination of form was made
 - Amounts distributed
 - Copies of the Forms W-2 and Forms 1099 furnished to these individuals

NRP Audit Background

- **NRP audit focus is a review of employers' compliance with employment tax requirements**
 - Comprehensive employment tax audits initiated
- **Three-year program**
- **First in 25 years**
- **High priority**

NRP Audit Background (cont.)

- **6,000 total NRP audits**
 - 2,000 in 2010
 - 2,000 in 2011
 - 2,000 in 2012
- **Tax year(s) covered by NRP audit**
 - Initial focus - 2008 tax year
 - Issues identified during 2008 audit - 2007 and 2009 tax years added

IRS' NRP Audit Goal

- **Collect data**
 - Assess employment tax compliance
 - Assess accurately compute employment tax gap
- **Reduce tax gap by increasing compliance**
 - GAO report - \$15 billion tax gap attributable to nonpayment of employment taxes
- **Provide more accurate assessment of employment tax compliance**

IRS' NRP Audit Goal (cont.)

- **Assist IRS in selecting and auditing future employment tax returns with greatest compliance risk**
- **Reduce number of workers believed by IRS to be misclassified as independent contractors**

Taxes at Issue

- **4 types of employment tax**
 - Social Security
 - Medicare
 - FUTA
 - Income tax withholding

NRP Audit Focus

- **Compensation arrangements**
- **Non-qualified deferred compensation arrangements**
- **162(m) compliance**
- **Loans**
- **Retirement contracts**
- **Stock-based compensation**
- **Golden parachutes**

NRP Audit Focus (cont.)

- **Worker classification - Employee vs. Independent Contractor**
- **Fringe benefits, including aircraft usage, housing**
- **Backup withholding**
- **Form 1099 Compliance**

NRP Audit Selection and Notification of Taxpayers

- **Random selection**
 - Large & small businesses
 - Publicly traded & privately held
 - For-profit & nonprofit
 - Private sector & public sector
- **Small businesses will comprise majority of NRP audit subjects**
- **Initial contact may be as early as mid-February**
- **IRS Letter 3850-B or notice to taxpayer of “compliance research examination”**

Impact of Either Form of Audit on Taxpayers

- **Significant allocation of resources**
 - Financial/Tax
 - Human Resources
 - Legal
- **If fortunate, no compliance issues identified during audit**
 - Nonetheless, costly and disruptive
- **For 409A, Employer bears burden of audit but Employees have tax consequences**
- **Could impact employees at all levels -- rank and file, officers, terminated Employees**

Impact on Audited Taxpayers (cont.)

- **If compliance issues are identified during audit**
 - More costly than “self correction”
 - Additional taxes may be owed
 - Penalties
 - Potential referral for income tax audit of employee returns

Recommendations

- **Employers should review compensation arrangements**
 - Evaluate “audit readiness”
 - Assess current compliance
 - Identify potential problems
- **“Voluntary compliance” to mitigate potential penalties**
- **Contact counsel**
 - Assist in review
 - Assist with voluntary compliance
 - Assist with response to IDR

Continuing Problematic Issues in Implementing Section 409A Rules

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Continuing Issues

- **Undiscovered deferred compensation arrangements**
 - Merger acquisition, subsidiary activity
 - Loosely documented or undocumented
 - Initial review predates final IRS regulations
 - Drafted based on precedents pre-dating 409A
- **Conditioning payment upon execution of a Waiver and Release**
 - Remove condition; or
 - Remove ability to delay or accelerate payment by setting a fixed payment date

Continuing Issues

- **"Stealth" non-exempt deferral arrangement**
 - Retirement vesting features
 - Disability creates entitlement to later payment
 - Separation pay in excess of exemption
 - Broad Good Reason definition
 - Non-compliant distribution events
 - Discretionary terms regarding payment
 - Open-ended reimbursement terms for taxable reimbursements

Continuing Issues

- **Six month deferral**
 - Monitoring and operational compliance
 - Identification of Specified Employees
 - Analysis of applicability vs. short-term deferral or separation pay exception
- **Change in employment status**
 - Monitoring and evaluating separation of service on change to limited service
 - Timing of "Disability" vs. termination of employment

Continuing Issues

- **Impermissible payment "toggle"**
 - Voluntary termination vs. involuntary termination
 - Termination due to disability vs. other termination events
- **Service recipient stock subject to option/SAR**
 - Valuation concern with private company
 - Satisfaction of "service-recipient stock" requirement in non-traditional partnership/corporate structures

IRS Issues Notice with Plan Document Correction Procedures for 409A – Which Goes Way Beyond Correction Procedures

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Notice 2010-6

- On January 5, 2010, the IRS issued Notice 2010-6, Relief and Guidance on Corrections of Certain Failures of a Nonqualified Deferred Compensation Plan to Comply with § 409A(a) (the "Notice").
- The Notice does much more than just offer correction methods.
- It contains numerous examples of situations that the 409A final regulations do not clearly address – and provides for significant penalties for many plan provisions that a normal person might view as a foot fault.
- For many employers, that means 409A reviews all over again, as we endeavor to ensure that plans and agreements comply with the IRS' new stricter standards.

Notice 2010-6 - Limitations

1. Correction of Plans Containing Substantially Similar Document Failures
2. Relief not Available to Service Providers and Certain Service Recipients Under Examination
3. Relief not Available for Intentional Failures or Listed Transactions
4. Linked Plans and Stock Rights not Eligible for Relief
5. New or Modified Payment Events Required as a Condition of Correction

Notice 2010-6 – Specific Issues

1. Plan Terms Providing for a Payment “As Soon as Practicable” or Substantially Similar Language Following a Permissible Payment Event
2. Permissible Payment Event with no Definition or an Ambiguous Definition
3. Correction of Impermissible Definition of Otherwise Permissible Payment Events
 - ✓ Separation from Service
 - ✓ Change in Control Event
 - ✓ Disability

Notice 2010-6 – Specific Issues

4. Correction of Impermissible Payment Periods following a Permissible Payment Event

- ✓ Payment Periods of Longer than 90 Days Following a Permissible Payment Event
- ✓ Payment Periods Following a Permissible Payment Event Dependent upon the Service Provider Completing Certain Employment-Related Actions

Notice 2010-6 – Specific Issues

5. Correction of Certain Impermissible Payment Events and Payment Schedules
 - ✓ Plans with Permissible and Impermissible Payment Events under 409A
 - ✓ Plans with Only Impermissible Payment Events
 - ✓ Certain Impermissible Alternative Payment Schedules
 - ✓ Impermissible Employee or Employer Discretion with Respect to a Payment Schedule Following a Permissible Payment Event
 - ✓ Impermissible Employer Discretion to Accelerate Payment Events
 - ✓ Impermissible Reimbursement or In-Kind Benefit Provisions Elections

Notice 2010-6 – Specific Issues

6. Correction of Failure to Include Six-Month Delay of Payment for Specified Employees
7. Correction of Provisions Providing for Impermissible Initial and Subsequent Deferral Elections

Notice 2010-6 – Ambiguous Plan Terms

- First, the good news: the Notice expressly approves the form of "savings clause" or "catch all" that many of us have been using in our documents. The Notice contains the following example:
- However, there are good "savings clauses" and bad savings clauses." Thankfully, the Notice permits Employers to add a saving clause now. I don't want to give you legal advice, but as your friend, I **STRONGLY URGE YOU TO REVIEW THIS POINT.**

Notice 2010-6 – "Savings" Clause

- Employee's employment agreement provides for payment of \$100x upon Employee's "termination of employment."
- The employment agreement does not define what events constitute a "termination of employment" *and does not include a provision that the terms of the agreement must be interpreted in a manner consistent with 409A.*
- Employees of Employer with substantially similar plan provisions have never reduced their employment to part-time and have only been paid upon an event that constitutes a complete cessation of services to Employer with no anticipated return to providing services to Employer.
- Consequently, there is no pattern or practice of paying amounts upon payment events that would not constitute separations from service under 409A, or not paying amounts upon payment events that would constitute separations from service. There is no indication that the term was intentionally left vague.
- On April 1, 2010, before any amendment of the employment agreement, Employee ceases providing services to Employer with no anticipated return and Employer determines that Employee has become entitled to the payment of \$100x. Employer pays Employee B the \$100x on April 1, 2010.

Notice 2010-6 – "Savings" Clause

- The Notice states that the plan provision providing for payment upon a “termination of employment” will not cause the employment agreement to fail to satisfy the document requirements of 409A to the extent the term is not interpreted to provide for payment under circumstances that would cause the employment agreement to fail to satisfy the requirements of 409A in operation.
- The Notice also states that the Employer may amend the agreement at any time to provide either (i) the plan provision must be interpreted to comply with the requirements of 409A, or (ii) an explicit definition of termination of employment that qualifies as a separation from service under 409A (provided that in either case the amendment may not have the effect of either expanding the definition to include as a payment event any event that was not a payment event under the plan before the amendment, or narrowing the definition to eliminate as a payment event any event that was a payment event under the plan before the amendment).
- The payment of \$100x on April 1, 2010, will not be an operational failure and will not result in the employment agreement being treated as failing to satisfy the requirements of 409A.

Permissible Payment Event with no Definition or an Ambiguous Definition

- Foot fault example: To comply with 409A, a plan or agreement must provide for payment only upon a "permitted event," such as death, disability or a separation from service, and also must specify that the date of the event is the payment date, or specify another payment date (or a fixed schedule) that is objectively determinable and nondiscretionary.
- A plan also may provide that a payment (including a payment that is part of a schedule), is to be made during a designated period objectively determinable and nondiscretionary at the time the payment event occurs, but only if the designated period (i) both begins and ends within one taxable year of the employee, or (ii) is not more than 90 days and the employee does not have a right to designate the taxable year of the payment.

Some Good News – But the Clock is Ticking

- Because of the difficulty of making payments exactly on the date of a permitted event, most plans and agreements require payment during a designated period after the permitted event.
- What if an employer's plan or agreement does not precisely specify the designated period according to these foregoing requirements?
- The good news is that the Notice permits the employer to amend the plan or agreement to precisely specify the designated period according to the requirements of the regulations.
- The bad news is that the employer had better amend the plan or agreement quickly, or employees could face penalties.

Some Good News – But the Clock is Ticking

Employee A has an employment agreement with Employer, which entitles Employee A to \$100x severance upon a separation from service, payable within 180 days following the separation from service, with the exact timing of the payout within the 180 days in the Employer's discretion.

- ✓ On February 1, 2011, A has a separation from service.
- ✓ On March 1, 2011, Employer pays A the \$100x severance, giving A no election regarding the timing of the payment
- ✓ On March 15, 2011, Employer amends the employment agreement to provide for payment within 90 days of Employee's separation from service, with the exact timing of the payment within the 90 days at the Employer's discretion.

Some Good News – But the Clock is Ticking

- Despite the fact that Employer paid Employee A the \$100x severance well within 90 days following A's separation from service, Employer gave A no election regarding the timing of the payment, and Employer amended the employment agreement to comply with the 90-day rule within a short period of time following A's separation, the Notice provides that Employee A must include 50% of the amount deferred under the plan to which the pre-correction plan provision applied as an amount includible in income under 409A and pay all applicable Federal taxes, including the additional 20% tax on such amount.
- Employer must report the amount in A's income under 409A for 2011 on the Form W-2, Box 1 and Box 12 using Code Z.
- The Notice graciously allows that Employee A will not be required to include in income under 409A any further amount solely as a result of the plan provision providing a 180-day payment period.

Some Good News – But the Clock is Ticking

- Contrast that example with the result when Employee B, with the same employment agreement, does not separate from service until March 30, 2011, 15 days after the Employer amended the Agreement.
- The Notice provides that, because Employer corrected Employee B's employment agreement before Employee B's separation from service, B will not be required to include any amount in income under 409A(a) solely as a result of the 180-day payment period under the pre-correction provision.

Notice 2010-6 - Definitions

In the Notice, the IRS makes clear that it will require word-for-word compliance with terms defined in the 409A regulations, such as Change in Control and Disability.

Notice 2010-6 - Definitions

- Employee participates in a plan that provides for a payment of \$100x to her upon the earliest of her attaining age 65, death, or “change in control” of Employer.
- The Plan's definition of “change in control” does not satisfy the definition of a change in control event under 409A solely because the definition includes an IPO.
- On February 15, 2011, at which time Employee is age 50, Employer amends the definition of change in control under the plan to delete the occurrence of an IPO as a “change in control” of Employer.
- Employer has an IPO on July 1, 2011.

Notice 2010-6 - Definitions

- The Employer corrected the provision before the initial public offering, but the IPO occurred within one year following the date of correction.
- Thus, even if Employer does not pay Employee any amount under the plan due to the event, Employee must include 25% of the "amount deferred under the plan" to which the pre-correction plan provision applied in income under 409A, and pay all applicable Federal taxes, including the additional 20% tax on such amount.
- Employer must report 25% of the amount deferred as income under 409A for 2011 on the Form W-2, Box 1 and Box 12 using Code Z, for Employee.

Notice 2010-6 - Definitions

- Employee will not be required to include in income under 409A any further amount solely as a result of the pre-correction plan provision.

The Notice not only does not allow even a slight variance from the change in control definition arbitrarily imposed by the regulations, but also imposes a penalty even after the employer revised the definition to comply!

Remember, they are from the government and they are here to help.

Notice 2010-6 - Definitions

- "Separation from service" definition incorrectly includes an employee's transfer from the parent corporation to an 80%-owned subsidiary.
- Employee transfers to the subsidiary on January 10, 2011.
Because the plan provision was not corrected before Employee transferred from the parent corporation to a subsidiary corporation, *regardless of whether Employee is paid \$100x severance*, the plan fails to satisfy the requirements of 409A for 2011 and all previous years in which the plan contained that plan provision, and Employee must include amounts in income and pay the additional taxes under 409A.

Notice 2010-6 - Definitions

- Incorrect definitions of separation from service garner no sympathy from IRS.
- If Employer takes steps to amend the plan and provide a compliant definition of separation from service, IRS will provide limited relief.
- Suppose the same impermissible separation from service definition, but Employee does not separate from service on January 10, 2011.
- Instead, Employer amends the definition of separation from service on March 1, 2011, to delete the impermissible payment event regarding transferring to a subsidiary, which brings the definition into full compliance with 409A.

Notice 2010-6 - Definitions

- On July 1, 2011, Employee E transfers to a subsidiary.
- Employer and Employee corrected the provision before Employee transferred from the parent corporation to one of the subsidiary corporations.
- However, Employee transferred from the parent corporation to a subsidiary corporation within one year following the date of correction.
- Even though Employer does not pay Employee any amount under the plan due to the transfer, Employee must include in income under 409A, 50% of the amount deferred under the plan to which the pre-correction plan provision applies, and pay all applicable Federal taxes, including the additional 20% tax on such amount.

Notice 2010-6 - Definitions

- Though Employer correctly identifies and amends the plan's deficiency before any harm is done and does not make payments on account of the impermissible payment event, the parties remain on the hook for penalties for an entire year following the date of the plan correction.

Impermissible Payment Periods following a Permissible Payment Event

- What about the everyday situation where the employer requires the employee to sign a release of claims before it pays him/her severance?.

Notice 2010-6 - Releases

- Employee's employment agreement entitles him/her to \$100x severance upon a separation from service.
- The severance is payable upon Employee executing and submitting a release of claims (and after expiration of the revocation period), but the agreement does not include any time limit for payment.
- On April 1, 2011, Employer and Employee amend the employment agreement to provide for payment of \$100x severance on the 60th day following Employee's separation from service, provided that Employee has executed and submitted a release of claims and the statutory period during which Employee is entitled to revoke the release of claims has expired on or before that 60th day.

Notice 2010-6 - Releases

- Employee has a separation from service with Employer on June 16, 2011.
- Employee executes and submits a release of claims on July 1, 2011.
- Employer pays Employee \$100x on August 15, 2011.

Because Employer and Employee N corrected the provision *before* Employee's separation from service, Employee is not required to include any amount in income under 409A solely due to the pre-correction plan provision.

Notice 2010-6 - Releases

- The good news is that the Notice allows the employer and employee to amend the employment agreement to set a hard deadline for execution (and failure to revoke) the Release.
- The bad news is that the example implies that, **without that amendment, the employment agreement was in violation of 409A.**

Notice 2010-6

- Bad news: IRS may be preparing to whack us for minor document deficiencies
- Good news: IRS is giving us warning now, and the opportunity to correct the deficiencies.
- For many employers, that means 409A reviews all over again, as we endeavor to ensure that plans and agreements comply with the IRS' new stricter standards.

Notice 2010-6 – Impermissible Payment Events

- Correction of plans with both for one or more "permissible payment events" under 409A, and one or more impermissible payment events.
- Employer may correct this defective plan provision by amending the plan to remove it, before the time any Employee has elected the impermissible payment event.
- For this purpose, an impermissible payment event will not be treated as elected until the Employee's election is irrevocable under the terms of the plan.
- The Notice requires that the Employer take commercially reasonable steps to identify and correct all substantially similar language in its other plans.

Notice 2010-6 – Impermissible Payment Events

- What if an Employee already has elected the impermissible payment event – but not yet received a payout on account of the impermissible payment event?
- The Employer may amend the plan to remove the impermissible payment event.
- The amendment must be effective immediately, and before the date any of the impermissible payment events occurs.
- However, . . .

Notice 2010-6 - Plans with Only Impermissible Payment Events

- Employer may correct a plan provision that provides for payment only upon one or more impermissible payment events (does not include any permissible payment events under 409A),
 - ✓ before the date one or more of the impermissible payment events occurs, and
 - ✓ as long as no impermissible payment event occurs within 12 months following the amendment.
- The amendment may provide for payment only upon the later of the Employee's separation from service and the sixth anniversary of the date of correction.

Notice 2010-6 – Impermissible Payment Events

- Employee is a participant in a plan that provides a \$100x distribution in the event the Employee's child enrolls in an institution providing post-secondary education. [Not a permissible payment event]
- On October 1, 2011, Employer may amend the plan to remove the enrollment provision and replace it with a provision providing payment upon the *later of* a separation from service and October 1, 2017.
- However, . . .

Notice 2010-6 – Impermissible Payment Events

- Despite the fact that Employer and Employee corrected the plan provision before a child enrolled in an institution providing post-secondary education, *Employee must include in income under 409A 50% of the amount deferred under the plan to which the pre-correction plan provision applied and pay all applicable Federal taxes, including the additional 20% tax on such amount .*
- If an Employee's child had actually enrolled in a post-secondary education institution before Employer corrected the provision, *regardless of whether the plan distributes the \$100x to Employee*, the plan is not eligible for correction, and Employee must include the full amount of "deferred compensation" in income and pay the taxes under 409A.

Notice 2010-6 - Impermissible Alternative Payment Schedules

- An Employer may correct a plan provision that provides for more than one time or form of payment of the deferred amount upon the occurrence of a single type of permissible payment event under 409A ("Toggle").
- The Notice provides two alternatives:
 1. To the extent the multiple forms of payment relate to the occurrence of a Employee's voluntary and involuntary separation from service, the Employer may amend the plan to provide that the form of payment upon a voluntary separation from service will be the same form of payment that the pre-correction plan provision provided for upon an involuntary separation from service (subject to the six-month delay requirement, if applicable).

Notice 2010-6 - Impermissible Alternative Payment Schedules

- The amendment must be made before the date a separation from service occurs that could result in the impermissible multiple forms of payment for any Employee, and must be effective immediately.
- If an Employee has a voluntary separation from service *within one year following the date of correction* which results in the corrected plan provision being applied to avoid a form of payment that would have been due under the pre-correction plan provision, 50% of the amount deferred under the plan to which the pre-correction plan provision applies must be included in income under 409A by the affected Employee in the Employee's taxable year within which the event occurs.

Notice 2010-6 - Impermissible Alternative Payment Schedules

2. To the extent the multiple forms of payment result from an alternative payment schedule relating to a factor other than whether a Employee's separation from service is voluntary or involuntary, the Employer may correct the plan provision that provides for more than one time or form of payment upon the occurrence of a single type of permissible payment event, as long as the correction occurs before the date a payment event occurs that could result in the impermissible multiple forms of payment for any Employee.
 - Until that time, the Employer may amend the plan to remove forms of payment until the remaining forms of payment no longer cause the plan to fail to satisfy the requirements 409A.
 - In determining which of two forms of payment should be removed, the remaining form of payment must be:
 - the form of payment resulting in, or potentially resulting in, the latest final payment date, and
 - if two forms of payment result in, or potentially result in, the same latest final payment date, the form of payment commencing, or potentially commencing, at the latest possible date (and if those two dates are the same, the form of payment generally anticipated to result in the amount deferred being paid at later dates).

Notice 2010-6 - Impermissible Alternative Payment Schedules

- The amendment must be effective immediately. If a payment event corrected under this provision occurs within one year following the date of correction, 50% of the amount deferred under the plan to which the pre-correction plan provision applies must be included in income under § 409A(a) by the affected Employee in the Employee's taxable year within which the event occurs.
- If a form of payment has no possibility of applying to a Employee because the Employee is not eligible and can never become eligible, or is no longer eligible and cannot again become eligible, for such a form of payment, that form of payment is not required to be removed from the plan with respect to that Employee and the Employer and Employee may treat the plan as not failing to satisfy the requirements of 409A with respect to that Employee merely because of the inclusion of that form of payment in the plan.

Notice 2010-6 - Impermissible Alternative Payment Schedules

- In determining which of two forms of payment should be removed, the remaining form of payment must be:
 - ✓ the form of payment resulting in, or potentially resulting in, the latest final payment date, and
 - ✓ if two forms of payment result in, or potentially result in, the same latest final payment date, the form of payment commencing, or potentially commencing, at the latest possible date (and if those two dates are the same, the form of payment generally anticipated to result in the amount deferred being paid at later dates).
- The amendment must be effective immediately. If a payment event corrected under this provision occurs within one year following the date of correction, 50% of the amount deferred under the plan to which the pre-correction plan provision applies must be included in income under § 409A(a) by the affected Employee in the Employee's taxable year within which the event occurs.
- If a form of payment has no possibility of applying to a Employee because the Employee is not eligible and can never become eligible, or is no longer eligible and cannot again become eligible, for such a form of payment, that form of payment is not required to be removed from the plan with respect to that Employee and the Employer and Employee may treat the plan as not failing to satisfy the requirements of 409A with respect to that Employee merely because of the inclusion of that form of payment in the plan.

Notice 2010-6 - Impermissible Alternative Payment Schedules

- The amendment must be effective immediately.
- If a payment event corrected under this provision occurs within one year following the date of correction, 50% of the amount deferred under the plan to which the pre-correction plan provision applies must be included in income under 409A by the affected Employee in the Employee's taxable year within which the event occurs.

Impermissible Discretion as to a Payment Schedule Following a Permissible Payment Event

- This section applies to a plan provision that provides a Employee or a Employer with discretion to change the time or form of payment of an amount due under the plan following a permissible payment event (which would causing the plan to fail to satisfy the requirements of 409A).
- In most cases, an Employer may correct a plan provision that provides Employee or Employer with discretion to change the time or form of payment of an amount due under the plan following a permissible payment event, as long as it is before the date of a payment event.
- The plan may be corrected by amending the plan to eliminate the discretion.

Failure to Include Six-Month Delay of Payment for Specified Employees

- The Notice allows an Employer to correct a plan that is required, but fails to, include the six-month delay requirement for select employees, by amending the plan to:
 - ✓ add the six-month delay provision, and
 - ✓ provide that an amount payable under the plan that is subject to the six-month delay requirements may not be paid before the later of (i) 18 months following the date of correction, or (ii) six months following the date of the payment event.
- The amendment must be effective immediately.

Failure to Include Six-Month Delay of Payment for Specified Employees

- However, if an Employee subject to the six-month delay requirement participates in the plan that is amended to add that requirement, and has a separation from service within one year following the date of correction that results in the corrected plan provision being applied to avoid a payment that would have been due under the pre-correction plan provision, 50% of the amount deferred under the plan to which the pre-correction plan provision applies (and that thus is delayed due to the amendment) must be included in income under 409A by the Employee in the Employee's taxable year within which the separation from service occurs.

Notice 2008-113

- Transition relief permitting corrections of certain document failures without current income inclusion or additional taxes under 409A, if the document failure is corrected by December 31, 2010, and any operational failures resulting from the document failure are also corrected in accordance with Notice 2008-113, by December 31, 2010.

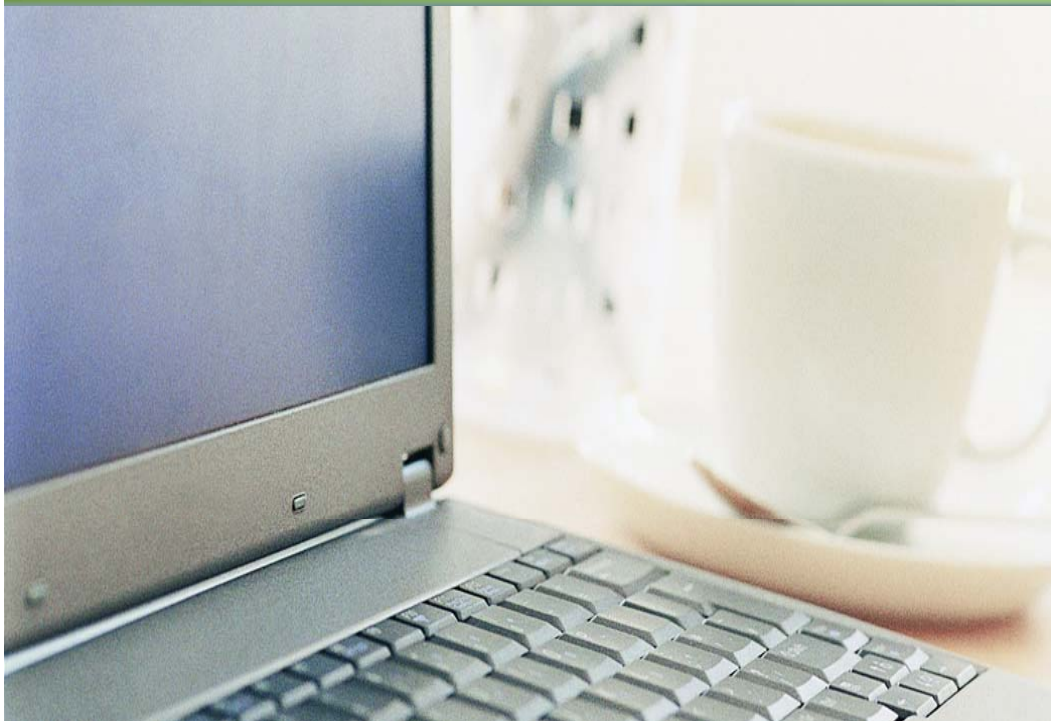
Steven J. Friedman

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212-583-2687

Likely IRS Audit Issues



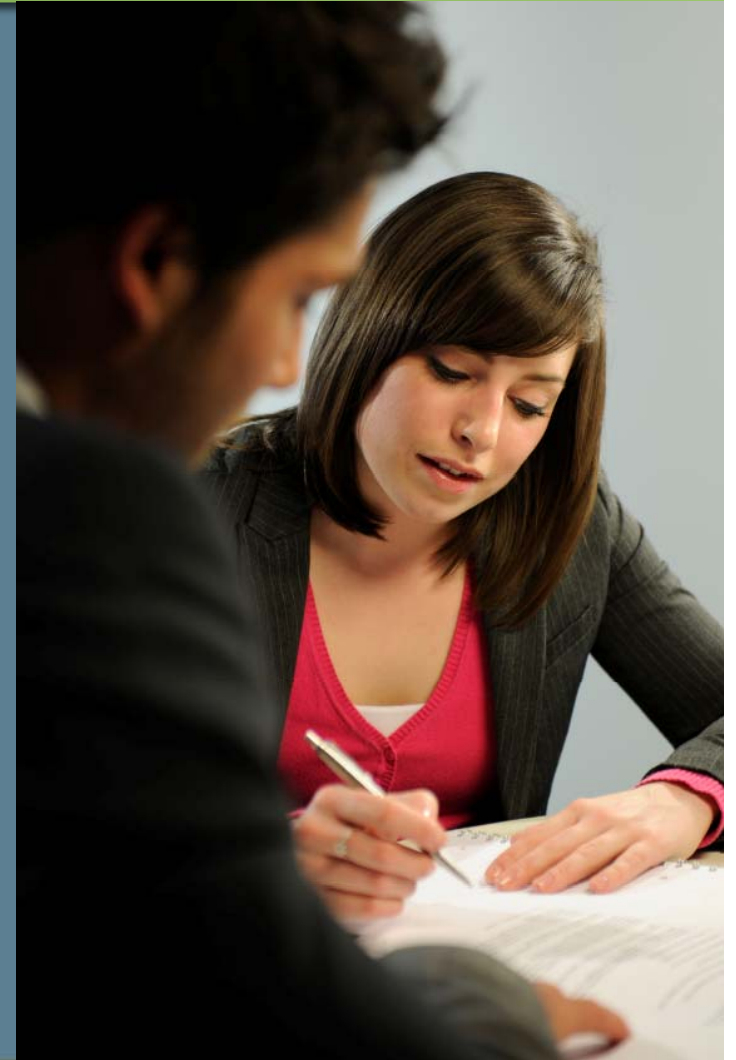
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Elusive Deferred Compensation Arrangements

- ⊕ Many employment related documents defer compensation
 - Employment agreements
 - Long-term incentive arrangements
 - Bonus Plans
 - Severance arrangements
 - Stay incentives



Election Procedures

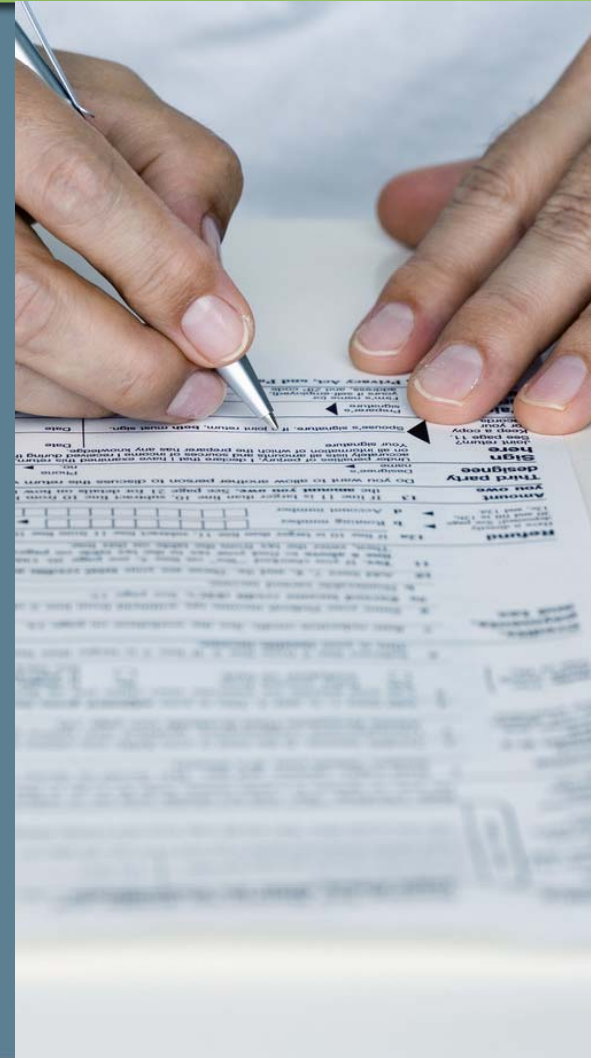
- ⊕ IRS likely to examine timeliness of elections
 - Salary and bonus elections
 - Special care must be exercised in connection with performance-based pay
 - Election may be 6 months prior to end of performance period
 - Especially where performance period is longer than one year



Payment-Related Issues

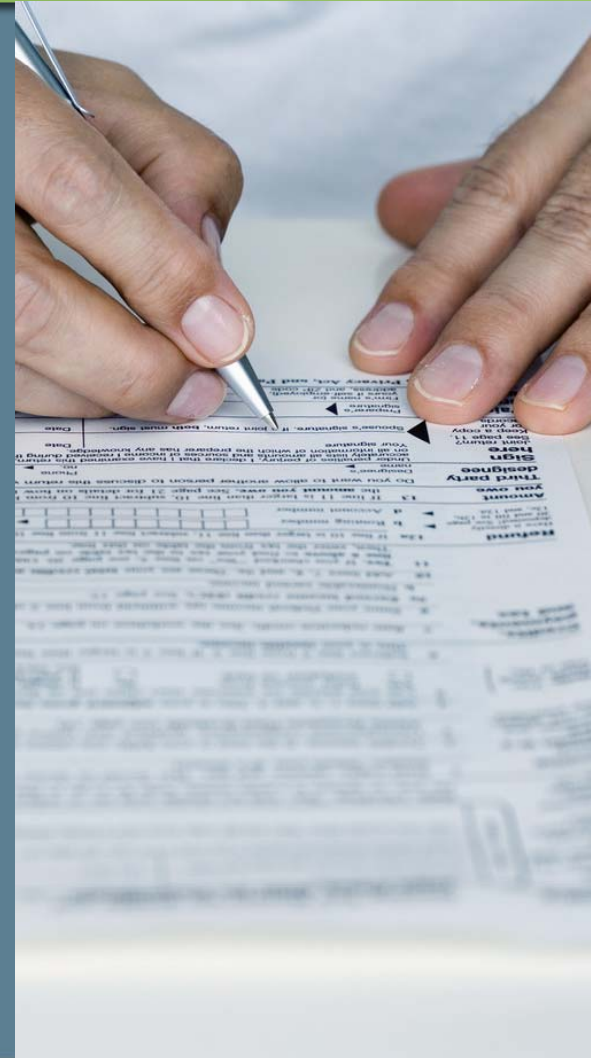
⊕ Non-Compliant Distribution Triggers

- Inappropriate payment triggers
- Accelerations and subsequent deferrals
- Dates tied to permissible payment events but too far in the future
 - Example – Payment within 120 days of separation from service
- Dates tied to impermissible payment event following permissible payment event
 - Example – Payment tied to release following separation from service
 - “As soon as practicable” language



Payment-Related Issues

- ⊕ Issues Impacting Specified Employees
 - Identification procedures
 - Good reason provisions
 - Other early vesting provisions
 - Separation pay in excess of exemption
 - Issues created on account of corporate transaction
 - Change in employment status



Other Payment Issues

- ⊕ Discretionary payments
 - Vesting vs payment issue
- ⊕ Reimbursement issues
 - Is timeframe adequately established?
- ⊕ Payment toggles

Stock Compensation Issues

- ⊕ Impermissible modifications
- ⊕ Private company valuation concerns
- ⊕ Appropriate entity must be offering stock
- ⊕ Strike price at less than fair market value
 - Non-US operations may have established practices which must be changed
- ⊕ Service recipient stock issues

20%

Preventive Measures

- ⊕ Inventory all arrangements which could defer compensation
- ⊕ Determine if any 409A issues need to be addressed
- ⊕ Take advantage of Notice 2010-6 amendment relief for 2010
- ⊕ Insert “savings clauses” where appropriate
- ⊕ Identify “specified employees”
- ⊕ Draft agreements with “separate payments” for installments where appropriate

Questions and Answers



THANK YOU

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