

Year-End Corrections Under Section 409A

In late 2008, the Internal Revenue Service instituted a program for the correction of operational errors in nonqualified deferred compensation plans (“NDCPs”) subject to Section 409A of the Internal Revenue Code of 1986 (the “Code”). Under the program, employers have until December 31, 2009, to correct errors made in 2009, or between 2005 and 2007. If they do so, the penalties imposed on employees (a 20% excise tax and additional interest) will be eliminated or abated. It thus would be advisable for employers to review any NDCPs subject to Section 409A before year-end and make any needed corrections before then.

In general, the types of errors that can be corrected include: a failure to pay when required (whether early or late); payment of incorrect amounts; and incorrect payments to “specified employees” (*i.e.* key employees of public companies). The program specifies correction methodologies for each type of error, including repayment by the affected employee and payment by the employer.

Correction will avoid the excise tax and the premium interest, provided that it is made:

- (i) in the same tax year that the error occurred;
- (ii) in the tax year immediately following the year of the error, provided that the affected employee is not an “insider” (*e.g.* an officer, director or 10% owner of the employer); or
- (iii) by December 31, 2009, to correct errors made from 2005 to 2007.

Correction may also be made in the second tax year following the year of the error, but in this case, only the interest will be waived (*i.e.* the excise tax will be payable).

Also, for the correction to be effective, the employer must take commercially reasonable steps to avoid a recurrence of the error, and the employee’s tax return for the year of the error must not be under examination.

The need to review plans for errors made in 2005 to 2007 is particularly acute, as these will not be correctable after December 31, 2009. It also is the last chance to correct 2008 errors involving non-insiders and avoid the excise tax. For any questions about compliance, feel free to contact any member of the Employee Benefits and Executive Compensation practice group for assistance.

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