

## **409A Audits by IRS Begin: Employers Need to Act Now**

The Internal Revenue Service (“IRS”) recently undertook an audit program for compliance with Section 409A of the Internal Revenue Code (“Section 409A”) that is to reach at least 6,000 employers in 2010 and 2011. Given the effort that most companies have expended over the last four years to comply with Section 409A, one might have thought that compliance would now be a foregone conclusion, and the audits little more than a nuisance. Unfortunately, the IRS’ recent unveiling of two correction programs (for operational and documentary errors<sup>i</sup>) calls that conclusion into question for two principal reasons. First, the two programs demonstrate that Section 409A’s meaning remains frustratingly opaque in far too many instances, and, second, that the IRS can be counted upon to analyze and interpret most questions and issues unfavorably to executives.

### **IRS Requests**

To date, the few audits that have been commenced apparently have not been finally resolved (or at least any resolutions have not been publicly reported). Reports indicate that the IRS is requesting detailed information from employers about their plans, including their terms and operation, the timing of deferral elections, payment events, payment forms and employees who have received payment. The IRS reportedly also has asked for numerous documents.

### **Need for Internal Audits**

The breadth and obvious seriousness of the IRS’ effort should discourage employers from waiting and playing the “audit lottery,” particularly inasmuch as the two new correction programs cannot be used if an employer is under audit. It would seem far preferable for employers to conduct their own internal audits before they receive an information request from the IRS. This would begin by identifying every plan subject to Section 409A, and then carefully reviewing each of them for documentary and operational compliance. The ultimate bottom line is that, while such an audit is likely to be time-consuming and somewhat costly, it will either allow employers to discover problems that hopefully can be corrected before the IRS acts or will prepare it to easily deal with an audit by the IRS.

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<sup>i</sup> For more information, please see the Kaye Scholer January 21, 2010 Employee Benefits Client Alert, “IRS Issues Notice Allowing Correction of Documentary Errors for Purposes of Section 409A,” which can be found at:

[http://www.kayescholer.com/news/client\\_alerts/20100121/res/id=sa\\_File1/EBCA01212010.pdf](http://www.kayescholer.com/news/client_alerts/20100121/res/id=sa_File1/EBCA01212010.pdf)

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