

**Author: Jeff Witt**

If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

**Elizabeth T. Dold**  
edold@groom.com  
(202) 861-5406

**Jeffrey W. Kroh**  
jkroh@groom.com  
(202) 861-5428

**Louis T. Mazawey**  
lmazawey@groom.com  
(202) 861-6608

**John F. McGuinness**  
jmcguinness@groom.com  
(202) 861-6625

**David W. Powell**  
dpowell@groom.com  
(202) 861-6600

**Allison Ullman**  
aullman@groom.com  
(202) 861-6336

**Brigen L. Winters**  
bwinters@groom.com  
(202) 861-6618

**Jeff Witt**  
jwitt@groom.com  
(202) 861-6651

## CCA on Correcting 409A Document Errors Reinforces IRS Informal Position

Many employers diligently amended their nonqualified plan documents to be compliant with section 409A of the Internal Revenue Code ("Section 409A") by December 31, 2008. While the process of updating plan documents for Section 409A may seem like an item of the past, new programs and agreements that involve deferred compensation must also satisfy the Section 409A documentation requirements. Plan document compliance with Section 409A also arises in the M&A setting, as part of the due diligence or to clean up outstanding awards of an acquired company. If document errors are discovered, employers may be able to correct the document and avoid (or reduce) additional Section 409A taxes and penalties.

One method for correcting documentation problems is addressed to some extent in proposed regulations on Section 409A penalties that the IRS issued in 2008. These proposed regulations address how an error may be remedied before a deferred compensation amount vests, *i.e.*, before the substantial risk of forfeiture on such amount lapses. In the years since these regulations were proposed the IRS has informally addressed this potential correction method for unvested amounts on a regular basis.

In the recent Chief Counsel Advice memorandum, CCA 201518013 (April 14, 2015), the IRS provided its view, this time in writing, that a document error can be corrected in the year prior to the year of the lapse of the substantial risk of forfeiture (*i.e.*, vesting) consistent with the proposed regulations. While CCAs are not precedential under the IRS' guidance, there are indications that the IRS may use them to get the word out on issues where official guidance has not been forthcoming. In the CCA, a retention bonus was awarded that would vest upon the completion of three years of continuous service, and be paid in equal installments on the next two anniversaries of the vesting date. The Section 409A document problem arose because the employer had discretion under the terms of the retention agreement to accelerate the payment to a single lump sum payment on the first anniversary of the vesting date. Chief Counsel noted that if the amount was subject to a substantial risk of forfeiture at all times during a year (*i.e.*, no vested benefit at the end of the year), there is no amount includible in income as a result of the Section 409A failure during such year.

However, the IRS was clear on its interpretation of the proposed regulations that if an amount was not subject to a substantial risk of forfeiture at all times during the year, a Section 409A failure would occur and applicable Section 409A taxes and penalties would apply. Accordingly, the employer's correction before the amounts vested, but in the same year as vesting, was not effective to avoid Section 409A taxes and penalties.

As noted in the CCA, the proposed regulations do not specifically address or include an example like the situation presented in the CCA. Nevertheless, the CCA reflects the position that the IRS has been informally sharing for some time on the proposed correction method. While some practitioners have suggested a same year correction before vesting would be compliant with Section 409A, the IRS has now put pen to paper on its position that such a correction does not work. We would expect that when the proposed regulations are finalized, they will be clear on the IRS position that a document correction made in the same year that the substantial risk of forfeiture lapses does not avoid Section 409A taxes and penalties.

As an interesting aside, we note that in the situation described in the CCA, the document failure (i.e., the employer's ability to impermissibly accelerate payments) would appear to be correctable under Section VII.E of the document correction program in IRS Notice 2010-6, free from any additional Section 409A taxes or penalties. Of course, the IRS document correction program does have certain requirements that could have prevented the parties from using the program (e.g., the employee or the employer is under audit with respect to nonqualified deferred compensation in the year of the document failure) or wanting to use the program (e.g., the requirement to attach correction notices to the tax returns of the employee and employer for the year of the correction). However, it is always useful to keep the IRS document correction program in mind as another tool to mitigate the impact of document errors.

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