Documentary correction program (IRS Notice 2010-6)

Summary

The documentary correction program provides methods to voluntarily correct certain nonqualified deferred compensation plan document failures and omissions, to comply with the requirements of Internal Revenue Code Section 409A (IRC Section 409A). Although the scope of the notice is quite broad, there are many plan provisions that aren't covered by this notice and may not be corrected. Therefore, full IRC Section 409A income inclusion and penalties would apply for non-covered violations. Relief provided under the notice will **generally reduce or avoid income inclusion and penalties** under IRC Section 409A, if the offending provision has not already been utilized before the correction is made. (See additional relief provided in IRS Notice 2010-80.)

This program provides ongoing relief for correction of non-compliant document provisions. Full relief is available when, for one year following the date of the correction of the offending provision, no event occurs which would have triggered operation of the previously incorrect provision. Otherwise, income inclusion to some degree may be required. Therefore, "pre-corrected provisions" will need to be tracked on an ongoing basis to see if a failure would have occurred if they were still in place. After the one-year period expires, the corrected plan document will govern the operation of the plan in determining compliance with IRC Section 409A with no additional penalties due under this notice regarding corrected provisions.

If a non-compliant document is not corrected and an event triggering a payment (or non-payment) based on the incorrect language occurs, **the participant's full account balance is subject to IRC Section 409A income inclusion and penalties**. And, if a plan sponsor is under examination by the IRS for the period in which the violation occurs, they may not take advantage of relief under this notice.

Eligibility

Eligibility requirements for relief under this notice generally include:

- The failures being corrected are unintentional.
- The amendment is in writing and effective immediately.
- The plan sponsor corrects all other plans with similar failures.
- The correction must be noted on both the plan sponsor and employee tax returns.
- All taxes and the applicable IRC Section 409A penalty (20% penalty tax, but not IRC Section 409A interest) must be paid by the employee.
- The participants and/or the plan sponsor are not currently under examination as defined in the notice.
- Listed transactions within the tax shelter rules are not involved.

Correctable document provisions

This table shows document corrections covered under this notice and the amount of income inclusion if an actual operational failure under the uncorrected terms of the plan would have occurred within one year of the document correction. The amounts included are subject to income taxes as well as the additional 20% IRC Section 409A penalty, but not IRC 409A interest.

Note that during the one-year period, the corrected plan provisions govern the operation of the plan. In practice, this may cause a taxable income inclusion event to occur under the one-year rule even when no actual payment to the participant occurs. Also, for those corrections where no additional income inclusion is indicated, as well as for any other corrected provisions, any actual operational failures caused by the operation of impermissible plan provisions are still covered by Notice 2008-113.

Correctable document provisions	One-year income inclusion
Impermissible definitions of payment events:	
Separation from service	50% of violation
Change in control	25% of violation
Disability	None
Impermissible payment periods:	
Period longer than 90 days	50% of violation, if after 90 days
Release or non-compete	None
Other impermissible events or discretion:	
Impermissible event	50% of violation
Impermissible payment schedule	50% of violation
Impermissible participant discretion	50% of violation
Failure to include a six-month delay for specified employees	50% of violation
Impermissible deferral election	Must correct any amounts improperly not paid under Notice 2008-113
Impermissible employer discretion to accelerate payment events	None

New plans

This notice also allows plan sponsors to correct document failures in newly established plans. Relief is only available if the new plan is the first plan of the same type under IRC Section 409A plan aggregation rules (employee account balance, employer account balance, non-account balance, etc.). Only document failures covered by this notice may be corrected, and the correction must be made by the end of the calendar year the plan is established. Or, if later, by the 15th day of the third calendar month after the plan is established. Again, any actual operational failures that occur due to following incorrect provisions would be covered under Notice 2008-113.

Certain ambiguous plan terms

Although not subject to the other provisions of this notice (the 12-month income inclusion rules), this notice gives guidance regarding ambiguous plan terms.

Before IRC Section 409A became effective, a common plan provision required payment “as soon as reasonably practicable” (or similar language) following the permissible payment event. This notice specifies that a plan will not have a documentary failure because of a phrase like payment “as soon as reasonably practicable”, if payments are made in compliance with IRC Section 409A provisions. However, if the plan sponsor has established a pattern of making late payments, then the provision is no longer ambiguous, and a IRC Section 409A plan failure has probably occurred. At that point, relief is not available under either this notice or Notice 2008-113.

This same logic would apply to use of the term “termination of employment”, rather than the IRC Section 409A defined term “separation from service”. Again, if the provision has been utilized in a manner consistent with IRC Section 409A, then no action is necessary. If the provision has been used in a manner that’s inconsistent with IRC Section 409A, then it would be considered operational failure covered by Notice 2008-113. The plan document would have to be amended by the end of the year in which the failure is corrected.

When used to eliminate ambiguous plan terms, except as necessary to satisfy the requirements of IRC Section 409A, plan amendments may not expand or narrow definitions resulting in allowing a payment event that wasn’t a payment event, or by eliminating a payment event that was a payment event.

Conclusion

Notice 2010-6 provides welcome relief to plan sponsors who haven’t brought their nonqualified deferred compensation plan documents into full compliance with IRC Section 409A. Plan sponsors with defective documents should use the notice to reduce or eliminate penalties under IRC Section 409A. Although the notice covers many document deficiencies, there are also many it does not. Although full IRC Section 409A income exclusion and penalties will apply for non-covered deficiencies, document correction will limit inclusion and penalties to amounts already deferred. Plan sponsors should work closely with legal counsel and proactively make corrections, as relief is not available once the plan sponsor or the participant comes under audit from the IRS.

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