

THE NONQUALIFIED ADVISOR

An Independent Resource for Plan Sponsors and Participants of Nonqualified Plans

Client News Bulletin

February 2009

Correction Program for 409A Operational Failures

In December 2008, the IRS released Notice 2008-113 offering taxpayers an opportunity to correct certain operational failures that do not comply under Section 409A. This notice replaces Notice 2007-100 and expands upon the correction program announced last year in Notice 2007-100.

The following highlights the key requirements of the revised correction program:

General Eligibility

To be eligible for relief under Notice 2008-113, the taxpayer must demonstrate that the following conditions have been met:

- 1) Employer must avoid recurrence of the operational failure;
- 2) Failure must be inadvertent and unintentional;
- 3) Tax returns are not under examination;
- 4) Service provider repays any erroneous amounts paid; and
- 5) Payment does not occur when the employer is experiencing a “substantial financial downturn”.

Correction Procedures

Like Notice 2007-100, the procedure for correcting operational failures depends on whether the error is corrected in the same tax year or a subsequent year. Notice 2008-113 provides several different correction options and procedures, and expands on the type of relief available to taxpayers.

Correction in the same tax year the failure occurred. If an eligible operational failure is identified and corrected in the same tax year, there are generally no tax consequences. The failure simply disclosed in a statement to the IRS.

Correction in the tax year following the tax year the failure. For non-insiders, the employer reports the correction amount as a taxable wage payment on Form W-2, W-2c or Form 1099. The wage payment is subject to income tax, but avoids the 20% tax penalty and premium interest charge. For insiders¹, the taxable wage payment is subject to both income tax and the 20% penalty, but avoids the premium interest charge.

Corrections made by the end of the second year following the year the failure. For corrections that occur before the end of the second year, the correction amount is reported as an additional wage payment subject to income taxation and the 20% penalty, but no premium interest.

Corrections Involving Limited Dollar Amounts. Failed deferrals and excess deferrals involving amounts no greater than the 402(g) limitation for qualified plans (\$16,500 for 2009) are also eligible for relief under the correction program. The correction amount is reported as an additional wage payment subject to income taxation and the 20% penalty, but no premium interest.

¹ For purposes of this Notice, an “insider” is defined as a director, officer or an owner of more than 10% of any class of equity security

Eligible Operational Failures

Only certain types of operational failures are eligible for relief under Notice 2008-113. Generally, the following types of failures are eligible for correction:

- 1) Failure to defer an amount that should have been deferred.
- 2) Early payment of an amount payable in the same tax year.
- 3) Failure to delay payments to “specified employees” for six months.
- 4) Excess deferrals of compensation.
- 5) Discounted or incorrectly priced stock rights.

Reporting and Disclosure

If an individual is entitled to claim relief under Notice 2008-113, the employer must provide the employee with a detailed statement describing the failure as specified by the IRS. If the failure and the correction occur in the same tax year, the statement is attached to the return in the year the failure occurred. If the failure occurred in a subsequent year, the statement is attached to the return in the year the failure was discovered.

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