COMMITTEE ON EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

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By first-class mail and e-mail [*Notice.comments@irscounsel.treas.gov*]

Internal Revenue Service
CC:PA:LPD:RU (Notice 2010-6)
Room 5203, P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Notice 2010-6

Ladies and Gentlemen:

The Committee on Employee Benefits and Executive Compensation of the New York City Bar (the "Committee")[1] is composed of attorneys with diverse perspectives on employee benefits issues, including members of law firms and counsel to corporations. We commend the Treasury Department ("Treasury") and the Internal Revenue Service (the "Service") for issuing Notice 2010-6, 2010-3 I.R.B. 275 (Jan. 5, 2010) (the "Notice" or "Notice 2010-6"), which gives taxpayers the opportunity pursuant to the program established by the Notice (the "Program") to correct documentary failures regarding Section 409A of the Internal Revenue Code of 1986, as amended ("Section 409A"). We write to respond to the request by Treasury and the Service for comments regarding other document failures that commonly occur and methods to correct them and to urge Treasury and the Service to revise the Program in certain respects.

As practitioners who deal with the requirements of Section 409A in many different settings and situations, we can report that a determination of whether a complex modern compensation arrangement[2] is exempt from or meets the requirements of Section 409A has been a consistent

challenge. Accordingly, we commend the decision of Treasury and the Service to give taxpayers the opportunity to correct inadvertent and unintended documentary failures regarding Section 409A under the Program. We believe, however, that elements of the Notice are unnecessarily punitive or restrictive and hope that Treasury and the Service will eliminate or revise them in additional guidance.

A. Other Documentary Failures.

1. Documentary Failures that Affect Multiple Service Providers.

Since the enactment of Section 409A in 2004, Treasury and the Service have clearly indicated through the promulgation of regulations as well as informally that many types of compensation arrangements – ranging from individual agreements to broad-based plans covering significant numbers of service providers – constitute nonqualified deferred compensation plans subject to Section 409A. While many of the requirements imposed by the regulations issued under Section 409A must be applied on an individual basis (service provider by service provider), the reality is that many compensation arrangements are implemented by service recipients, particularly employers, through a single plan document or single form of plan document (a "Multi-Participant Plan Document"). As a result, any documentary failure affecting such a Multi-Participant Plan Document would affect many service providers, including both "insiders" and non-insiders.

Although a documentary failure affecting a Multi-Participant Plan Document will be the same for all service providers covered by such Plan, the Program can result in the correction being different for each service provider based on when the documentary failure is corrected and, where facts require correction under Notice 2008-113, 2008-51 I.R.B. 1305 (Dec. 5, 2008) ("Notice 2008-113"), whether the service provider is an "insider." We believe that such differing treatment is unnecessarily punitive and unfair, with random traps for the unwary or unlucky.

For example, consider an employer that establishes a nonqualified deferred compensation plan that covers a significant number of its workforce and includes a provision that plan benefits be paid upon an employee's termination of employment. If the definition of termination of employment under the Multi-Participant Plan Document does not comply with Section 409A, the Program would be available to correct this failure. However, pursuant to the Program, if, during the one-year period following the date of correction, an employee incurs a termination of employment that does not constitute a "separation from service" that complies with Section 409A but would have required payment under the pre-corrected plan, and the corrected plan provision would be applied to avoid a payment that would have been due under the pre-corrected plan, 50% of the amount deferred under the plan by the affected employee must be included in the employee's taxable income. In stark contrast, any employee who is fortunate enough not to terminate employment during the one-year period following the date of correction will recognize no taxable income.[3]

Our Committee believes that such differing treatment of service providers under a Multi-Participant Plan Document is unfair and that the use of the one-year provision currently imposed by the Program (presumably to avoid the possibility of abuse) is unwarranted. We see no reason for the Program to cause any service provider participating in a Multi-Participant Plan Document to be treated differently solely because of timing which he or she may not be able to control. To prevent this, we recommend that the Program include a separate method to correct documentary failures in Multi-Participant Plan Documents which we would define as: (i) a single nonqualified deferred compensation plan with a single plan document in which multiple service providers participate or (ii) multiple nonqualified deferred compensation plans maintained by a single service recipient that have separate but substantially similar plan documents for each participating service provider. We also urge Treasury and the Service to include the following principles in such documentary correction method:

- each service provider participating in a Multi-Participant Plan Document should be treated similarly under the documentary correction method (regardless of whether a payment event or the problematic provision was triggered before or after the date of correction and regardless of whether the service provider is an insider); and
- no service provider should be required to have income inclusion.

2. Correction of Documentary Failures Affecting <u>Compensation Intended to Be Exempt from Section 409A</u>.

We urge Treasury and the Service to revise the Program to permit taxpayers who did not intend for compensation to be subject to Section 409A to correct inadvertent errors that may cause them to become subject to Section 409A. Given the complexity of modern compensation arrangements, it would not be unexpected to determine that an arrangement that was intended to satisfy the short-term deferral rule or otherwise be exempt from Section 409A may inadvertently contain a term (or that, upon future review, a more creative practitioner could envision a scenario where compensation would be paid in a manner that would not meet the short-term deferral exception or another exception) that would cause all or a portion of the arrangement to constitute nonqualified deferred compensation subject to Section 409A. In such a situation, the Notice would not be available to permit the offending provision to be corrected to take the arrangement out of the ambit of Section 409A. Since such an arrangement would not have been designed to comply with Section 409A, it would be unlikely for the arrangement to have included any documentary provisions necessary to comply with Section 409A.

We believe that it is reasonable to afford taxpayers who in good faith designed arrangements to satisfy an exemption from Section 409A relief to correct the terms of those arrangements so as to ensure that they be exempt from Section 409A. By not providing those taxpayers with relief similar to that provided for in the Program for arrangements intended to constitute nonqualified deferred compensation plans, the Program will be providing an unwarranted advantage to taxpayers participating in nonqualified deferred compensation plans that more obviously fail to comply with Section 409A. In fact, the Program treats those taxpayers who attempted to comply

with an exemption from Section 409A exactly like taxpayers who did not invest any resources to comply with Section 409A.

B. Changes to the Program.

1. Reporting.

As we noted at the beginning of this letter, we commend and appreciate the intention of Treasury and the Service to provide a means to encourage taxpayers to identify and correct documentary failures promptly. However, we believe that this intention is undermined by the requirement that all affected service providers attach a statement to their income tax returns regarding the documentary correction. To the detriment of affected service providers, these requirements could easily prove to be a disincentive to service recipients and, to a lesser extent, service providers to make corrections, particularly where a single documentary failure affects a significant number of service providers (such as with a Multi-Participant Plan Document).[4] Accordingly, we request that Treasury and the Service consider eliminating this requirement.

2. Insiders.

Relief available under the Program is available only for failures to comply with the plan document requirements that are inadvertent and unintentional. Accordingly, a taxpayer who drafts or intentionally designs a plan to fail to comply with Section 409A could not rely on the Program.[5] Given this requirement, it is unclear to our Committee why all taxpayers are not treated the same under the Notice. Yet, because certain documentary failures also require that payments that have been made by the date of correction be treated as operational failures under Notice 2008-113, the correction of a documentary failure under the Program provides different relief depending on whether a taxpayer is an "insider."

In the unlikely situation where an insider could or would deliberately cause a plan to violate the documentary requirements of Section 409A, we believe that the general eligibility requirements of the Program (as well as the same eligibility requirements provided under Notice 2008-113) are more than sufficient to prevent such insider from utilizing the benefits of the Notice.[6] In our view, if noncompliance with the documentary requirements of Section 409A is inadvertent and unintentional, then the same relief should be available to all taxpayers, i.e., where both insiders and non-insiders participate in a compensation arrangement that contains an inadvertent and unintentional documentary failure, we see no compelling reason to treat the two groups differently.

3. Releases.

The Notice concludes that a plan violates Section 409A if it provides for payment after an otherwise permissible payment event that is dependent on an employment-related action of the service provider such as the execution and submission of a release of claims ("Release Agreement"). The stated concern of Treasury and the Service is that, by delaying the execution of a Release Agreement, a service provider could defer receipt of income from one taxable year to another, thereby evading one of the purposes of Section 409A. This provision of the Notice suggests that one or more parties to the compensation arrangement would use the execution of a Release Agreement pursuant to which a service provider will waive bona fide legal or economic rights for "tax planning" purposes, which, in our collective experience, is a practice that is very unlikely.

As a practical example, we believe that it is simply unrealistic in the context of an employer-employee relationship to believe that a terminated employee would jeopardize his or her (often considerable) severance payments or other benefits by delaying the execution of a release into another year. Certainly, few, if any, employers would assist a former employee in any such delay and would be far more likely to press for execution as soon as possible. More importantly, from a professional perspective, we believe that the decision to waive legal or economic rights or claims must be taken seriously by any service provider and should involve a deliberative process involving the service provider's legal counsel and other advisors. Yet, the position of Treasury and the Service regarding the operation of Release Agreements under Section 409A may cause service providers to skip such a careful review.

We believe that a decision by a service provider to execute a Release Agreement is analogous to a service provider's decision to separate from service within a predetermined period of up to two years following the initial existence of a "good reason" condition described in Treasury Regulation Section 1.409A-1(n)(2)(ii)(A). In both situations, a service provider could theoretically manipulate the timing of his or her actions for "tax planning" purposes. However, as Treasury and the Service have determined at least in the good reason situation, such a theoretical concern is outweighed by the importance and significance of the consequences of the service provider's decision and should not cause a violation of Section 409A.

We urge Treasury and the Service to amend the terms of the Program (or the regulations promulgated under Section 409A) to expressly provide that a nonqualified deferred compensation plan can be established (within the meaning of Treasury Regulation Section 1.409A-1(c)(3)) to condition payment of nonqualified deferred compensation on the execution of a Release Agreement, notwithstanding that the service provider can elect when to execute that Release Agreement (a "Release Agreement Rule"). If necessary to address the concerns of Treasury and the Service, we suggest that the Release Agreement Rule incorporate one or more of the following elements as a precondition for satisfying Section 409A:

- the Release Agreement must provide for the waiver of one or more material and bona fide legal or economic rights or claims;

- the Release Agreement must be executed and become effective during a predetermined period of time not to exceed ninety (90) days following the applicable payment event (which, in the vast majority of situations involving a Release Agreement, will be a separation from service);
- payment of the nonqualified deferred compensation conditioned upon the Release Agreement must made or begin to be made no later than the ninety (90) days following the applicable payment event (subject to a six month delay, if required by Section 409A(2)(B)(i)); and
- the avoidance of the requirements of Section 409A must not be a purpose of the inclusion of a requirement that a service provider execute a Release Agreement as a condition of payment under the plan.

We also believe that it is appropriate for the determination of whether a Release Agreement provides for the waiver or release of material and bona fide legal or economic rights or claims to be made at the time that the nonqualified deferred compensation plan is "established" (within the meaning of Treasury Regulation Section 1.409A-1(c)(3)) to avoid any disputes (and other unintended consequences) regarding the analysis of the substance of a service provider's legal and economic rights and claims at the time of the execution of the Release Agreement.[7]

Finally, we urge Treasury and the Service to establish a transition period to enable taxpayers to amend nonqualified deferred compensation plans to conform to any conditions imposed by a Release Agreement Rule without requiring either service providers or service recipients to provide information statements or report such amendments to the Service under Section XII of the Notice.[8]

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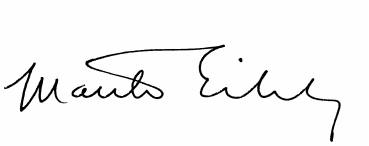
Members of the Committee would be pleased to answer any questions you might have regarding our comments, and to meet with Treasury or the Service if that would assist your efforts.

Respectfully submitted,



Matthew L. Eilenberg

Cc: Arthur F. Woodard, Esq.
Ian L. Levin, Esq.
David Gallai, Esq.
Kenneth J. Laverriere, Esq.
Alan Rothstein, Esq.

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[1] This letter was prepared by an ad hoc committee of the Committee on Employee Benefits and Executive Compensation of the New York City Bar chaired by Arthur F. Woodard, the other members of which were David Gallai, Kenneth J. Laverriere and Ian L. Levin (Adjunct Member of the Committee).

[2] While we appreciate that Treasury and the Service have informally recommended to practitioners that compensation arrangements be simplified in order to more easily satisfy the requirements of Section 409A, based on our collective experiences, our Committee does not believe that this is a viable alternative in all cases.

[3] We note that the Notice recognizes that multiple service providers could be affected by a single plan document or single form of plan document. For example, Section IV.B.1 of the Notice looks to "pattern or practice of the application of a specific interpretation" of a term to establish whether a particular plan provision may be treated as ambiguous.

[4] We also note that this requirement would force service recipients to file physical tax returns with the Service rather than filing electronically.

[5] We have interpreted the Notice, as well as Notice 2008-113, to mean that a failure to comply with Section 409A, whether documentary or operational, must have been "inadvertent and unintentional" and not solely that the result of a provision was intentional.

[6] In our collective experience, we doubt that a service provider and/or service recipient would collude to intentionally violate the requirements of Section 409A and then rely on either Notice 2008-113 or Notice 2010-6 to correct the operational or documentary failure. However, if such unusual facts were to occur and the parties to a nonqualified deferred compensation plan were to have "second thoughts" and desire to correct the intentional failure, we believe that the general requirements of Notice 2008-113 and Notice 2010-6 would satisfactorily prevent it from happening.

[7] We note that a service provider will need some time after a separation from service or other payment event or time to obtain legal counsel that he or she does not have any material bona fide legal rights or claims against a service recipient, and, thus, the execution of a release by the service provider may be advisable. Accordingly, it would be inappropriate to determine whether a release provides for the waiver of material bona fide legal rights or claims at the time that the Release Agreement is required to be executed.

[8] We note that there is precedent for such a distinction. Documentary "ambiguities" that are corrected under Section IV of the Notice are not required to comply with the information and reporting requirements of Section XII of the Notice.