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## IRS Issued Notice 2007-100 Provides Limited Relief

In December 2007, the Internal Revenue Service (the "IRS") issued Notice 2007-100, providing limited relief for certain operational failures under Internal Revenue Code Section 409A. Section 409A, enacted by Congress in 2004, drastically altered the creation and operation of affected plans, including, but not limited to, severance, stock option, performance-based, and bonus plans. The penalties for not complying with this Section affect the plan participants in that the amounts are subject to inclusion in gross income in the year of deferral along with an additional penalty of 20%. In light of these harsh repercussions, companies offering such plans and participants in them should examine their existing plans now to determine if there are operational failures.

However to correct operational failures, certain eligibility requirements must be met. Additionally, plan sponsors must notify the IRS that they have self-corrected under this guidance.

### Eligibility Requirements

As indicated above, Notice 2007-100 may be relied upon only if certain eligibility requirements are fulfilled. These eligibility requirements the following:

- Only an unintentional failure to comply with plan provisions that either meet the terms of section 409A, or follow the section in practice, may be corrected.
- The failure must be due to inadvertent errors in plan operation.
- The failure must not be egregious.
- The company must take commercially reasonable steps to avoid recurrence of the failure.

Note: Companies and plan participants relying on Notice 2007-100 bear the burden of demonstrating that they satisfy the aforementioned requirements. Plans that meet such eligibility requirements and that choose to correct violations under this guidance within the applicable tax year will be able to avoid the adverse tax consequences.

### Failures Correctible Within the Taxable Year

This Notice provides that the following operational failures are correctible provided that they are corrected in the year of occurrence and that this Notice's requirements are followed, and that the eligibility requirements listed above are satisfied:

- Failure to defer correct amounts or incorrect payment amounts,
- Incorrect payments of nonqualified deferred compensation violating Section 409A,
- Excess deferrals of compensation, and

## IRS Issued Notice 2007-100 Provides Limited Relief, Continued

- Correction of the exercise price of otherwise excluded stock rights such as stock options or stock appreciation rights.

However, correction for early payments or payments made during the key-employee waiting period (for public companies) is *not* available if the failure occurs during a year in which the employer experiences a substantial financial downturn.

### Relief for Operation Failures During Tax Years Beginning Prior to 2010

If an unintentional operational failure does not meet the stringent eligibility requirements laid out above, it may nevertheless qualify for limited corrections relief. The Notice also provides transitional relief through 2010 for operational failures up to \$15,500 for 2007 and 2008 when not corrected within the same taxable year. However, the correction of a failure under these provisions *will* result in tax penalties, but only the amount involved in the failure is subject to immediate taxation and the 20% penalty rather than the entire amount deferred under the plan.

### Correction Program Under Consideration

The IRS is considering adopting a program to allow for corrections of certain operational failures, including corrections in subsequent tax years, allowing compliance with Section 409A. Comments on such a program are due before March 3, 2008, and the IRS will issue guidance on a correction program, if adopted, after that date.

### Could you have a noncompliant nonqualified deferred compensation plan?

Now is the time to begin analyzing your plans, if you have not already done so to determine if there is an operation failure or, more importantly, what can be done to prevent such failures. These §409A rules are difficult to navigate and interpret if you do not deal with them regularly. This is a very complex area of tax law and you benefit from receiving guidance from professionals who focus on these issues on a daily basis. Contact the Chamberlain Hrdlicka Employee Benefits Group: Toll-free at 1.800.342.5829, or call Jewell Lim Esposito and Rebecca Jordan Manners at 610.772.2300; Jerome M. Harris at 713.654.9651; and Stephen M. Mason at 713.654.9646.

