



WRNewswire

An AALU Washington Report

Friday, 30 May 2014

WRN# 14.5.30.2

The *WRNewswire* is created exclusively for AALU Members by insurance experts led by Steve Leimberg, Lawrence Brody and Linas Sudzius. The *WRNewswire* provides timely reports and commentary on tax and legal developments important to AALU members, clients and advisors, delivered to your inbox as they happen.

TOPIC: IRS Announces New Program to Audit 409A Compliance

CITES: [Internal Revenue Code Section 409A](#), [Treas. Reg. Section 1.409A](#)

SUMMARY: The IRS is getting ready to ramp up enforcement of Section 409A compliance with respect to non-qualified deferred compensation arrangements. This new compliance initiative project (“CIP”) for Section 409A will focus on fifty large companies. However, this foreshadows a much broader Section 409A enforcement initiative.

The Service plans to issue Information Document Requests (“IDRs”) to about 50 large employers. These initial IDRs will request documents regarding deferred compensation elections and payouts. The IRS informally indicated that these will focus on three issues: 1) initial deferral elections, 2) subsequent changes in deferral elections and, 3) timing of payouts. Requested data will initially be limited to the top 10 highest paid employees in each company. Information gained from the first 50 audits will be used by the IRS to target future 409A audit and enforcement activity.

FACTS: As a reminder, Section 409A governs the tax treatment of non-qualified deferred compensation and retirement plans which are often funded by corporate owned life insurance. However, the rules of Section 409A have been broadly interpreted by regulations to impact almost every type of compensation arrangement including employment, severance and change in control agreements, short and long term equity, incentive and bonus plans and other contingent compensation arrangements.

On May 9 of this year, an IRS attorney informed the American Bar Association Taxation Section that the IRS is beginning a CIP focused on Section 409A compliance. The recently announced

CIP is quite narrow (50 large employers; 10 highest paid employees at each), but is intended as the first phase of a much larger Section 409A enforcement initiative.

Section 409A is complicated, confusing and often ambiguous. Many employers had hoped that the IRS would issue clearer guidance before beginning broad enforcement initiatives. Section 409A creates special complications, because actions of the employer can cause large tax liabilities for its employees—often key executives. Employer noncompliance in both documentation and administration can lead to harsh results for employees. These include accelerated taxes and excise taxes (generally full, immediate income inclusion, a 20% additional federal tax and interest during the deferral period of all vested amounts; and, sometimes, additional state tax liability.) It is not yet clear how the IRS might use information from the planned employer audits to assert claims against employees.

RELEVANCE: We do not yet know the scope of the IDRs planned under the newly announced CIP. The IRS previously released draft Section 409A IDRs that require employers to provide detailed information regarding deferred compensation, plans, payments made and deferral elections. Prior draft IDRs also required employers to take legal positions on whether particular arrangements were covered by 409A, and to identify any violations of 409A. This requires key tactical decisions to be made very early in the audit process. Employers being audited need to be very careful regarding the information provided and the legal positions taken to avoid generating tax liability for their employees.

The IRS has issued corrections procedure which allows for less harsh treatment when documentary or administrative errors are self-discovered and voluntarily disclosed. However, taxpayers are generally ineligible for this program if the issues are disclosed after an audit begins. Therefore, this is a good opportunity for employers, both large and small, to make sure all of their compensation arrangements are in compliance with Section 409A.

Practitioners should inform clients that the IRS is stepping up its scrutiny of deferred compensation arrangements and enforcement of Section 409A. You may wish to advise and assist your clients to start a self-audit for 409A compliance and address any deficiencies *before* the IRS begins an inquiry of their firm.

WRNewswire #14.05.30 was written by Marla Aspinwall of Loeb & Loeb, LLP.

DISCLAIMER

In order to comply with requirements imposed by the IRS which may apply to the Washington Report as distributed or as re-circulated by our members, please be advised of the following:

THE ABOVE ADVICE WAS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED, BY YOU FOR THE PURPOSES OF AVOIDING ANY PENALTY THAT MAY BE IMPOSED BY THE INTERNAL REVENUE SERVICE.

In the event that this Washington Report is also considered to be a “marketed opinion” within the meaning of the IRS guidance, then, as required by the IRS, please be further advised of the following:

THE ABOVE ADVICE WAS NOT WRITTEN TO SUPPORT THE PROMOTIONS OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED BY THE WRITTEN ADVICE, AND, BASED ON THE PARTICULAR CIRCUMSTANCES, YOU SHOULD SEEK ADVICE FROM AN INDEPENDENT TAX ADVISOR.

The AALU *WRNewswire* and *WRMarketplace* are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation’s most advanced life insurance professionals.