

# Expert Q&A on Section 409A Audits

PRACTICAL LAW EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

LAW STATED AS AT MAY 13, 2014

## An expert Q&A with Jeffrey W. Kroh of Groom Law Group, Chartered in Washington, D.C. on the Internal Revenue Service's Section 409A Audit Initiative.

The Internal Revenue Service (IRS) has commenced a formal audit initiative to test compliance with Section 409A of the Internal Revenue Code. This initiative will focus on a limited number of large companies at the outset, and then the IRS will decide what further action to take. The audits will be conducted by the IRS's Small Business/Self-Employed (SB/SE) Division. Practical Law asked Jeffrey W. Kroh, from Groom Law Group, Chartered, to answer a few questions about the Section 409A audit initiative, and for his thoughts on what companies should do to prepare for a potential Section 409A audit.

### THE IRS HAS INDICATED THAT THE SECTION 409A AUDIT INITIATIVE HAS A "LIMITED SCOPE." CAN YOU EXPLAIN WHAT THAT MEANS?

The Section 409A audit initiative is one of the first steps of an IRS compliance initiative project (CIP). CIPs are generally designed to identify trends of non-compliance and improper tax treatment and improve voluntary compliance. In this initial phase, the IRS intends to limit the scope and burden on taxpayers by focusing on the top ten most highly compensated individuals at no more than 50 companies. The companies being audited were previously identified for audit on employment tax issues and were chosen for this CIP based in part on the likelihood that they would sponsor a nonqualified deferred compensation program.

### WHAT TYPES OF ISSUES WILL THE IRS BE ASSESSING DURING ITS AUDITS?

An IRS official who spoke unofficially at the American Bar Association Section of Taxation May 2014 meeting indicated that the IRS plans to focus on the following three issues:

- Initial deferral elections.
- Subsequent deferral elections.
- Payouts (including compliance with the six-month delay for payments made to specified employees in connection with their separations from service).

The IRS official clarified that the audits will not be limited to traditional, voluntary deferral programs. Other types of programs, such as supplemental executive retirement plans (SERPs), will also be reviewed.

### WHAT SHOULD COMPANIES DO TO PREPARE FOR A POTENTIAL SECTION 409A AUDIT?

In light of this renewed potential for an IRS audit, companies should take this opportunity to review their plans for compliance with Section 409A. From an operational standpoint, at a minimum, companies should review the deferral elections of, and payments to, their top 10 highest compensated employees. Under the IRS correction program, certain types of operational failures, if corrected promptly, can be relatively easy to correct with few consequences. In addition, companies that last reviewed their plan documents in 2008 may consider taking a fresh look, particularly to ensure documentary compliance prior to an IRS audit. Importantly, once a company or an executive is under an IRS audit on these issues, the correction programs are no longer available.

For additional information on Section 409A and resources designed to facilitate compliance, see Practical Law's *Internal Revenue Code Section 409A Toolkit* ([www.practicallaw.com/1-500-6652](http://www.practicallaw.com/1-500-6652)).



For the links to the documents referenced in this note, please visit our online version at <http://us.practicallaw.com/4-567-9366>

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