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Document Failures in the § 409A-Covered Plan: Correcting With and Without Notice 2010-6

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Introduction

Document failures in a 409A-covered plan are hard to correct and may be hard to avoid, two points underscored by the formal correction program set forth in Notice 2010-6. The Notice provides a program that, while providing welcome relief for many kinds of failures, is not penalty free for corrections made after 2010, and is at all times cumbersome. Moreover, like other IRS guidance—both formal and informal—it appears to create new rules, and so new failures where none existed before. By combining strict-liability enforcement with intricate rules that are not always clear, consistent, or even complete, Notice 2010-6 signals that document failures may beset the most carefully drafted plan by the most conscientious drafter.

In this article we outline the available ways of correcting document failures, both within Notice 2010-6 and outside of it. We conclude with a few thoughts on drafting approaches to mitigate the chance of document failure. The article is organized as follows:

In Section I, we first address the puzzles raised by identifying the written 409A-covered ''plan.'' Why this threshold inquiry? Before determining whether a ''failure'' in the ''plan document'' needs to be corrected,

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these terms must first be defined—but in many cases definition remains surprisingly elusive. As will be seen, the difficulty of identifying the ''plan'' and the plan ''document'' (and in some cases the failure) is a problem besetting all four correction approaches that we discuss below.

In Section II, we discuss specific approaches to correcting the plan document. These are fourfold:

First, under proposed IRS regulations, document failures of *nonvested* amounts can be corrected without tax or penalty. We discuss this rule's scope, in particular the most pressing open question: whether a document failure can be corrected in the vesting year, if correction is made before the actual vesting date. We conclude that, at least pending issuance of final regulations or other guidance, the better answer is that correction is possible until the vesting date, even if vesting occurs later in the same year.

Second, we discuss the welcome provisions under Notice 2010-6 for correcting failures outside of its formal program. First, Notice 2010-6 allows informal correction of certain ambiguous plan terms. This is a rule of interpretation, rather than of correction. Second, Notice 2010-6 provides that, in a handful of circumstances, *failed election provisions* can be corrected with no tax consequences of formal filing. While limited, this relief may be useful.

Third, we discuss in detail the formal correction program under Notice 2010-6. Many document failures can be corrected in 2010 with no penalty. After 2010, most corrections of failed payment terms are subject to a ''One-Year Rule'' providing that, even after the failure is corrected, reduced penalties apply to a service provider who incurs the pre-correction payment trigger within one year of the correction. When the one-year period has elapsed, no further penalty applies. As with its sister program under Notice 2008-113, the detailed structure of Notice 2010-6 makes it hard to follow. We have organized it into what we hope is a more user friendly way. We discuss, in order,

(i) failed payment terms subject to the One-Year Rule;

(ii) payment terms correctable *without* the One Year Rule;

(iii) payment terms correctable only with at least some penalty; and

(iv) failed *deferral election* terms, and the special rules that apply.

We conclude by addressing the special rules applicable to new plans, and the transition rules applicable in 2010 and 2011. While critical now, these transition rules are placed at the end because they are already addressed in the literature.

Fourth and finally, we take a step back and address the more fundamental question underlying a document ''failure.'' Is it always right to say that, if the terms of a document do not conform precisely to 409A, there is a failure? Or are there circumstances where the plan conforms with 409A, even though the document does not? We explore basic precepts of contract construction—for example, scrivener's error or ''extrinsic ambiguity''—to set forth circumstances where it may be concluded that the plan complies with 409A's formal requirements, even if some of its written expression fails to conform.

I. Open Issues in the Plan Document Rules

1. Basic Rules. Section 409A requires that a nonqualified deferred compensation plan comply with the statute's payment and election rules in both form and operation.[1] Regulations require that the plan's ''material terms''—defined as the amount or formula for determining the amount payable under the plan, and the time and form of payment—be in writing no later than the end of the taxable year[2] in which the legally binding right arises, or if no amount is payable in the year next following that year, not later than the 15[th] day of the third month following the year in which the legally binding right arises.[3] Any deferral election must be set forth in writing before the date the election would become irrevocable. For example, a provision for second elections must be in writing not later than one year before the initially specified earliest payout date. The six-month rule must be set forth in writing on or before the date any participant becomes a specified employee, generally, on or before the specified employee effective date.[4]

2. Unanswered Questions. Despite the seeming precision of the regulations and the IRS notice guidance, fundamental questions about the definition of the plan and plan document remain unanswered.

a. What is the plan? For 409A document failures, the answer is not entirely clear. Final regulations sort deferred compensation into nine types, or ''buckets.'' An aggregation rule provides that for certain purposes the plan is every arrangement in the same bucket covering the same service provider.[5] The aggregation rule does not apply, however, for purposes of the plan document rules.[6] Thus, for example, a document failure in a parachute plan designed as a ''nonaccount balance'' plan does not trigger tax under 409A in every other nonaccount balance plan covering the same employee.

Having partly determined what the plan is not, it is not entirely clear what the plan is. Is it each identifiable promise considered alone? Or is it every identifiable promise within a single instrument?

While guidance does not address this issue, the better view is that the plan must be defined as the promise, rather than all the promises in the single instrument. With few exceptions, nonqualified deferred compensation plans lack the Form 5500 filings or other identifiers typical of most ERISA plans. Few such plans have an express integration clause. It would thus be difficult to identify the instrument. Moreover, even an identifiable single instrument does not create a single 409A plan. For example, if the plan is a top-hat ERISA pension plan, an initial Labor Department filing is required, and the single instrument could arguably be identified by the filing.[7] But the same top-hat pension plan could be two or more plans for 409A purposes. For example, consider a SERP providing wraparound benefits for both a final average pay formula and a cash balance formula under a single qualified defined benefit plan. The SERP is a single ERISA plan for top-hat filing purposes. But it is two separate plans under Treas. Reg. § 1.409A-1(c)—an account balance plan (the cash balance formula wrap) and a nonaccount balance plan (the final average pay formula wrap). Identifying the plan by the instrument would be difficult to interpret, administer, and enforce.

To see the practical problems raised by the definition question, consider an employment agreement with two vested deferred compensation promises: (A) a fixed dollar amount payable in two years, and (B) a special payout if and when the employee's *former* employer pays certain specified bonuses. Promise A is 409A compliant, Promise B is not. If they are both part of the same plan, then 409A taxes and penalties apply to both promises; if different plans, then only to Promise B. If correction is attempted under Notice 2010-6, different corrections might apply depending on whether the two promises are one plan or two. This is because a different correction applies to a plan with no compliant payment provision (Promise B considered in isolation) than to a plan with at least one compliant payment provision (both promises considered as a single plan). The appropriate answer appears to be that there are two plans. A different answer would produce different tax and administrative results depending on whether an economically identical arrangement was provided on one piece of paper or two.

b. What is the plan document? If each promise is the plan, the next question is: where is the promise located?

[1] I.R.C. § 409A(a)(1)(A) (taxation under 409A applies if a nonqualified deferred compensation plan either ''fails to meet'' or ''is not operated in accordance with'' the requirements of 409A).

[2] Unless otherwise specified, the ''taxable year'' herein is always the taxable year of the service provider.

[3] Treas. Reg. § 1.409A-1(c).

[4] Treas. Reg. § 1.409A-1(c)(3)(v).

[5] Treas. Reg. § 1.409A-1(c)(2)(i).

[6] Treas. Reg. § 1.409A-1(c)(3)(viii) (plan aggregation rule does not apply to ''written plan requirements of this paragraph (c)(3),'' which requires that certain terms of the plan be set forth in writing, including the time and form of payment and the six-month delay rule for specified employees).

[7] 29 C.F.R. § 2520.104-23.

Section 409A's writing requirement means that the promise must be in a writing, and parol evidence will generally be inadmissible to alter its terms.[8] But what documents comprise the writing? Regulations state that the plan need not be confined to a single document.[9] Accordingly, the 409A plan may include instruments other than the formal agreement. But how far does this deemed paperclip rule go? Does the plan document include, for example, e-mails, participant communications, letters of intent, the minutes of board meetings, shareholder communications? So far, there is no clear answer.

Return to Promise B in the above example, paying a stated amount if and when the employee's former employer pays certain bonuses. As discussed, Promise B is most reasonably viewed as a stand-alone plan. On the face of the employment agreement, Promise B has no permissible payment date. Under Notice 2010-6, it can be corrected before the payment trigger occurs, but only if 50 percent of the deferral is subject to tax under 409A. Now assume that the bonuses promised by the former employer state, in writing, that the outside payment date is Dec. 31, 2010, and further assume that correspondence between new employer and incoming executive reflect a shared understanding of this date. If this provision is read into Promise B, then Promise B has both an impermissible and a permissible payment date (Dec. 31, 2012), and can be corrected with (possibly) zero tax under 409A, under a different section of Notice 2010-6.[10]

c. What is a "failure"? A more fundamental difficulty is determining whether a document failure exists. This issue arises because IRS guidance is in many instances unclear, incomplete, or contradictory. One of many examples is the definition of "employer stock" for purposes of the rule exempting certain options and stock appreciation rights (SARs) from 409A. Among other things, good "employer stock" may be subject to a call right only if the call right involves a " lapse restriction."[11] Guidance concerning what constitutes a "lapse restriction" is sparse and inconsistent. For example, if the optioned stock is subject to a call right that lapses on a "merger, acquisition or other change in control," then under IRS guidance, the call right might be a lapse restriction—or, on the other hand, might not be a lapse restriction, meaning that the option might be failed deferred compensation under 409A—or, on the other hand, might not.[12]

Moreover, the ongoing release of new IRS guidance has a pattern of creating new and hitherto unknown rules, typically ones giving rise to failures where none existed before. For example, Notice 2010-6 gives rise to implied "failures" that arguably did not exist under previous guidance:

■ *Failures in new plans*. Notice 2010-6 includes a formal correction method for failures arising in new plans. The correction must be made in the taxable year in which the right first arises (or 2 ½ months after it arises, if no amount is payable in the next taxable year); must be run through the Notice 2010-6 program; and is not available if the employer has maintained any plan in the same aggregation group or "bucket," for any service provider, in any previous year. This provision is inconsistent with previous guidance. Under regulations, the deferred compensation plan is not required to be in writing until the end of the year in which the right first arises (or 2 ½ months after it arises, if no amount is payable in the next taxable year), and is not subject to the aggregation rule for document failure purposes. Absent the new-plan rule, any document creating a new legally binding right to deferred compensation of any kind, could be corrected without penalty, until the end of the taxable year in which the right arises (or by the 2 ½ month deadline), because the writing would not be fixed and no failure would exist, until that time. Notice 2010-6 appears to create a new category of failures that did not before exist.

■ *Reservation-of-rights clauses*. Many deferred compensation plans state that the company has the right to "terminate or amend" the plan, generally at any time for any reason. Under Notice 2010-6, a statement that the employer may "terminate the plan and immediately pay all amounts deferred" fails 409A as impermissible employer discretion to accelerate. Notice 2010-6 raises the possibility that all "terminate or amend" clauses could give rise to 409A failure. Plan drafters can almost certainly eliminate the uncertainty and the problem by adding a clause stating that the plan is to be construed as 409A-compliant (see discussion at Section II.A of this article below). But again, Notice 2010-6 arguably creates failure where none existed, and the need for further revision where none was called for.

■ *Participant waivers provisions*. Regulations provide that, if a plan specifies a payout period, the period must fall within a single taxable year, or be a specified period of not more than 90 days, where the service provider has no "right to designate the taxable year" of the payment.[13] Notice 2010-6 takes the position a failure arises if payment is contingent on employee action, for example, signing release of claims. The thinking seems to be that the employee can impermissibly designate the year of payment by choosing when to sign the release. By reading these provisions as a per se failure of the 90-day rule (rather than as a payment condition that may be implicitly bounded by other 409A-compliant payment constraints in the plan), this rule may arguably go beyond previous guidance.

■ *"As soon as reasonably practicable" qualifiers*. Here, in contrast with the preceding three provisions, Notice 2010-6 reverses earlier guidance in a pro-taxpayer direction. The 2007 preamble to the regulation states that a plan providing for payment "as soon as reasonably practicable after" a payment trigger cause

[8] Cf *Feifer v. Prudential Ins. Co. of Am.*, 306 F.3d 1202, 1210-1211, 29 EBC 1005 (2d Cir. 2002) (statutory requirement of ERISA § 402(a)(1), requiring that plan be a written instrument 'essentially operates as a strong integration clause, statutorily inserted in every plan document' (quoting *Senior Executive Benefit Plan Participants v. New Valley Corp.*, 89 F.3d 143, 149, 20 EBC 1537 (3d Cir. 1996)).

[9] Treas. Reg. § 1.409A-3(c)(3)(1) ("material terms of the plan may be set forth in writing in one or more documents").

[10] *Compare* Notice 2010-6 § VII.A (corrections of failed payment terms where plan has at least one permissible payment term) *with* Notice 2010-6§ VII.B (correction where plan has no permissible payment term).

[11] Treas. Reg. § 1.409A-1(b)(5)(E)(iii)(a).

[12] *Compare* TAM 9744001 (restriction that expires upon "liquidation, merger, acquisition or other reorganization" is a "lapse" restriction) *with* PLR 9308022 (restriction that expires upon a "change in control" or initial public offering, not a lapse restriction).

[13] Treas. Reg. § 1.409A-3(b).

409A failure, unless an express outside payment date is stated, complying with the regulations' ''payment period'' rule (generally, a single taxable year, or a period of not more than 90 days).[14] Notice 2010-6 states that such phrases do not automatically cause 409A failure. Payment must be generally made by the end of the calendar year of (or by 2 ½ months following) the stated payment trigger—the rule applicable to specified payment dates and events. IRS guidance no longer reads the phrase as creating an impermissible payment period, but rather as the empty qualifier of a provision creating a discrete payment date or event. This interpretation is sensible—but it is not where guidance started.

In all these cases, the underlying problem is the same. Compliance with 409A rests on precise adherence to rules that are often undefined, incomplete, or ambiguous. IRS interpretation of these rules is subject to revision, clarification, even change. Employers can protect their plans in some limited ways (suggested at Section II.D of this article below). Nonetheless, even with the most careful drafting, opportunities for springing failure abound.

II. Correcting Plan Document Failures

A. Correcting Document Failures in Nonvested Deferred Compensation.

Document failures can be completely corrected without incurring tax under 409A, and without the correction program of Notice 2010-6, in the year in which the compensation is nonvested. This follows from three key provisions in guidance governing income inclusion under 409A: First, a noncompliant deferred compensation plan is taxed under 409A only to the extent of vested amounts under the plan in the failure year.[15] Second, vested amounts are not taxed under 409A in a year in which they comply with 409A, even if deferred from an earlier year in which they failed 409A.[16] Third, under a year-end rule, the noncompliant vested amount includible for a taxable year is determined as of the ***last day*** of the year, generally as the year-end value of compensation vested as of such last day, plus distributions made during the year.[17] Taken together, these rules mean the following:

■ *Correctable if nonvested for entire year*. A document failure can be corrected without 409A tax and penalties, and without the program of Notice 2010-6, to the extent of compensation that is nonvested throughout the service provider's entire taxable year.

■ *Correctable in vesting year before vesting date*. In addition, a document failure in nonvested deferred compensation can apparently be corrected, without the Notice 2010-6 program, at any time before the substantial risk of forfeiture lapses, even if the compensation becomes vested later during the same taxable year, *after* the correction date. It is not clear that this rule will survive into the final regulations. But this is the preferred reading of the proposed regulation.

Because this question is not entirely free from doubt, a brief discussion is warranted. If there is a failure (in either document or operation) under 409A on any date when the amount deferred under the plan is *vested*, the vested deferred amount is includible in income under 409A for that year. This is true even if at the beginning of the year the plan was 409A-compliant. Accordingly, states IRS guidance, if nonvested but 409A-compliant deferred compensation becomes vested and then ''first fails'' (in document or operation) after the vesting date, the vested amount is subject to tax under 409A for the year.[18] It follows that, if deferred compensation has a document failure *on or after* the vesting date, the vested amount is subject to tax under 409A for that year, even if the noncompliant plan term is corrected before the end of the year. But this begs the question of whether a document failure has arisen in the first instance, if the noncompliant plan term is corrected *before* the vesting date. Neither the proposed regulation nor its preamble addresses this question, as both address only cases where the failure (either in document or operation) remains uncorrected as of the date the compensation first vests.[19]

The better reading is that the document ''failure'' no longer exists if the noncompliant plan term is corrected before the substantial risk of forfeiture lapses. Under this preferred reading, amending the noncompliant plan term before the vesting date is an effective ''correction'' of the plan document failure without the Notice 2010-6 correction program, even if the compensation vests later in the correction year. This preferred reading is consistent with the year-end snapshot approach of the proposed regulation. Moreover, the obverse reading would make corrections of noncompliant plan terms excessively contingent. If a document correction of nonvested compensation depended on its vested status at year's end, the correction's success would not be known until the end of the year, would depend in many cases on chance events, and would impose differences in the tax treatment of covered service providers for that year based solely on whether they happened to vest before the end of the year.

■ *Taint rule does not apply*. There is an important difference between corrections of operational and document failures. Any operational failure of a nonvested amount taints all deferred compensation in the same plan as defined under the aggregation or ''bucket'' rule of Treas. Reg. § 1.409A-1(c)(2). Accordingly, if an operational failure is corrected (outside of the formal correction program for operational failures under Notice 2008-113) with respect to nonvested compensation, all vested deferred compensation in the same bucket is generally subject to tax under 409A. This is so even

[14] 72 Fed. Reg. 19,233, 19,255-6 (April 17, 2007).

[15] Prop. Treas. Reg. § 1.409A-4(a)(1)(i).

[16] Preamble to Prop. Treas. Reg. § 1.409A-4, 73 Fed. Reg. 74,380, 74,381 (Dec. 8, 2008).

[17] Prop. Treas. Reg. § 1.409A-4(a)(2)(i).

[18] Prop. Treas. Reg. § 1.409A-4(a)(2)(i) (''an amount may be includible in income under section 409A(a) for a taxable year even if such amount is subject to a substantial risk of forfeiture during the taxable year if the substantial risk of forfeiture lapses during such taxable year, including if the substantial risk of forfeitures lapsed after the date the nonqualified deferred compensation plan under which the amount is deferred first fails to meet the requirements of section 409A(a)''). *See also* Prop. Treas. Reg. § 1.409A-4(a)(2)(ii) *Example*; Preamble to Prop. Treas. Reg. § 1.409A-4, § III.B.5., 73 Fed. Reg. 74,380, 74,383 (Dec. 8, 2008) (deferred compensation required to be included in income under 409A(a) ''does not distinguish between amounts deferred in a taxable year before a failure to meet the requirements of section 409A(a), and amounts deferred in the same taxable year after such failure'').

[19] *Id.*

though the vested deferred compensation is compliant, and even though the operational failure in the nonvested compensation is corrected.[20] (This same rule does not apply for correction of an operational failure made under the Notice 2008-113 program, which forestalls tax under 409A for vested compensation in the same bucket). By contrast, the bucket rule does not apply to document failures.[21] Accordingly, if a document failure arises in nonvested deferred compensation, the failure does not taint vested compensation in the same bucket. Thus, correcting a noncompliant plan term in nonvested deferred compensation cures the failure, outside the Notice 2010-6 correction program, and results in escape from taxation under 409A.

One technical aside: Note that the taint rule for operational failures has no bearing on the question, discussed in the preceding bullet, of whether a document failure in nonvested compensation can be corrected (without Notice 2010-6) before the vesting date if the compensation vests later in the same year. When an operational failure taints *vested* amounts in the same aggregated plan, correcting the aggregated plan before the vesting date has been made impossible. This rule is thus irrelevant to the separate question of whether a document failure disappears if corrected before the vesting date of the ''plan'' defined without the aggregation rule.

■ *But definitional questions still do*. For purposes of document failures, the ''plan'' is defined without the aggregation rule. Nonetheless, document failures of nonvested amounts might still taint vested amounts in the same ''plan.''[22] Thus, defining the ''plan'' is still important. As we concluded above in Section I of this article, defining the ''plan'' is difficult and subject to question, but the best answer is that the ''plan'' is each separately identified deferral promise, rather than every promise in the same instrument.

■ *Anti-abuse rule*. The proposed regulation provides that compensation will not be treated as nonvested for this purpose if the service recipient has a ''pattern or practice'' of permitted impermissible changes in the time or form of payment in nonvested compensation.[23]

B. Corrections Permitted By Notice 2010-6 Outside of Formal Program.

The bulk of Notice 2010-6 sets forth a program allowing corrections subject to detailed formal requirements. In addition, Notice 2010-6 sets forth a number of informal corrections effective outside the program.

1. Ambiguous payment terms. Section VI.B of Notice 2010-6 provides that ''ambiguous'' payment terms are deemed to comply with 409A. Examples are ''termination of employment'' and ''acquisition.'' This is a rule of interpretation, rather than a correction. An ambiguous payment term can be amended at any time to disambiguate it, most simply by amending the plan to state that its terms are intended to be construed in compliance with 409A, or words to that effect.

The ambiguous-term rule applies to payment provisions that could be ''reasonably interpreted'' to include both compliant and noncompliant payment triggers, or compliant but incomplete triggers. An example is ''termination of employment,'' which can be read to include both events that are separations from service and those that are not (e.g., transfer to an 80 percent owned subsidiary), or to exclude events that are separations from service (e.g., ceasing to perform services but continuing to receive salary-like payments for a stated period thereafter).

Notice 2010-6 defines the meaning of ''ambiguous'' for this purpose. To be ambiguous, the term cannot expressly violate 409A. That is, it cannot expressly include events that are nonpermissible payment events, or exclude required ones. A provision is not ambiguous if there is a pattern or practice of administering the provision in a noncompliant way. A provision is not ambiguous if a court with jurisdiction over enforcement of the contract interprets the provision in any particularly way. The pattern-or-practice and court-interpretation rules apply as well to any ''substantially similar'' provision in any other plan of the service recipient. And finally, a provision is not ''ambiguous'' if the plan states that its terms are to be interpreted as 409A-compliant (or a provision with the same effect). Notice 2010-6 states that a 409A interpretation clause of this kind renders the provision unambiguously 409A-compliant.

An ambiguous plan term can be amended at any time to remove the ambiguity. The amendment can spell out the payment rule, in which case it cannot add or subtract payment events. (This constraint may be a challenge, given that the term is by definition ambiguous). Or, more simply the amendment can add a 409A interpretation ''savings'' clause, stating that the plan is intended to comply with 409A, and its terms are to be interpreted accordingly. Adding a 409A savings clause is probably the most effective as well as the simplest correction because it renders all ambiguous payment terms 409A-compliant. And, as we discuss below in subsection D of this article, may have broader compliance effects as well.

A non-409A compliant payment under an ambiguous payment term can be corrected as an operational failure under Notice 2008-113. In this case, however, clarifying the ambiguous payment term is mandatory by the end of the 2008-113 correction year. Failure to clarify renders the 2008-113 correction of the operational failure ineffective and apparently renders the ambiguous payment term no longer ''ambiguous.'' As a practical matter, this means that clarifying ambiguous plan terms should be done soon as possible. Over time, some kind of mistaken payment is reasonably likely to occur; clarifying now cures the need for a rushed plan amendment later.

While Notice 2010-6 does not so state, it presumably covers ambiguous terms that are amended by being taken out of 409A altogether, for example, by being made short term deferrals. Accordingly, the ambiguous-term rule may be among the most valuable correction tools of Notice 2010-6. Consider, for example, a plan providing for payment of tuition assistance when an employee's child enrolls in college. Standing alone, this payment term is an arguable 409A violation correctable

[20] Prop. Treas. Reg. § 1.409A-4(a)(1)(i); *see also* Preamble to Prop. Treas. Reg. § 1.409A-4, 73 Fed. Reg. 74,380, 74,382 (Dec. 8, 2008).

[21] Treas. Reg. § 1.409A-1(c)(3)(viii) (plan aggregation rule does not apply to ''written plan requirements of this paragraph (c)(3)'').

[22] Prop. Treas. Reg. § 1.409A-4(a)(1)(i) (409A income inclusion applies to excess of ''total amount deferred under the plan'' for taxable year, over the nonvested ''portion of such amount'').

[23] Prop. Treas. Reg. § 1.409A-4(a)(1)(ii)(B).

under Section VII.B of Notice 2010-6 (discussed below). This provision can be corrected as an ambiguous payment term, without using the Notice 2010-6 correction program, by amending the plan to specify that the employee must still be employed when payment is made. This renders the provision a nonambiguously compliant short term deferral. (This correction is possible, of course, only if the plan's administrative practice allows it.)

2. Noncompliant provisions for employee deferral elections. Plan provisions allowing noncompliant service provider elections generally do not trigger tax under 409A for participants who do not make an election under the defective provision. This relief is narrow, however. A service provider who makes an election under a defective provision may be subject to tax under 409A even if the election itself is operationally compliant with 409A. The relief applies only to elections to defer. Provisions allowing ''haircuts'' and other employee accelerations may not be corrected, even under Notice 2010-6, and apparently even as to service providers who do not use them.

a. Noncompliant second-election provisions when service provider does not make second election (Section VII.D). If the plan provides impermissible employee discretion to defer already deferred compensation, there is no failure as to employees who do not exercise the discretion. This is so even if the plan remains uncorrected. The discretion is not exercised if the employee makes no election, or makes an election but revokes it before it becomes irrevocable. An example is a plan providing for payment of deferred compensation upon age 65, and further providing that the employee may elect any time before age 65 to defer payment by 12 months. Under Notice 2010-6, an employee who does not exercise his election right, and receives payment at age 65, is not subject to tax under 409A. This is the case even if the impermissible election provision was not corrected before the employee attained age 65 (Example 10). Change the example so that the employee makes an election under the bad provision, but revokes before the election becomes irrevocable—that is, one year before he attains age 65. The employee is not subject to tax under 409A, even though the impermissible provision remains uncorrected (Example 11).

b. Noncompliant initial deferral election provisions when service provider does not make initial deferral election (Section IX). If a plan has a failed provision for initial deferral elections, in some cases informal correction is possible. Assume, for example, a plan that allows an initial deferral election any time up to the last day of the month before the month the compensation is earned (instead of the last day of the year). No tax under 409A arises for a service provider if the provision has not been ''applied'' with respect to that service provider. Generally, this means that no tax under 409A arises for a service provider who has not made an election under the failed election provision, or has made an election but revoked before it became irrevocable. For these service providers, no formal document correction under Notice 2010-6 is necessary. It is further required, however, that the service recipient take ''commercially reasonable steps'' to correct the same provision in all its plans.

C. Formal Corrections Under Notice 2010-6.

1. In General. On Jan. 6, 2010, the IRS released Notice 2010-6, providing a program for correcting 409A document errors. Generally, the corrections are effective only if detailed administrative rules are followed, including the requirement that both service recipient and service provider attach written statements to their federal income tax returns filed for the year of the correction. Notice 2010-6 thus generally follows the IRS's model for correcting 409A operational failures under Notice 2008-113. An alternative correction model was available, but was not adopted for 409A purposes: the IRS's program for voluntary corrections of qualified plans, or Employee Plans Compliance Resolution System (EPCRS). EPCRS allows the plan sponsor to correct plan documents by amending, filing with the IRS, and paying a stated fee.

2. Failures Not Correctable Under Notice 2010-6. The correction program of Notice 2010-6 is unavailable for some document failures:

- *Haircuts and other employee accelerations (Section VII.E)*. Provisions allowing a service provider to accelerate payment under the plan are not correctable.

- *Option and SARs (Section III.G)*. Failures in option and SAR agreements are not correctable under Notice 2010-6. Failures arising because the option or SAR was granted in the money (the strike price exceeds the stock's fair market value on the grant date) can be corrected in some cases under Notice 2008-113.

- *Failures in plans linked to qualified plans (and nonqualified plans after 2011) (Section III.G)*. Failures in wraparound SERPs and other nonqualified deferred compensation plans cannot be corrected to the extent caused by linkage with the time or form of benefits paid under a qualified plan. Failures arising from linkage of payments between a nonqualified deferred compensation plan and any other kind of compensation arrangement—that is, ''offsets''—can be corrected under a special transition rule until Dec. 31, 2011, but cannot be corrected thereafter.

3. Requirements for all Corrections Under Notice 2010-6. Except for the provisions described under Section B, above, all corrections made under Notice 2010-6 are subject to detailed administrative requirements.

- *Information and reporting requirements (Section XII)*. Under Section XII of Notice 2010-6, a correction is effective only if both the service recipient and service provider attach to their federal income tax returns detailed statements describing the correction. The service recipient must attach to its federal income tax return for the service recipient's taxable year of correction a statement identifying itself as ''409A document corrections'' under Notice 2010-6. The written statement must identify highly detailed information about the failure and correction, including the name and TIN of each affected service provider, and the amount of 409A taxable income reported pursuant to the correction. The statement must be attached to the service provider's income tax return for the correction year, and also the subsequent taxable year if any service provider must pay a 409A tax under the correction in that next year. The service recipient must supply a statement to each affected service provider, containing substantially similar information. The service provider must attach a copy of these statements on his or her federal income tax return for the taxable year of the correction, and also any subsequent taxable year in which the service provider must pay any 409A tax pursuant to the correction.

■ *Tax and reporting (Section III.E)*. Certain corrections under Notice 2010-6 require affected service providers to treat a portion (generally 50 percent) of the vested compensation deferred under the corrected plan as subject to tax under 409A. The correction is not effective unless the service provider pays the tax, and the service recipient reports the 409A-includible income on the service provider's W-2 or other appropriate information return. For example, an employer would report the 409A-includible amount on the employee's Form W-2, in Box 1 and Box 12 using Code Z. In the event of an audit, each taxpayer must make ''reasonable efforts'' to notify the IRS agent of the correction.

■ *''Substantially similar'' failures (Section III.B)*. The service recipient must take ''commercially reasonable'' steps to identify and correct all ''substantially similar'' provisions in all of the service recipient's other 409A-covered plans.

■ *Audit exclusion (Sections III.C and XI.D)*. Generally, relief is not available for a service provider with respect to a tax year if either the service provider or service recipient is under examination for that year with respect to 409A-covered plans. For an individual, the audit net is defined widely. An individual is under examination with respect to 409A-covered plans for a year if her Form 1040 (or other individual federal income tax return) for that year is under audit. For any other service recipient or service provider, the audit net is defined somewhat less broadly. A person other than an individual is under examination with respect to 409A-covered plans if it has received an Information Document Request (IDR) or other written notification from the examining agent specifically citing nonqualified deferred compensation as an issue under consideration. The audit exclusion does not apply, however, and correction is available, if the neither the service recipient nor service provider was under examination with respect to the failure years on the date the correction is made.

A transition rule provides that for corrections made before Dec. 31, 2011, the audit exclusion is applied narrowly for a nonindividual service recipient. In this case, the service recipient is considered under examination as to any provision only if nonqualified deferred compensation has been specifically identified by the examiner.

■ *Intentional failures and listed transactions (Section III.C)*. Corrections under Notice 2010-6 are available only for ''inadvertent and unintentional'' failures and are not available for failures ''directly or indirectly related'' to participation in a listed transaction.

4. One-Year Rule. After 2010, corrections of most noncompliant payout provisions are subject to a reduced 409A penalty in some circumstances (the One-Year Rule). Under the One-Year Rule, if a noncompliant payment provision is corrected, but a service provider undergoes the noncompliant payment event within one year of the correction, the service provider treats 50 percent of vested compensation deferred under corrected plan as taxable under 409A. (The 50 percent is lowered to 25 percent for certain corrections of noncompliant change in control payout terms.) After the one-year period has elapsed, the provision as corrected gives rise to no further tax under 409A.

For example, consider a plan that provides for payment upon separation from service, when separation is defined to include transfer to an 80 percent controlled subsidiary, in violation of 409A. Assume the document is corrected on July 1, 2011. If on or before July 1, 2012, an employee transfers to an 80 percent-controlled subsidiary, 50 percent of that employee's vested compensation under the plan is subject to income tax and the additional 20 percent tax under 409A (but not the additional ''interest'' tax). The employer must report 50 percent of the amount deferred under the corrected plan by the employee on her Form W-2, Box 1 and Box 12 using Code Z. This is so even though the plan does not (and under the correction may not) pay any amount to the employee. The One-Year Rule applies only to occurrences of the *noncompliant* payout trigger. Change the assumption so that, within one year of the correction, the employee does not transfer to the 80 percent-owned subsidiary, but rather has a 409A-compliant separation from service. In this case, the employee's deferred compensation is not subject to tax under 409A. After expiration of the one-year period, no further 409A tax applies. Further change the assumption so that the employee has no employment change until one year and one day after the correction, on which date she transfers to the 80 percent owned subsidiary. No 409A tax applies.

IRS spokespersons have unofficially explained that the One-Year Rule is intended to prevent manipulation of the correction rules—to prevent, for example, deliberately drafting a plan with an impermissible payout trigger with an eye towards last-minute revision to avoid penalty. This might appear to be perverse tax policy. To the extent that residual manipulation is possible, it would be exercised most easily by employees in control positions, leaving the rule's most onerous effects on those individuals lower down the chain of command.

5. Failed Payment Terms Correctable Subject to One-Year Rule. The following document failures are correctable under Notice 2010-6, subject to the One-Year Rule. In all cases, correction must be made before the impermissible event occurs, must be effective immediately, and may not expand or contract the definition except as necessary to bring the term into compliance. In all cases, the correction is subject to the rules listed above. In some cases other rules apply as well, and are noted below:

■ *Impermissible definition of a separation from service (Section V.A)*. This category includes any term providing for payment upon a change in the service relationship that is not a 409A compliant separation from service. An example is a term defining separation from service to include transfer from one 80 percent owned subsidiary to another. This category also includes any provision *failing* to provide for payment on a 409A separation from service. One possible example (not in Notice 2010-6) might be a provision deferring payout until the end of a noncompete period.

■ *Impermissible definition of change in control (Section V.B)*. An example is a provision for payment upon an initial public offering of 30 percent of the employer's stock. The relief does not cover changes in control defined in terms of ''specifically identified assets.'' For example, explains Notice 2010-6, the correction is not available for the employees of the parent corporation with respect to a change in control defined as the sale of an identified subsidiary. The One Year Rule applies, but with only 25 percent inclusion by affected service providers.

■ *Impermissible payout trigger, when plan has at least one permissible payout trigger (Section VII.A)*. An example is a provision for payout upon the earlier of an initial public offering (impermissible) or separation from service (permissible). This correction does not cover payout triggers that involve impermissible discretion, either by service recipient or service provider. The correction does not cover plans that have no permissible payment trigger.

■ *Alternative payout schedules for voluntary versus involuntary separations (Section VII.C)*. An example is a provision for payout as a lump sum upon involuntary separation, and as 10-year installments upon voluntary separation. The plan may be corrected by amending the *voluntary* payout form to equal the *involuntary* payout form. In this case the One-Year Rule applies to voluntary separations, but apparently not to any involuntary separation. If the alternative payout schedule relates to anything other than the voluntary versus involuntary separation toggle, a different correction rule applies, described below.

■ *Other alternative payout schedules (Section VII.C)*. A different rule applies to impermissible alternative payout schedules upon the occurrence of a single kind of payout event when the event involves anything other than a voluntary versus involuntary separation toggle. The example in Notice 2010-6 is a provision for payment as a lump sum if separation occurs when the employee is classified as a ''Level 1'' employee, and as 10-year installments when classified as a ''Level 2'' employee. Another conceivable example (not in Notice 2010-6) is a provision for payment as a lump sum upon separation until age 50, as 10-year installments on separation after age 50, and as a life annuity on separations on or after age 65. In this case, the correction must remove all but one of the schedules, according to the following rule: The surviving payout form must be the form with the latest actual or possible *final* payment date, or, in the event of a tie, the form with the latest actual or possible *commencement* date, or, finally, in the event of a tie, the form ''generally anticipated to result in the amount deferred being paid at later dates.'' The One-Year Rule appears to apply to any event that would have triggered any of the deleted payout forms under the pre-correction plan.

■ *Impermissible service recipient discretion as to payout timing or form (Section VII.D)*. An example is a provision for payment at age 65 in either a lump sum or 10-year installments at the sole discretion of the employer. If the provision has a default payment term, the correction is revocation of the form subject to discretion. If the provision has no default payment term, the amendment is similar to the general correction for alternative payout schedules. That is, the surviving payout form must be the form with the latest actual or possible final *payment* date, or, in the event of a tie, the form with the latest actual or possible *commencement* date, and finally, in the event of a tie, the form ''generally resulting in the amount deferred being paid at later dates.''

A different correction rule applies when the discretionary power rests with the service *provider*, rather than the service recipient. Somewhat confusingly, Notice 2010-6 lumps this rule together with the quite different rule for service recipient discretion under Section VII.D. Corrections for discretion resting with the service provider are described below.

■ *Impermissible reimbursement and in-kind benefit provisions (Section VII.F)*. An example is a provision for reimbursement of expense incurred for three years after separation from service, with $100,000 cap for the entire three-year period. The provision must be amended so that the reimbursement (or in-kind benefit) is allocated pro-rata over the period. If the stated period is the service provider's lifetime, the allocation must be based on the service provider's life expectancy using ''reasonable actuarial assumptions.'' If the stated period ends with a stated event, the proration period must be established based on ''reasonable assumptions'' for a period of at least three years.

■ *Failure to include six-month rule (Section VIII)*. If a plan provides for payment on separation from service, but neglects the six-month rule, it may be amended to provide that payment to a specified employee upon separation from service will not be made until the later of (i) 18 months following the correction date or (ii) six months following separation from service.

6. Failed Payment Terms Correctable Without One-Year Rule. Certain corrections are effective without any tax under 409A if made before the payment trigger occurs, without regard to the One-Year Rule. In all cases, however, the corrections are subject to the generally applicable rules for a correction under Notice 2010-6 set forth above in this article.

■ *Incorrect definition of ''disability'' (Section V.C)*. An example is a provision for payment upon disability defined as inability to work for three months. The correction is relatively liberal. If the definition is corrected before the specified (but noncompliant) disability occurs, no penalty arises, even for an individual who incurs the noncompliant condition immediately after the correction. Moreover, the same rule applies even as to an individual who incurs the noncompliant condition before the correction. In this case, however, if the individual actually received payment under the noncompliant disability provision, the payment must be corrected as an operational failure under Notice 2008-113.

■ *90-day rule failures—noncompliant payment period (Section VI.A)*. Correction is available for a provision that, in violation of Treas. Reg. § 1.409A-3, specifies a payout period of more than 90 days. An example is a provision for payment ''within 180 days after separation from service.'' The correction is not available if the specified payment period is more than 365 days. The correction can either delete the payment period, or shorten it to fit within the permitted 90 days. The One Year Rule does not apply. A 50 percent penalty applies if the service provider incurs the payment trigger before correction, but correction is made within a ''reasonable time'' thereafter. For example, assume that in the above example, 180 days is amended to ''90 days,'' and the correction is made on April 15. An employee who separates from service on April 16 is not subject to tax under 409A. An employee who separated from service before April 15 treats 50 percent of vested compensation deferred under the corrected plan as subject to tax under 409A, assuming that the April 15 correction date is within a ''reasonable time'' after his or her separation. The sole example illustrating ''reasonable time'' involves a separation from service on February 1 occurring one month before the correction date of March 1.

■ *90-day rule failures—employee waivers (Section VI.B)*. Regulations provide that, if a plan specifies a payout period, the period must either fall within a single year of the service provider, or be a specified period of not more than 90 days, and not give the service provider the ''right to designate the taxable year'' of the payment. Notice 2010-6 takes the position that the 90 day rule is violated if payment is contingent on the service provider signing a waiver or on other ''employment-related actions.'' An example is a provision for payment on separation, contingent on the employee's signing a release of claims within 90 days after separation from service, with payment forfeited thereafter. The IRS's thinking seems to be that, even if the 90-day period is specified, for a payment event on or after early October of any year, the employee can ''control'' the year of payout by delaying signing the waiver.

Correction is made by specifying a payment date, rather than a payment period. If the payment period is specified, the payment date must be the last day of the period. In the above example, the payment period is 90 days, so the amendment must provide for payment on the 90th day following separation. If the payment period is not specified, the plan must specify a payment date, but has only two choices: either 60 days or 90 days following the payment trigger. The correction is not subject to the One-Year Rule. An employee who separates before the correction is not subject to 409A tax or penalties. The correction, however, is not subject to the ''reasonable time'' exception applicable to 90-day rule failures under Section IV.A of Notice 2010-6. Accordingly, an employee who separates after the correction date is apparently subject to tax under 409A on all amounts deferred under the plan, even if the employee did not exercise his purported ''right to designate'' the tax year of the payment.

■ *Service recipient discretion to accelerate (Section VII.E)*. An example is a provision stating that the employer may terminate the plan and pay out amounts at any time. Notice 2010-6 provides that the plan may be amended at any time before the employer exercises its discretion and makes the payout. The One Year Rule does not apply. This correction is not available for service provider discretion to accelerate. These ''haircuts'' and other employee accelerations are apparently considered within the target zone of 409A policy concerns, with no correction available.

7. Failed Payment Terms Correctable Only With Penalty. If the plan lacks any permissible payment trigger, penalty-free correction is not available. This rule puts pressure on defining the ''plan,'' as we discussed above in Section I of this article.

■ *Plan has no permissible payout triggers (Section VII.B)*. An example is a plan providing solely for payment of $100 upon the enrollment of a child in college or graduate school, expressly without regard to whether the employee is still employed at the time reimbursements are made. If correction is made before the payment trigger occurs, 50 percent of the vested amount deferred under the plan is subject to tax under 409A. This reduced penalty amount is available only if the correction follows all the procedural requirements at Section III.C.3 above. No correction is available after the impermissible payment trigger occurs.

A simpler correction might be available, however. Change the assumption so that the plan provides for payment ''upon enrolment'' in college, without expressly stating that the employee must be employed on the date of payment. In this event—and if the plan's past administrative practice permits—it would make more sense to amend the provision as an ''ambiguous payment term,'' by stating that the employee must be actively employed at the time of any reimbursement, and so turning the plan into an unambiguously compliant short-term deferral. As discussed above in this article, amending an ambiguous payment term is a complete correction, without using the formal correction program of Notice 2010-6, and without tax under 409A.

8. Failed Election Provisions—Special Rules. Corrections of provisions allowing noncompliant service provider elections are somewhat different from other corrections. In some cases, a service provider who has made no election under the defective term may not be subject to tax under 409A, even if the provision is not corrected. The relief is narrow, however, and in many cases corrections must be made under Notice 2010-6 to forestall tax under 409A.

■ *Impermissible second elections (Section VII.D)*. Above in this article, we pointed out that if a plan provides an impermissible second election, there is no document failure as to employees who do not exercise the discretion to defer. The illustrative example was a plan providing for payment of deferred compensation at age 65, where employees are allowed to further defer compensation to any future date of their choosing, by so electing at any time until age 65. Under Notice 2010-6, there is no document failure as to an employee who does not make a deferral election under the defective provision.[24]

Change the assumption, however, so that the employee makes an election (say, elects to defer payout until age 70), and does not revoke the election before it becomes irrevocable (one year before he attains age 65). Further assume that the plan remains uncorrected by the time he reaches the original payment date (age 65). The employee must include all amounts deferred under the plan as subject to tax under 409A (Example 12). This is apparently the case even if the employee's election is operationally compliant—that is, it was made earlier than one year before the original age-65 payment date, and pushed the payment date out for five years. Moreover, under Notice 2010-6 this is the case even if the employee revokes his election before age 65, but the revocation is made after the revocation deadline (within one year before attaining age 65). Change the example again so that the employee makes a second election, and does not revoke, but the impermissible election provision is corrected before he attains the original payment date (age 65). Correction is available under Notice 2010-6 if the employee includes 50 percent of the deferred amounts as subject to tax under 409A, and the employee and employer comply with the other requirements for Notice 2010-6 correction set forth above in this article.

■ *Impermissible initial deferral elections (Section IX)*. We observed above that if the plan has a failed provision for initial deferral elections, Notice 2010-6 provides that there is no document failure as to a service provider for whom the provision has not been ''applied''—generally, a service provider who made no deferral election under the failed provision.

[24] Notice 2010-6, § VII.D., Examples 10 and 11.

If, however, the provision has been ''applied'' to a service provider—generally, if the service provider has made an election and not revoked it, the plan is corrected under Notice 2010-6 by deleting the impermissible provision by the end of the second taxable year following the taxable year in which the election became irrevocable. For example, assume a garden variety deferred compensation plan (not covering performance-based compensation). The deadline for an irrevocable deferral election as to 2012 is Dec. 31, 2011. To be effective as to compensation deferred in 2010, the bad election provision must be deleted not later than Dec. 31, 2013. Any elections made under the defective provision must be revoked and treated as operational failures under Notice 2008-113. That is, any amounts deferred in 2012 would have to be paid to the participant and corrected as an impermissible deferral.

9. Failed Terms in New Plans—Special Rules (Section X). Newly adopted plans may be corrected not later than the end of the plan year or the 15th day of the third calendar month in which the first legally binding right to deferred compensation arose under the plan. No tax or penalty applies (although operational failures made under defective provisions may have to be corrected under Notice 2008-113). For purposes of this rule, the plan is defined as all plans that would be treated as one plan under the aggregation rule of Treas. Reg. § 1.409A-1(c)(2)(i) if they covered the same service provider. This means that a plan is a new plan for purposes of the correction only if no plan in the same bucket has been adopted by the service recipient. This restriction generally makes the new plan rule useful only for new employers.

10. Transition Rules. Certain corrections made in 2010 and 2011 are subject to a relatively lenient correction regime under Notice 2010-6:

- *Significant relief for corrections in 2010 (Section XI.A).* If a failure correctable under Notice 2010-6 is corrected in 2010, no taxes otherwise payable under the correction will apply. For example, a failed payment provision corrected in 2010 will not be subject to the One-Year Rule. Moreover, even if the noncompliant payment event has already occurred, correction is treated as retroactively effective back to Jan. 1, 2009. Any payments made pursuant to the impermissible provision can be treated as operational errors, correctable under Notice 2008-113. The same rule relief applies to corrections of provisions allowing noncompliant elections. For example, assume that an employee made a second election under a noncompliant second election provision, and the correct (original) payment deadline has passed. If the provision is corrected in 2010, and the election revoked and corrected under Notice 2008-113 by Dec. 31, 2010, no income is included under 409A.
- *Offsets Corrected by Dec. 31, 2011 (Section XI.B).* Under regulations, payments under a nonqualified deferred compensation plan may not be offset or reduced by amounts payable at a different time under another arrangement, if the resulting ''substitution'' could result in prohibited acceleration or deferral of amounts payable under the plan.[25] Under Notice 2010-6, failed offsets can be corrected until Dec. 31, 2011, without 409A tax or penalty. The correction must ensure that the timing and form of payments under the two plans are identical. As with similar corrections, the surviving payment form must be the payment form that yields the latest final payment date, or, in the event of a tie, the latest commencement date, or again in the event of a tie, the schedule ''generally resulting in the amount deferred being paid at later dates.'' Any amounts actually paid under the failed offset provision can be corrected under Notice 2008-113 as an operational failures.
- *Back-to-back payment provisions corrected before Dec. 31, 2011 (Section X1.C).* Certain payments schedules that are determined by the timing of payments received by the service recipient may be corrected before Dec. 31, 2011.

D. Scrivener's Error and Other Interpretations of the Contract.

1. Threshold question: Is each plan term confined to its written expression? The fundamental threshold issue is whether these interpretive principles apply to correct plan documents for 409A compliance. The premise of contract construction is that the contract is the parties' agreement; the writing is only their expression of the agreement. If it can be shown that the writing when read as a whole does not reflect the parties' agreement—for example, there is ''ambiguity'' or ''mutual mistake''—the instrument can be interpreted, or in some cases reformed, to reflect the parties' intent. These precepts imply that the plan—the parties' agreement to defer compensation—may conform with 409A, even if some of its written expression violates 409A.

A contrary view is that strict documentary compliance is required by 409A and IRS regulations. Under this contrary view, failures on the face of the document trigger penalties under 409A, even if the writing does not conform with the parties' intent. The difference between these two views informs, for example, how one perceives the relief under Notice 2010-6, for ambiguous payment terms. Under the first view, the ambiguous-payment-term provision merely restates—and restricts (as discussed further below)—principles already applying under present law. Under the contrary view, the ambiguous-payment-term rule is a gratuitous rule of administrative grace.

This contrary or strict-liability view would appear to be incorrect, for two reasons. First and most fundamentally, legislative history and the statute show that 409A was intended only to codify the longstanding doctrine of constructive receipt. Under the principles of constructive receipt, a deferral election by a cash basis taxpayer is effective for tax purposes only because the obligor and obligee can enter into a contract—binding on the parties for payment purposes, and on the IRS for income recognition purposes—to defer compensation. Section 409A and regulations require that this contract be in writing. But a writing requirement does not nullify the basic rule of contract law—and is indeed consistent with it—requiring that the writing be interpreted to conform with the real contract, which is the parties' underlying agreement. A fuller account of this constructive-receipt view of § 409A is beyond the scope of this article, but is set forth in greater detail elsewhere.[26]

Second, even if the constructive-receipt notion is not accepted, the contrary or strict-liability view would still

[25] Treas. Reg. § 1.409A-3(f).

[26] Rosina B. Barker & Kevin P. O'Brien: ''409A Failures: Correcting With and Without Notice 2008-113,'' *Tax Notes* 557 (Aug. 10, 2009).

appear to be an incorrect view of the writing requirement of 409A. At least in the income tax arena, contract interpretation principles apply to *any writing* expressing an agreement, even when statute provides that the writing has legal effect for tax purposes. An example is the frequent controversy arising from agreements to extend the statute of limitations under tax code § 6501, where the IRS agent filling out the Form 872 (consent to extend) misidentified the tax year, the taxpayer, or other needed information. If given effect, this failure on the face of the document voids the extension, and typically benefits the taxpayer. The IRS takes the position that the document failures are disregarded, on the grounds that the parties' real and effective ''agreement'' lies outside of the failed documents, when such agreement is determined by applying such familiar contract precepts as ''scrivener's error'' and ''latent ambiguity'' to determine the parties' intent.[27] The courts have agreed with the IRS's position.[28] In opposition, taxpayers have argued (among other things) that the statute requires ''written consent.'' Therefore, taxpayers argue, the writing itself is the agreement, rather than mere expression of the agreement, making it impermissible to look beneath the failed writings to determine intent.[29] Taxpayers' argument has not prevailed. The Fifth Circuit, for example, disagreed with the position, reasoning that, even thought the agreement is not a contract (but rather unilateral waive of a defense), principles of contract construction are ''relevant'' because the statute requires that the extension be by ''written agreement.''[30] The Tax Court and the IRS have reasoned similarly in cases of failed Forms 872 (consents to extend).[31]

That is, even when the statute provides that the agreement must be in writing, it is permitted and even required to look beneath the written instrument to determine what the agreement is. The same principles should apply to the terms of plans governed by 409A. Even though the plan is required by regulations to be in writing, it should be appropriate to look beneath the writing when contract principles allow, to determine whether the agreement itself is compliant with 409A.

2. Which contract law applies? SERPs and other top-hat pension plans under ERISA § 3(2) are not subject to ERISA's fiduciary requirements, but are still ERISA plans enforceable under ERISA § 502(a)(1). Their terms are construed under the ''federal common law'' of contracts.[32] In arrangements that are not ERISA plans—restricted stock units (RSUs), employment agreements, and option contracts, for example—state law applies.

3. Where is the contract located? In Section I of this article, we set forth the problems of defining the plan, which is to say defining the contract. Under 409A, the plan must be in writing, but, as we discussed above, it will not always be clear which writings may comprise the plan. These may conceivably include, for example, the plan document, participant communications, letters, shareholder agreements, compensation committee minutes, and even participant e-mail. Or the plan may be viewed as only a subset of these. Absent more guidance, the intended scope of the contract is unclear.

4. 409A Savings clauses. The dominant IRS concern driving the rigidity of 409A administration is the apparent belief that executives exercise unlimited control over terms of their deferred compensation in light of a finely tuned cost-benefit analysis. This apparent concern explains the One-Year Rule. For example, consider an executive concerned about her status at her company. Her deferred compensation plan provides for payment upon separation from service, which, at her insistence, is defined to include demotion. Payment upon demotion, enforceable under the contract, is an operational failure causing tax under 409A, but, in this putative scenario, is acceptable to her as a 20 percent haircut. The One-Year rule doesn't eliminate the possibility of this manipulation. but greatly increases its expected cost. Even after the definition of ''separation'' is amended to be 409A compliant (again at her insistence) a 50 percent tax under 409A arises if the once-feared demotion event occurs within a year of the amendment. Manipulation is possible, but subject to contingent cost.

In short, the apparent policy concern about noncompliant term is that they are not reliably inadvertent, but rather reflect executives' express intent. The most obvious drafting line of defense is a 409A savings clause nullifying noncompliant terms, thus making them unenforceable and placing them outside the zone of 409A policy concerns. This line of defense is discouraged by IRS regulations and by practical concern. Nonetheless, analogous case law makes them a potentially stronger tool than official IRS policy will allow, as the following discussion shows.

a. Savings clauses to cure ambiguity. Assume that the plan has a 409A savings clause, for example, ''Notwithstanding any other provision of this plan, no election shall be permitted, and no payment shall be made, that would violate the requirements of or cause taxation to any person under § 409A. . . .'' Regulations state that such clauses are ''disregarded.''[33] Unofficially, however, IRS spokespersons have suggested that savings clauses may be used to interpret ambiguous plan

[27] *See, e.g*. CCA 200204001 (July 20, 2001) (mutual mistake). PLR 8435014 (latent ambiguity).

[28] *Woods v. Comm'r*, 92 T.C. 776, 784 (1989);*Kelley v. Comm'r*, T.C. Memo 1990-158 (1990), *aff'd sub nom.*, 45 F.3d 348 (9th Cir. 1995); *Buchine v. Comm'r*, 20 F.3d 173 (5th Cir. 1994); *Ambur v. U.S*., 206 F. Supp. 2d 1021 (D. S.D. 2002) (citing to *Woods*, applied principles of contract interpretations in holding taxpayer consented to extension of SOL period); *U.S. v. Burlington Resources Oil and Gas Co*., 86 A.F.T.R.2d (RIA) 5282 (S.D. Tex. 2000) (citing to *Woods*, that the court may consider facts beyond the four corners of the consent at issue to determine the taxpayer's intent); *Atkinson v. Comm'r*, T.C. Memo 1990-37 (1990) (holding the court can look beyond the face of the Form 872-A (consent to extend) to determine the intent of the parties).

[29] *Buchine v. Comm'r*, 20 F.3d 173 (5th Cir. 1994); *see also Woods v. Comm'r*, 92 T.C. 776, 784 (1989).

[30] *Buchine*, 20 F.3d at 179.

[31] *Woods*, 92 T.C. at 789 (''In determining that we can give effect to the actual agreement of the parties, we are aware that I.R.C. § 6501(c)(4) requires that extensions be in writing. Such a requirement does not preclude reformation of a written agreement.''); CCA 200204001 (July 20, 2001),

[32] *See, e.g., Aramony v. United Way Replacement Benefit Plan*, 191 F.3d 140, 150, 23 EBC 1865 (2d Cir. 1999); *Senior Exec. Benefit Plan Participants v. New Valley Corp*., 89 F.3d 143, 20 EBC 1537 (3d Cir. 1996).

[33] Treas. Reg. § 1.409A-1(c)(1) (for purposes of determining the ''terms of the plan,'' provisions that ''purport to nullify noncompliant plan terms'' or to supply required plan terms, are ''disregarded'').

terms.[34] Notice 2010-6 appears to formalize this informal position. Section IV.B provides that if a plan states that its terms are to be ''interpreted to comply'' with 409A, or words to that effect, any otherwise ambiguous payment term ''*is not ambiguous* and complies with the requirement of § 409A and § 1.409A-3(a).'' This an interpretive principle, rather than a correction. While not entirely clear, it appears apply to *all ambiguous terms in a plan document*, and not merely the payment terms specifically addressed by Section IV.B.[35]

Under principle of Notice 2010-6, however, this interpretive principle can cure only terms that are ambiguous when read in isolation. It could not override noncompliant plan terms. It cannot even introduce ambiguity into the document—thus allowing the document as a whole to be construed under normal contract principles—if the terms on their face are clear.[36]

b. Savings clauses to create ambiguity. Under the interpretive rule implied by Notice 2010-6, a 409A savings clause can cure ambiguous plan terms, but has no effect on clear ones. This is consistent with the IRS view of similar clauses in wills and other testamentary documents. Savings clauses can aid in interpreting already ambiguous provisions, but cannot override clear terms, or even introduce ambiguity into terms that are clear when read by themselves. For example, Revenue Ruling 75-440 involved a will creating both a marital and a residual trust. The will enumerated a single list of powers for both trusts, including a power (to invest in life insurance polices) that, if applied to the marital trust, disqualified it from the marital deduction. A savings clause stated that, ''notwithstanding any other provision'' of the will, any power would be ''absolutely void'' to the extent it jeopardized the marital deduction. The ruling held that, although this clause could not void a disqualifying power, it could be used to interpret the testator's intent as to any ambiguous one. Further reasoning that the intended scope of the disqualifying power was ambiguous (both trusts? or only the residual trust?), the ruling concluded that, reading all terms of the instrument, including the savings clause, together, the testator intended that the disqualifying power apply only to the residual trust, thus preserving the deduction for the marital trust. This use of the savings clause, cautioned the IRS, was permissible only because the intended scope of the disqualifying power was ''initially unclear.[37] Other IRS rulings follow the reasoning of Revenue Ruling 75-440.[38]

As shown in the previous paragraph, the IRS does not allow savings clauses to introduce ambiguity in the face of otherwise clear but inconsistent terms in a will. The courts, however, give savings clauses broader effect. Numerous cases have considered the availability of the marital deduction in wills where one provision read in isolation unambiguously grants a disqualifying power, and elsewhere the will contains a marital deduction savings clause. When the two inconsistent provisions are read together, the will is ambiguous, and the resulting ambiguity allows the court to interpret the entire document in light of the testator's intent. Using this precept, and on the basis of all the facts and circumstances including extrinsic evidence, the courts may read the disqualifying power out of the document, as inconsistent with the testator's governing intent.[39]

These cases are instructive in the 409A context. First and most generally, they are relevant to 409A plans because the same principles of document interpretation apply equally to contracts and wills (except that in the latter the relevant ''intent'' is that of the testator alone, rather than that of the parties to the agreement).[40] Second and more specifically, they are applicable because in no case was it argued that the testator did not intend to convey the power at issue. Rather, it was held that the intended power could be ignored as contrary to the testator's intent, because it mistakenly contravened his intended tax effect (when his intended tax effect was shown as a primary purpose under the totality of the circumstances). Under similar principles, a 409A savings clause might allow a document, when read in light of the parties intent, to be read as omitting a noncompliant provision. This would be the case even if it were undisputed that the noncompliant payment or election

[34] *See, e.g.*, remarks of Schmidt, Tackney, Hogans, and Morrison, as transcribed in 239 *Pens. & Ben. Daily (BNA)*, Dec. 15, 2008, ''Annotated: Application of Section 409A to Nonqualified Deferred Compensation as of November 2008.''

[35] Notice 2010-6, IV.B. If the plan includes a savings clause, ''this section [relating to ambiguous payment terms] does not apply because the provision is not ambiguous''—implying that the savings clause rule applies without regard to Notice 2010-6.

[36] Payment term is not ''ambiguous'' if it expressly violates 409A— that is, if its ''explicitly includes'' noncompliant payment events, or ''explicitly excludes'' required ones. A term is not ''ambiguous'' but unambiguously noncompliant, if there is a ''pattern or practice'' of administering it in a noncompliant way. Presumably, this definition of ''ambiguous'' applies for the broader rule set forth above, as well as for ambiguous payment terms.

[37] Revenue Ruling 75-440, 1975-2 CB 372.

[38] *See, e.g.*, TAM 200234017 (where will granted spouse lifetime power of appointment (in violation of I.R.C. § 2056(b)(7)(B)), and also forbade trustee from administering marital trust in any manner that would disqualify from marital deduction. *Held*, marital deduction unavailable, because savings clause is effective only to construe intent, and may be used as aid in interpreting the instrument only when ''ambiguity is present in another part of the instrument''). TAM 199932001(savings clause cannot void a trustee power or direction that would otherwise disqualify trust from marital deduction, but can be used as aid in construing testator's intent). TAM 9104003 (''savings clause'' not effective to override QTIP-disqualifying power, since savings clauses can be used to construe but not ''negate'' other provision).

[39] *Estate of Merton L. Cline*, TC Memo 1982-90 (pre-nuptial agreement gave widow bonds following testator's death, subject to two inconsistent conditions: (i) with ''full power to consume'' corpus during lifetime [qualifying for marital deduction] and (ii) only for ''care and support'' [which would not qualify for marital deduction]. *Held*, ''savings clause'' allows court to read disqualifying provision out of the agreement. Savings clause shows intent and allows court to disregard ''inconsistent statement.'' *Estate of Alexander* (dictum); *Estate of Mittleman*, 522 F.2d 132 (D.C. Cir. 1975). *See also, e.g., Estate of Ellingson v. Comm'r* , 964 F.2d 959 (9th Cir. 1992) (marital deduction trust satisfy requirement for QTIP deduction, even though trustee had disqualifying power to accumulate income in excess of surviving spouses need; satisfaction of ''best interest'' requirement of trust, in light of surrounding circumstances, required paying surviving spouse all income, in satisfaction of QTIP requirements).

[40] 5-24 *Corbin on Contracts* § 24.1.

term itself was contemplated, if it could be shown that it was inconsistent with the parties' clearly demonstrated intent of 409A compliance. Third, it is important to note that none of the foregoing cases holds that a savings clause overrides nonambiguous disqualifying provision in the will. Rather, the courts only allow the clause to introduce ambiguity; the document is then read as a whole for its legal and tax effect in light of the testator's intent based on all surrounding circumstances. Applied to 409A-covered plans, the principle of the foregoing cases do not contradict the 409A regulation voiding plan provisions that purport to nullify noncompliant terms, or to supply required ones.

A savings clause introducing ambiguity does not necessarily mean that the tie between two inconsistent provisions (clearly 409A-noncompliant provision versus provision ensuring 409A compliance) is resolved in favor of 409A-compliant intent. It may well be necessary to look at other intrinsic or extrinsic evidence to demonstrate the parties' purpose. This evidence may be sparse in the formation of the unilateral contract that typifies 409A plan, where there is no generally bargained for exchange. But e-mails, written and oral employee communications, and other parol evidence, for example, explaining the plan amendments and their intent to ensure 409A compliance, may all exist and are all fair game.

c. Savings clauses to eliminate ambiguity by deleting noncompliant provisions and replacing with compliant ones. Ideally, a savings clause would not only eliminate a noncompliant plan term, but would replace it with a compliant one. There are two difficulties with drafting an effective clause of this kind. First, of course, is the regulation's statement that they will be disregarded. Practitioners may wish to consider including them in any case. From a policy perspective they are nonabusive. And notwithstanding the IRS's broad authority to write regulations administering 409A, it is not yet clear whether the IRS can instruct the federal courts how to interpret a contract.

The second difficulty with savings clauses is that—even assuming they can delete noncompliant provisions—it will be technically more difficult to draft them so that they insert compliant ones. For example, consider a plan stating, in violation of 409A, that amounts payable upon the employee's death will paid either as a lump sum or a life annuity, at the election of the beneficiary. Elsewhere, the plan states, ''notwithstanding any other provision of this plan, no payment shall be made and no election shall be given effect if such payment or election would give rise to taxation under 409A to any person. . . .'' This clause cannot be a self-executing document correction. While purporting to delete a bad provision, it fails to supply a good one, and leaves the plan silent as to the form of payout on death. Accordingly, it may be ineffective to override the specific but noncompliant death benefit payment provision.[41] A possibly better-drafted provision might further state something like ''and any amount payable under such provision shall be paid on the earliest date permitted with respect to such provision by 409A, and not before such date.'' Under normal contract precepts, such ''notwithstanding'' clauses are generally effective to override inconsistent provisions,[42] and in this example would completely supply a compliant rule in place of a noncompliant one.

5. Scrivener's error. When a term is unambiguous but 409A-noncompliant on its face (even when read together with other plan provisions), can it be argued that the failure is ineffective as a mere scrivener's error? For example, consider a payout provision stating payment will be made ''no earlier than'' 90 days after a stated event, when ''no later than'' is presumably intended. Or consider a more problematic but equally black-and-white mistake, such as omission of the six-month rule. Can the omitted plan term be supplied as a scrivener's error?

It is first necessary to clear up an ambiguity in the term ''scrivener's error.'' If the written terms of an agreement are clear and unambiguous on their face, but do not reflect the parties' intent, it may be decided that the result is a ''mutual mistake'' justifying ''reformation'' of the instrument under longstanding principles set forth in *Restatement of Contracts* (2d) § 155 Reformation is not a self-executing remedy, but must be undertaken by the court acting in its equitable power. This is the position of the Fourth Circuit, for example, when construing qualified pension plans and other employee benefit plans governed by ERISA's fiduciary protections. If the mistake is a ''mutual mistake'' in this sense, modifying the terms is not permitted by the plan administrator or the employer, but may be undertaken only by the court acting in its equitable power.[43]

But a second doctrine may be available to correct a failed writing, when the document is clear on its face, but the writing does not reflect the parties' agreement. Under the doctrine of ''extrinsic ambiguity, '' a mutual mistake in the document may be read out via the process of contract interpretation, without equitable reformation by a court. It is this second sense of ''scrivener's error''—where correction is allowed by *interpretation*, rather than by reformation—that is meant here.[44]

Interpretation, of course, is permitted only when the document is ambiguous. And the premise of this discussion is that the plan's 409A-noncompliant terms are unambiguous. When a document's terms are clear on their face, interpretation to determine whether the parties agreement is contrary to the document is made possible by the doctrine of ''latent'' or ''extrinsic'' ambiguity. Under this doctrine, extrinsic evidence is permitted to

[41] *Cf. Aramony v. United Way of Am.*, 254 F.3d 403, 26 EBC 1647 (2d Cir. 2001) (*Aramony II*) (where SERP's introductory clause states generally that plan is to supply benefits lost because of tax code-induced limits on qualified plan benefits, and document specifically enumerates the tax code-induced limits compensated for, the court held the general introductory clause cannot supply code-induced limits not specifically enumerated).

[42] *Morse Diesel Inc. v. Trinity Indus. Inc.*, 67 F.3d 435 (2d Cir. 1995); *Cisneros v. Alpine Ridge Group*, 508 US 10 (1993).

[43] *Cross v. Fleet Reserve Ass'n Pension Plan*, 329 Fed. Appx. 443, 454 , 48 EBC 2186 (4th Cir.. 2009); *Blackshear v. Reliance Std. Life Ins. Co.*, 509 F.3d 634, 642, 42 EBC 1609 (4th Cir. 2007) (''reformation, whether it is based upon scrivener's error or mutual mistake, is most decidedly a remedy available in a court of equity''); *Audio Fid. Corp. v. Pension Benefit Guar. Corp.*, 624 F.2d 513, 518, 2 EBC 1856 (4th Cir. 1980) (noting that ''a court of equity can reform a contract to correct a mistake disclosed by oral proof'' if ''the mistake [is mutual, or [is] accompanied by fraud on the part of [one] contracting party'').

[44] 5-24 *Corbin on Contracts* § 24.18 and text accompanying footnotes *infra*.

show that the parties intended some result not shown on the face of the document, and that when read together with this external evidence, the doctrine is ambiguous.[45] Extrinsic evidence necessary to establish ambiguity in a clear document cannot be ''subjective, or ''self serving,'' Once ambiguity is shown by the introduction of this ''objective'' evidence, other evidence is admissible to show intent as to the contract's meaning—in just the same way as for documents where ambiguity is clear on the face of the document, or ''intrinsic.''[46]

The doctrine of extrinsic ambiguity has been applied by the Seventh Circuit to construe qualified pension plans and other plans subject to ERISA's fiduciary requirements. An example is *Mathews v. Sears Pension Plan*, where the Seventh Circuit sets forth the doctrine in detail. *Mathews* is occasionally lumped together with the ''reformation'' cases involving qualified plans, but is distinguishable because it is an exercise in contract interpretation. The doctrine of extrinsic ambiguity is thus generally part of the federal common law of contracts, and thus should be applicable to 409A-covered plans that are ERISA plans. The doctrine, however, may not be part of the contract law of all 50 states, and so may not invariably apply to 409A-covered plans that are not ERISA plans.

The doctrine of extrinsic ambiguity may be used to insert omitted terms to fill gaps, and to override incorrect or unintended terms. In *Rossetto v. Pabst Brewing*,[47] for example, the Seventh Circuit remanded an ERISA health benefits plan to the district court to determine whether a plan could be read to allow insertion of a missing lifetime promise of health benefits. In *Sharewell v. Comm'r* ,[48] the Tax Court used the doctrine to read a missing term (specifically, a covenant not to compete) into a contract, when the omitted term was necessary to give effect to the taxpayer's intended tax treatment of the document. In *State Pipe & Nipple v. Comm'r*,[49] the Tax Court used the doctrine to conclude that no ''purchase'' was intended, when the contract unambiguously stated that the transaction was a ''purchase,'' and the taxpayer's claimed deduction turned on the transaction not being a purchase. In PLR 8435014 the IRS used the doctrine to correct a defective Form 872 (agreement to extend the statute of limitations), by deleting the incorrect information stated on the face of the document, and replacing it with the omitted but correct information. In all cases, the interpretive act was not equitable reformation, but merely interpretation of the agreement.

The distinction between the doctrines of scrivener's error in its sense of ''mutual mistake'' and its sense of ''extrinsic ambiguity'' is explored at some length here only because in the compensation arena, the doctrine has gained new salience. As noted, a number of federal courts, such as the Fourth Circuit, have invoked ERISA's policy concerns to find that mistakes in qualified plan documents (and other funded ERISA plans subject to ERISA's fiduciary rules) may be performed only by the court as ''reformation'' of a ''mutual mistake.''[50] Not all federal circuits agree. For example, the Seventh Circuit does not agree with the Fourth Circuit that mistakes in qualified plans must be corrected by reformation rather than interpretation,[51] and in other arenas the distinction may have lost its vitality.[52] In the federal income tax world, indeed, the two doctrines appear to be sometimes conflated. For example, the Tax Court described the defect in the *Sharewell* document as a ''mutual mistake'' that would support ''reformation of the contract under the standards of this court.'' But while the court talked reformation, it thought interpretation. In practice, the *Sharewell* court applied the doctrine of extrinsic ambiguity to interpret the terms of a facially nonambiguous agreement. In applying contract precepts to correct an unambiguously failed Form 872 (agreement to extend the statute of limitations) the IRS has invoked both the doctrine of mutual mistake[53] and the doctrine of extrinsic (or latent) ambiguity.[54]

In a plan covered by 409A, another distinction may be more real, but harder to pin down absent additional guidance: the distinction between the two interpretive precepts of extrinsic and intrinsic ambiguity. What constitutes extrinsic evidence in a 409A covered plan? The answer depends in part on which documents comprise the plan. As has been noted, the answer may not always be clear.

Conclusions

Many document failures in the 409A-covered plan may be corrected with varying degrees of administrative pain and tax penalty. This article has outlined available correction approaches, both those formally recog-

[45] *Mathews v. Sears Pension Plan*, 144 F.3d 461, 466 22 EBC 1193 (7th Cir. 1998) (doctrine of ''extrinsic ambiguity'' allows consideration of extrinsic evidence ''to demonstrate that although the contract looks clear, anyone who understood the context of its creation would understand that it doesn't mean what it seems to mean''); *Rossetto v. Pabst Brewing Co.*, 217 F.3d 539, 543, 24 EBC 2089 (7th Cir. 2000) (Posner J.) (doctrine comes into play ''only if someone who reads the contract without knowledge of its real-world context of application would think it clear''); 5-24 *Corbin on Contracts* § 24.7.

[46] *Mathews v. Sears Pension Plan*, 144 F.3d at 466.

[47] *Rosetto v. Pabst Brewing Co.*, 217 F.3d 539, 543, 24 EBC 2089 (7th Cir. 2000).*Cf. also The Boeing Co. v. March* 2009 U.S. Dist. LEXIS 82533, 47 EBC 2258 (N.D. Ill. Sept. 9, 2009) (allowing union to show latent ambiguity to insert lifetime promise of health benefits not otherwise found on face of plan document, but holding against union, in that no grounds that no such ambiguity could be found).

[48] *Sharewell v. Comm'r*, TC Memo 1999-413 (1999) (when for purposes of claiming the benefit of amortization deductions, taxpayer argued that one quarter the purchase price was allocable to a covenant not to compete, even though the purchase agreement failed to include the covenant, *held*, when the contract is interpreted in light of the intent of the parties, omitted covenant-to-compete provision is included).

[49] *State Pipe & Nipple Corp. v. Comm'r*, TC Memo 1983-339 (1983) (where taxpayer's claimed deduction turned on transaction not being a purchase, but contract ''unambiguously'' provides for purchase, extrinsic (parol) evidence admitted to show no purchase intended or accomplished).

[50] See cases cited above at note 43.

[51] *But see Young v. Verizon's Bell Atlantic Cash Balance Plan* 2009 WL 3677350, 48 EBC 1011 (N.D. Ill. Nov. 2009) (district court in Seventh Circuit following *Blackshear* and other Fourth Circuit precedent, held that unambiguous plan provision that increased participants' accrued benefits by more than $1.6 billion over parties' expectations could be removed from the plan, but only by court using its equitable power to reform document for mutual mistake).

[52] *See, e.g.*, discussion at 5-24 *Corbin on Contracts* § 24.18.

[53] CCA 200204001 (July 20,2001),

[54] PLR 8435014

nized by the IRS, and those covering more uncharted territory. In the uncharted terrain, we have discussed longstanding principles of contract construction allowing the conclusion that, in some cases, the parties' agreement can conform with 409A even if the written instrument does not. While reasonable, these precepts are, of course, untested in the 409A arena. Even outside the 409A arena, it is not always easy to argue successfully that an agreement committed to writing means something other than what its terms say.

Nonetheless, some general drafting approaches suggest themselves as ways of mitigating the possibility of 409A failure. First and most obviously, drafting should be as simple as possible, and cross-reference § 409A to the extent feasible. Second, every 409A-covered plan should have a strong 409A savings clause. At the very least, the IRS takes the position that savings clauses may render ambiguous terms 409A-compliant. And for the reasons set forth above, they may have effect well beyond the limited scope acknowledged by the IRS. While the regulations do not allow this possibility, they may conceivably override noncompliant terms and, if carefully drafted, supply compliant ones. Third, it might be useful to consider documenting participants' agreement or understanding that every 409A-covered plan must conform with 409A. While subject to the same rules of construction as a bilateral contract, the unilateral contract may have fewer opportunities for producing evidence that 409A-compliance is an integral part of the plan's written terms; such documentation is a way of filling this gap.