The ERISA Industry Committee

March 9, 2009

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Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

Ladies and Gentlemen:

The ERISA Industry Committee ("ERIC") is pleased to submit these comments on the proposed regulations on income inclusion and calculation of the additional taxes required by Code § 409A(a), as published in the *Federal Register* on December 8, 2008, at 73 Fed. Reg. 74380. These comments also address the interim guidance set forth in Notice 2008-115 and respond to the request for comments on the requirement to report annual deferrals ("Code Y reporting").

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive retirement, health care coverage, incentive, and other economic security benefits directly to some 25 million active and retired workers and their families. ERIC has a strong interest in proposals affecting its members' ability to deliver those benefits, their costs and effectiveness, and the role of those benefits in the American economy.

ERIC applauds the efforts of Treasury and the Service to develop rules that are clear, practical, and administrable. These comments are divided into the following six general topics:

1. Assumptions for calculating amounts deferred, beginning on page 2;
2. The date as of which amounts deferred during a taxable year must be calculated, beginning on page 4;
3. Safe harbors to calculate the premium interest tax under Code § 409A(a)(1)(B)(i)(I), beginning on page 5;
4. Determining whether a previously included amount has been permanently forfeited or otherwise lost, beginning on page 8;
5. Code Y reporting, beginning on page 9; and
6. Other miscellaneous issues, beginning on page 11.

For the sake of simplicity, these comments use the terms "employer" and "employee," rather than "service recipient" and "service provider." References in the comments to "employer" and "employee" are intended to include other service recipients and service providers, respectively. ERIC may supplement this submission to make additional recommendations.

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1. Assumptions for Calculating Amounts Deferred

The proposed regulations provide that the amount deferred under a plan is the present value of all amounts payable to the employee under the plan. The proposed regulations generally require that present value be calculated using "reasonable actuarial assumptions and methods." *See* Prop. Treas. Reg. § 1.409A-4(b)(2)(ii). However, the proposed regulations mandate certain assumptions that, in many circumstances, are not reasonable.

The statute does not require that any particular assumptions be used or even presumed when calculating the amount of deferred compensation subject to § 409A. Rather than bind taxpayers to assumptions that might not be reasonable, the final regulations should allow taxpayers flexibility to establish reasonable assumptions based on the circumstances. In many cases, reasonable safe harbors would provide needed certainty while preserving flexibility. The following are examples of assumptions that should be more reasonable and, where applicable, safe harbors that should be available.

a. Payment Trigger Other than Separation

Prop. Treas. Reg. § 1.409A-4(b)(2)(vii) would require that, if a payment trigger (other than separation from service or similar reduction of services) has not occurred, the employer must assume that the trigger will occur on "the earliest possible date the trigger reasonably could occur." The final regulations should change the "earliest possible date" assumption to a safe harbor, and allow employers to assume that the trigger will occur on any reasonable date determined by the employer (in good faith) based on the particular facts and circumstances.

b. Separation from Service and Reduction of Services

Prop. Treas. Reg. § 1.409A-4(b)(2)(vii) would require that if the payment is triggered by a separation from service or a similar reduction of services (each a "separation"), the separation must be deemed to have occurred as of the last day of the employee's taxable year. However, an assumption regarding separation date is necessary only if the separation date is not known when the violation is discovered. If the separation date is known (either because the employee has separated or a separation date has been scheduled), the includible amount should be determined based on the known separation date.

If the individual's separation date is not known when the error is discovered, the final regulations should allow any reasonable assumption. The fact that an individual's separation date is generally unpredictable does not justify requiring an assumption that is almost always incorrect. At the same time, however, employers responsible for tax reporting and the taxpayers who rely on the reports need the certainty of safe harbor assumptions.

Rather than require one assumption for all circumstances that will be correct in very few, the final regulations should include a presumption that any assumed separation date within a specified number of years into the future (*e.g.*, any date within the next three or five years) is reasonable. Like Treas. Reg. § 1.409A-1(b)(5)(iv)(B)(2) (relating to methods of valuation), the final regulations could allow the Commissioner to rebut the presumption by a showing that application of the presumption was grossly unreasonable.

In addition, Treasury and the Service should consider allowing other presumptions related to the employee's incentive to continue working for the employer into the future. For example, subject to rebuttal by the Commissioner as described above, it should be reasonable to assume that an employee's separation date will be no earlier than the date of any of the following events:

- The employee reaches the average age at separation for similarly situated employees of the employer;
- The employee qualifies for a meaningful employer-provided benefit that is tied to a service milestone—*e.g.*, eligibility for an early retirement subsidy under a pension plan, eligibility for retiree medical benefits, vesting of a nonqualified retirement benefit, or vesting of discretionary or matching contributions under a profit-sharing plan; and
- The vesting date for a valuable equity or other employer-provided retention or incentive award that is in the money.

c. Assumed Time and Form of Payment

Prop. Treas. Reg. § 1.409A-4(b)(2)(vi)(A) would require that any deferred amount be treated as payable at the time and in the form for which the present value is highest. Although this assumption might be appropriate in many cases, it is not always reasonable. For example, if the most valuable form of payment is a joint and survivor annuity for the employee's spouse, but the employee's spouse is terminally ill or the employee and spouse are in the process of separating, it would be unreasonable to assume that the employee will elect the joint and survivor annuity. Similarly, if an annuity is the most valuable form of payment but plan participants predominantly elect lump sums, it would be unreasonable to assume that the employee will elect an annuity.

Because there are common cases where the "most valuable form" is not reasonable, the final regulations should change the assumption to a safe harbor, and allow the deferred amount to be calculated based on any assumption that the employer determines is reasonable based on the facts and circumstances.

d. Assumptions for Alternative Times and Forms of Payment

Prop. Treas. Reg. § 1.409A-4(b)(2)(vi)(A) states that "if payment of a deferred amount may be made at alternative times or in alternative forms, each amount deferred under the plan is treated as payable at the time and under the form of payment for which the present value is highest." Examples 8 and 9 in paragraph (b)(2)(ix) of the proposed regulations suggest that the "greater of" assumption applies even when the "greater of" assumption is inconsistent with a time or form of payment assumption that is required by the regulations.

The final regulations should provide that any assumption related to the time or form of payment will apply to alternative times and form of payment. The assumptions related to alternative times and forms of payment should be consistent with the assumptions for the payment trigger. For example, in Example 8, if the taxpayer is required to assume that separation from service occurs on December 31, 2010, which is before January 1, 2020 (the alternative fixed date set forth in the example), the payment trigger should be assumed to be the December 31, 2010, separation from service. As a result, the amount deferred should be equal to the present value of the benefit payable as of the employee's separation from service, without regard to the value of the payment as of January 1, 2020. There should be no need to value a payment that is assumed not to occur. The same analysis should apply in Example 9.

e. Assumptions for Reimbursements and In-Kind Benefits

Prop. Treas. Reg. § 1.409A-4(b)(4) would require a presumption that if expenses eligible for reimbursement (or in-kind benefits) are limited, the employee will incur the maximum permissible amount of expenses at the earliest possible date during the time period to which the limit applies. Under the proposed regulations, the presumption may be rebutted only by clear and convincing evidence that the presumption is unreasonable.

Requiring clear and convincing evidence that a presumption is unreasonable is inconsistent with the general principle that present value should be determined based on "reasonable, good faith assumptions." *See, e.g.*, Prop. Treas. Reg. § 1.409A-4(b)(2)(iv)(A). Rather than resolve inevitable uncertainty against the taxpayer, the final regulations should change the "maximum amount at the earliest time" presumption to a safe harbor, and allow the employer to make any assumption that it determines, in good faith, is reasonable under the circumstances.

The final regulations should allow the assumption to be based on (i) the employee's usage history of a particular benefit or similar benefits, and (ii) if the employee does not have a relevant usage history, experience regarding usage by similarly situated employees. For example, if an employee who is entitled to reimbursement of club dues is already a member of a club, it should be reasonable to assume that the employee's benefit will be the cost of membership dues at the same club. Similarly, if an employee is entitled to a tax-preparation benefit in the future, and the employer's experience shows that similarly situated employees have used less than 100 percent of the reimbursable amount, it should be reasonable to assume that the employee's reimbursable expense will be the amount that similarly situated employees typically incur. In addition, if the employer's experience shows that similarly situated employees do not always take advantage of a particular reimbursement or in-kind benefit, it should be reasonable to adjust the value of the benefit downward to reflect the probability that the employee will not incur the covered expense.

In any event, an employer or taxpayer should not be required to demonstrate by clear and convincing evidence that the "maximum amount at the earliest time" presumption is ***un***reasonable. It should be sufficient to demonstrate that an alternative assumption is reasonable.

2. Calculation Date for Amount Deferred During Year

Under the proposed regulations, the amount includible as a result of a § 409A violation must be measured as of the last day of the taxable year, even if the error is discovered and corrected early in the plan year. *See, e.g.*, Prop. Treas. Reg. § 1.409A-4(b)(2)(i). At the same time, § 409A prohibits canceling a deferral election in order to mitigate the adverse consequences of a violation. For example, if an employee elects to defer $10,000 in a year and a § 409A violation is discovered and corrected early in the year, when the employee has deferred only $1,000 of the $10,000, the adverse tax consequences would apply to the full $10,000—and the employee cannot avoid this result by stopping his or her deferrals.

The preamble to the proposed regulations states that this result is required because the statute says that the adverse tax consequences apply to "all compensation deferred under the plan for the taxable year and all preceding taxable years." Preamble § III.B.5, 73 Fed. Reg. at 74,383. Although the statute refers to all compensation deferred for the taxable year, the reference to "compensation deferred ***under the plan***" should be read to include only amounts deferred under the plan that failed to meet the requirements of § 409A. Taxpayers should be allowed to treat amounts deferred after a violation was corrected as having been deferred under a separate compliant plan, and therefore not subject to the adverse tax consequences.

For example, if a plan has a form violation that is corrected early in an employee's taxable year, amounts deferred after the correction should be treated as having been deferred under a separate compliant plan, and therefore should not be subject to the consequences of the violation. *See* Treas. Reg. § 1.409A-1(c)(2)(viii) ("deferrals of compensation under an . . . arrangement that fails to meet the requirements of section 409A solely due to a failure to meet the written plan requirements . . . are not aggregated with deferrals of compensation under other . . . arrangements that meet such requirements"). The final regulations should adopt a similar approach for purposes of determining the amount includible in income due to an operational violation that is corrected mid-year.

This interpretation is particularly appropriate for elective deferral arrangements, where the date of deferral is generally set in advance and easy to determine, and the § 409A rules prohibit canceling a deferral election mid-year. Stopping the adverse tax consequences at the time of correction would encourage taxpayers and employers to identify violations and correct them quickly.

3. Calculation of Premium Interest Tax

Prop. Treas. Reg. § 1.409A-4(d) would require that the premium interest tax under Code § 409A(a)(1)(B)(i)(I) be calculated in three steps. First, the taxpayer must determine the years in which amounts were deferred. Second, the taxpayer must calculate a hypothetical underpayment for each year of deferral. Third, the taxpayer must calculate interest on the hypothetical underpayments.

As Treasury and the Service have recognized, this calculation will be extremely time consuming and expensive. Not only will the calculation be complex, but many taxpayers will not have adequate records to retrace each year's deferral or to calculate hypothetical underpayments from years past. Such records often will not be available from employers or recordkeepers either. For example, accurate historical records often are not available for periods before an acquisition or a change in recordkeeper. Similarly, records of annual accruals generally are not maintained for excess benefit plans. (Indeed, it is not clear when a deferral occurs under a plan that determines whether there is an excess benefit only at the time the benefit is scheduled to be paid, such as upon separation from service.)

In order to simplify the calculation, the final regulations should include safe harbors. The safe harbors should be designed to be neutral in the aggregate (even if overstated with respect to some taxpayers and understated with respect to others). The differences between the safe harbor and the actual premium interest is justified both by practicality (because records may be unavailable or the precise year of deferral cannot be determined) and by the significant administrative savings for the taxpayer and for the Service (in terms of ease of administration and enforcement).

Below are descriptions of three suggested safe harbors: (a) a flat rate safe harbor, (b) a straight-line allocation safe harbor, and (c) a weighted allocation safe harbor. These safe harbors should be permitted as alternatives to the calculation process set forth in the proposed regulations—not as substitutes. Taxpayers who wish to do so should be permitted to calculate a more precise premium interest amount, using the process outlined in the proposed regulations. Also, in accordance with the definition of "plan" under Treas. Reg. § 1.409A-1(c)(1), the decision whether to apply a safe harbor, and which safe harbor to apply, should be made on an individual-by-individual basis: the assumptions and/or safe harbor used for one plan participant should not be required for any other participant.

a. Flat Rate Safe Harbor

Under the flat rate safe harbor, instead of the time-consuming process of calculating annual deferral amounts, recalculating taxes, and compounding interest, the taxpayer would be allowed to multiply the total amount deferred by a flat percentage (*e.g.*, 7-10 percent). The percentage should roughly approximate the premium interest tax as a percentage of the total amount deferred. The percentage should be set forth in the final regulations and could be adjusted by the Service from time to time, if necessary.

The flat rate safe harbor is particularly helpful where determining the number of years of participation is extremely difficult, if not impossible. For example, a participant's right to a benefit under an excess benefit plan may depend only on whether a benefit under a tax-qualified plan is limited by Code § 415 on a specified date (such as separation from service). Because annual accruals and years of participation are not relevant for this calculation, recordkeepers often do not track years of participation or annual accruals.

If Treasury and the Service are not comfortable specifying a flat rate, the final regulations should specify a variable rate that does not require calculating annual deferral amounts and compounded interest. For example, the final regulations could specify one of the following rates:

- ***Underpayment rate plus fixed percentage***—*e.g.*, multiply the total amount deferred by the underpayment rate plus 3 percent. Unlike a flat rate, this rate would adjust automatically as interest rates change. The combination of (i) the extra percentage added to the underpayment rate (in this example, 3% instead of 1%) and (ii) applying the percentage to the total amount deferred (rather than the hypothetical underpayment from each year) would approximate the effect of compounding interest on the smaller hypothetical underpayment amounts.

- ***Underpayment rate times a function of years of participation***—*e.g.*, multiply the total amount deferred by the underpayment rate times 20 percent of years of participation in the plan. This formula would provide a more accurate estimate of the effect of compounding interest. This approach, however, would not be helpful for a plan in which it is difficult to determine the years of participation, as described above.

b. Straight-Line Allocation Safe Harbor

Under the straight-line allocation safe harbor, the taxpayer would allocate the total amount deferred evenly over the number of years of participation in the plan. For example, if the total amount deferred is $30,000 and the taxpayer participated in the plan for three years, the taxpayer would treat $10,000 as deferred in the current year and $10,000 as deferred in each of the two previous years. Because years of participation often are not tracked (or otherwise are not available), the final regulations should allow taxpayers to use a standardized number of years rather than actual years of participation.

As an alternative to calculating hypothetical underpayments for each year, the safe harbor should allow the taxpayer to assume a reasonable tax rate and apply it to each year's deferral. For example, the taxpayer should be allowed to assume a hypothetical tax rate equal to his or her effective or marginal tax rate for (i) the year of the error or (ii) each year of deferral.

c. Weighted Allocation Safe Harbor

The weighted allocation safe harbor would be similar to the straight-line allocation safe harbor, except that the amount of annual deferrals would be weighted toward more-recent years. Because accruals tend to increase over time, it is reasonable to assume that greater accruals occurred more recently than in earlier years. As with the straight-line allocation safe harbor, the taxpayer would assume a reasonable tax rate and apply it to each year's deferral.

Rather than require each taxpayer to justify a weighted allocation based on particular facts and circumstances, the final regulations should allow taxpayers to choose from among standardized weighting formulas. For example, the final regulations should allow the taxpayer to apply a weighting method that is analogous to the "sum of the years" method of depreciation. *See generally* Code § 167(b) and the regulations and other guidance thereunder.

The following example illustrates the "sum of the years" approach. Suppose the total amount deferred is $30,000 and the taxpayer participated in the plan for three years. Suppose that the taxpayer's reasonable tax rate is 28 percent and the underpayment rate is 5 percent. The sum of the three years of participation would be 6 (3+2+1), and the amount deferred would be allocated to the three years of participation as follows:

- Current Year (year 3): $^{3}/_{6}$ths of $30,000, which is $15,000.
- Year 2: $^{2}/_{6}$ths of $30,000, which is $10,000.
- Year 1: $^{1}/_{6}$th of $30,000, which is $5,000.

The premium interest tax would be $341:

- For year 1, the hypothetical underpayment amount would be $1,400 (28% of $5,000), resulting in interest of $173 (6% interest on $1,400, compounded over two years).

- For year 2, the hypothetical underpayment amount would be $2,800 (28% of $10,000), resulting in interest of $168 (6% of $2,800).

- $173 + $168 = $341.

4. Determining Whether Forfeiture is Permanent

Prop. Treas. Reg. § 1.409A-4(g) provides that if an employee includes an amount in income under § 409A and subsequently forfeits all or part of the amount, the employee is entitled to a deduction for the forfeited portion. However, the deduction is not permitted until the forfeiture is permanent. The proposed regulations state that a forfeiture will not be treated as permanent if the employee "retains the right to an amount deferred under the plan."

The term "an amount deferred under the plan" is unreasonably broad. Although it is understandable to delay a deduction until the forfeiture is permanent, an employee's right to receive other payments under a plan should not affect the determination of whether a forfeiture is permanent. A forfeiture should be considered permanent when the employee no longer has a legally binding right to the forfeited benefit.

For example, suppose that when a § 409A violation occurs, the employee is married and the most valuable form of payment is a joint and survivor annuity for the employee's spouse. Because the joint and survivor annuity is the most valuable form, the amount includible at the time of the violation is the value of the joint and survivor annuity. Suppose that when the employee retires and the annuity begins to be paid, he or she is no longer married and must receive a single-life annuity that is less valuable than the joint and survivor annuity. At that time, the employee should be entitled to a deduction based on the difference between the value of the subsidized joint and survivor annuity and the single-life annuity, because the employee no longer has any right to receive a joint and survivor annuity.

The fact that the employee still has a right to receive single-life annuity payments should not delay the deduction: once the single-life annuity commences, there is no doubt that the value of the subsidy for a joint and survivor annuity has been forfeited permanently. Any single-life annuity payments that have not already been included in income will be includible in accordance with Prop. Treas. Reg. § 1.409A-4(f)(1). The right to receive those payments should not affect the timing of the deduction for the value lost from not being eligible to receive a subsidized joint and survivor annuity.

Similarly, suppose a Section 409A error occurs and is corrected in 2010. At the time of the error, the value of the employee's benefit is $100,000. The $100,000 is not subject to a substantial risk of forfeiture, but is contingent on complying with a non-compete agreement.

Accordingly, the $100,000 is included in income in 2010. In 2011, at a time when the plan complies with the § 409A requirements, the employee defers an additional $10,000 that is not contingent on complying with the non-compete agreement. In 2012, the employee separates from service and breaches the non-compete agreement, resulting in a forfeiture of the $100,000 that was included in income in 2010, but not the $10,000 deferred in 2011. Once the non-compete agreement has been breached, the employee no longer has any right to the $100,000 that was once included in income: the $100,000 benefit is forfeited permanently. The employee's right to receive the $10,000 deferred after the § 409A violation should not delay the deduction for the forfeited $100,000.

5. Code Y Reporting

The preamble to the proposed regulations indicates that, subject to certain exceptions, the rules for Code Y reporting will be based on the principles set forth in the income inclusion regulations (*i.e.*, the rules for Code Z reporting). Although it is generally appropriate for the Code Y reporting rules and the Code Z reporting rules to be consistent with one another, there are certain areas where differences are appropriate.

Because Code Z is used to report the amount of the employee's tax liability, Code Z reporting demands a higher degree of accuracy and completeness than is necessary for Code Y reporting. The Code Y reporting rules should balance the Service's need for useful information against the burden that Code Y reporting will impose on employers and recordkeepers. In light of the burden that Code Y reporting will impose on employers and recordkeepers, the Code Y reporting requirement should not become effective until after proposed regulations are published and the stakeholders have an opportunity to comment on the proposed regulations.

Below are specific comments related to Code Y reporting.

a. Amounts that are not Reasonably Ascertainable

ERIC agrees with Treasury and the Service that Code Y reporting should not be required for any amount before it becomes reasonably ascertainable. *See* Preamble § VII.B, at 73 Fed. Reg. 74392. However, the existing regulations under Code § 3121(v)(2) do not explain in detail how the "reasonably ascertainable" standard should apply to compensation that is subject to § 409A but not § 3121(v)(2). The guidance on Code Y reporting should include more detail on how to apply the reasonably ascertainable standard to the full range of compensation that is subject to § 409A.

In addition, the guidance should take into account the differences between the purpose of Code Y reporting and the purpose of reporting under § 3121(v)(2). Unlike Code Y reporting, § 3121(v)(2) reporting affects the amount of taxes that are withheld and paid. Accordingly, when the amount of a benefit does not become reasonably ascertainable until the year in which it is paid, § 3121(v)(2) reporting is required in the year of payment. By contrast, Code Y reporting is for informational purposes only, and the information provided will generally not be meaningful at the time the benefit is paid. Accordingly, the guidance should include an exemption from Code Y reporting for any amount that cannot be reasonably ascertained until the year in which it is paid.

For example, the guidance on Code Y reporting should address whether (and when) the amount deferred under separation pay arrangements and reimbursement/in-kind benefit arrangements must be reported. Because the amount deferred under such arrangements generally will not be ascertainable until the year in which the amounts are paid, amounts deferred under such arrangements should be exempt from Code Y reporting. In addition, the guidance on Code Y reporting should address when and how to calculate the amount deferred under split-dollar life insurance arrangements and stock rights.

b. Valuation Date for Calculating Amount to Report

Prop. Treas. Reg. § 1.409A-4(b)(2)(i) would require that the amount deferred be calculated as of the last day of the employee's taxable year—generally December 31st. As Treasury and the Service recognized in the regulations under Code § 3121(v)(2), it is often difficult for employers to calculate the amount deferred under an arrangement as of December 31st and report that amount accurately on Form W-2 or 1099-MISC by the next January 31st. *See, e.g.*, 64 Fed. Reg. 4542, 4545-46 (Jan. 29, 1999); 61 Fed. Reg. 2194, 2198 (Jan. 25, 1996).

Determining the amount deferred in any year will require a number of calculations that will take a substantial amount of time to complete. Given the number of arrangements that are subject to § 409A and the number of employees affected, the calculations required for purposes of § 409A will be significantly more involved than the calculations required for purposes of § 3121(v)(2). Moreover, because Code Y reporting is used for information purposes only, it is not essential to provide up-to-the-minute information.

In order to give employers and recordkeepers sufficient time to calculate amounts deferred in any year, employers should be allowed to report annual deferrals as of any valuation date established by the employer, provided that the valuation date is on or after January 1st of the year for which deferrals are being reported. For example, employers should be allowed to set the valuation date for determining the amount to report in Box 12 of an employee's Form W-2 for 2010 (issued in January 2011) as early as January 1, 2010 (*e.g.*, the employer would report the amount deferred as of the close of business on December 31, 2009).

In order to ensure consistent reporting, and to prevent abuses, the guidance on Code Y reporting could restrict an employer's discretion to change its valuation date. For example, the guidance could limit the circumstances under which a valuation date may be changed without prior approval.

c. Code Y Reporting Effective Date

Notice 2008-115 indicates that Treasury and the Service anticipate that the Code Y reporting will not be required for any calendar year that starts before the proposed regulations are finalized. As noted above, ERIC respectfully requests that Code Y reporting be suspended until after stakeholders have had an opportunity to comment on proposed regulations that address the specific requirements for Code Y reporting.

In addition, the final regulations should make clear that Code Y reporting will not be required for any amount deferred in a year that starts before the regulations are finalized. The amount reported in the first year for which Code Y reporting is required should not include amounts deferred in previous years.

6. Miscellaneous

a. Aggregation Rules Do Not Apply for Form Violations

The final regulations should acknowledge the rule in Treas. Reg. § 1.409A-1(c)(3)(viii) that the plan aggregation rules do not apply to violations of § 409A's form requirements. In particular, paragraphs (e)(2) and (g)(2), and Example 1 of paragraph (g)(3) of the proposed regulations should note that the aggregation rule referenced in those paragraphs does not apply if the only violation is a form violation.

b. Service Credit and Compensation Increases After Taxable Year Are Not Included in Amount Deferred for Taxable Year

Section III.D.2 of the preamble, 73 Fed. Reg. at 74386, states that "[a]ny potential additional service credits or increases in compensation after the end of the taxable year for which the calculation is being made would not be taken into account in determining the total amount deferred for the taxable year." This rule should be stated expressly in the text of the final regulations.

c. Carve-Out for Amounts Deferred Before Effective Date of Section 409A

Treas. Reg. § 1.409A-4(d)(2)(i)(F) states that the amount deferred in taxable years beginning before January 1, 2005, is treated as zero. Under Treas. Reg. § 1.409A-6(a)(1), certain amounts deferred before January 1, 2005, do not become subject to § 409A unless and until the plan is materially modified, which could occur after January 1, 2005. The final regulations should make clear that if any amount became subject to § 409A after January 1, 2005, no portion of that amount will be treated as deferred before the date as of which the amount first became subject to § 409A.

Also, additional guidance is needed on how to apply the grandfathering rules under Treas. Reg. § 1.409A-6 for purposes of calculating the includible amount, particularly with respect to nonaccount balance plans with early retirement subsidies.

d. Penalties If Error Is Discovered Years After It First Occurs

Under Prop. Treas. Reg. § 1.409A-4(a)(3), if a § 409A violation is discovered several years after it first occurred, the employee generally would be required to amend tax returns for prior years. The proposed regulations do not rule out the possibility that the employee could be subject to penalties for late payment of amounts that should have been reported as violations in the earlier years—even if the error was corrected as soon as it was discovered.

The final regulations should include relief from late payment penalties if the § 409A violation is corrected within a brief period after it is discovered. For example, the final regulations should include relief from late payment penalties related to any return that is amended by the filing deadline (including extensions) for the year in which the error was discovered.

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ERIC appreciates the opportunity to submit these comments. We will continue to solicit member analysis of these and other proposed regulations to assist the Department of Treasury and Internal Revenue Service in fashioning reporting, withholding, and inclusion rules that are clear, practical, and administrable. If we can be of any further assistance, please let us know.

Sincerely,

Mark Ugoretz
President