



IRS Suspends Deferred Compensation Reporting and Withholding Requirements

December 13, 2005

The Internal Revenue Service (IRS) issued Notice 2005-94 on December 8, 2005, which suspends the deferred compensation reporting requirements imposed under Section 409A of the Internal Revenue Code (the Code) for the 2005 calendar year. Section 409A was added to the Code by the American Jobs Creation Act of 2004 and imposes a wide variety of new requirements on employers that maintain nonqualified deferred compensation plans. Employers have found it difficult to determine the scope of the Section 409A reporting requirements and have encountered a number of computer system difficulties while trying to implement them.

Reporting Requirements Imposed by Section 409A

Section 409A, as interpreted by IRS Notice 2005-1 (issued in December 2004), imposes the following reporting requirements:

- The employer must report the total amount of deferrals for the relevant tax year under a nonqualified plan in box 12 of Form W-2 using code Y (“Deferral Reporting” for employees). It is clear that the “amount of deferrals” for a deferred compensation plan refers not only to elective deferrals but also to deemed employer contributions under a defined contribution plan and the incremental accrued benefit under a defined benefit plan.
- The employer must report amounts that are taxable under Section 409A in box 1 of Form W-2

as taxable wages, and also in box 12 of Form W-2 using code Z (“409A Inclusion Reporting” for employees).

- A service recipient must similarly report deferrals of a nonemployee under a nonqualified deferred compensation plan in box 15a of Form 1099-MISC (“Deferral Reporting” for nonemployees), and must report Section 409A income as nonemployee compensation in box 7 of Form 1099-MISC (“409A Inclusion Reporting” for nonemployees).

Relief Provided by Notice 2005-94

Notice 2005-94 provides the following relief for calendar year 2005:

- Employers are not subject to the Deferral Reporting requirements for employees or nonemployees for 2005. This means that, for 2005, employers will not have to report on Form W-2 or 1099-MISC any deferred compensation that is not otherwise actually or constructively received by the employee or independent contractor.
- Employers are not subject to Section 409A Inclusion Reporting requirements for employees and nonemployees for 2005. As such, any income that is subject to tax under Section 409A and that is not otherwise actually or constructively received during the 2005 calendar year is not subject to withholding. (Note: Given the liberal transitional rules under Section 409A for the 2005 calendar year, an income inclusion event for 2005 under Section 409A should be rare.)

Future Reporting Requirements with Respect to the 2005 Calendar Year

Notice 2005-94 holds out the possibility that employers may be required to file a corrected Form W-2 or 1099-MISC in the future, or to make other types of filings with respect to the 2005 calendar year. As a result, employers should retain records and be prepared to report 2005 activity if and when the IRS issues further guidance.

Service Provider Income Reporting Requirements

Notice 2005-94 does not absolve service providers (e.g., employees, independent contractors, consultants, outside directors) from the requirement to report amounts included under Section 409A in taxable income for 2005 and to pay income tax on such amounts. Notice 2005-94 recognizes that since employers will not be reporting Section 409A income for 2005 to service providers on Form W-2 or 1099-MISC, as a practical matter it will be difficult for service providers to “self report” Section 409A income. Notice 2005-94 promises further guidance on this issue and states that penalties will not be imposed for 2005 if service providers report Section 409A income (and pay the resulting tax) within the time period specified in such guidance; however, interest charges may be imposed.

Comment

For the 2005 calendar year, Notice 2005-94 clearly provides welcome relief to employers from the Section 409A reporting requirements. Further guidance will be needed to provide the details as to how employers can meet the Section 409A reporting requirements for 2006 and future years and what, if anything, employers will need to report in later years with reference to the 2005 calendar year.

Please contact any of the following Morgan Lewis attorneys for more information about the issues discussed in this Morgan Lewis LawFlash:

Chicago

Brian D. Hector 312.324.1160 bhector@morganlewis.com

Dallas

Riva T. Johnson 214.466.4107 riva.johnson@morganlewis.com

Erin Turley 214.466.4108 eturley@morganlewis.com

New York

Craig A. Bitman	212.309.7190	cbitman@morganlewis.com
Gary S. Rothstein	212.309.6360	grothstein@morganlewis.com

Palo Alto

S. James DiBernardo	650.843.7560	jdibernardo@morganlewis.com
Zaitun Poonja	650.843.7540	zpoonja@morganlewis.com

Philadelphia

Robert L. Abramowitz	215.963.4811	rabramowitz@morganlewis.com
Brian J. Dougherty	215.963.4833	bdougherty@morganlewis.com
I. Lee Falk	215.963.5616	ilfalk@morganlewis.com
Robert J. Lichtenstein	215.963.5726	rlichtenstein@morganlewis.com
Vivian S. McCardell	215.963.5810	vmccardell@morganlewis.com
Joseph E. Ronan, Jr.	215.963.5793	jronan@morganlewis.com
Steven D. Spencer	215.963.5714	sspencer@morganlewis.com
Mims Maynard Zabriskie	215.963.5036	mzabriskie@morganlewis.com

Pittsburgh

John G. Ferreira	412.560.3350	jferreira@morganlewis.com
R. Randall Tracht	412.560.3352	rtracht@morganlewis.com

San Francisco

Mark H. Boxer	415.442.1695	mboxer@morganlewis.com
Eva P. McComas	415.442.1249	emccomas@morganlewis.com

Washington, D.C.

Althea R. Day	202.739.5366	aday@morganlewis.com
Gregory L. Needles	202.739.5448	gneedles@morganlewis.com

About Morgan, Lewis & Bockius LLP

Morgan Lewis is a global law firm with more than 1,200 lawyers in 19 offices located in Philadelphia, Washington, D.C., New York, Los Angeles, San Francisco, Miami, Pittsburgh, Princeton, Chicago, Palo Alto, Dallas, Harrisburg, Irvine, Boston, London, Paris, Brussels, Frankfurt and Tokyo. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.

IRS Circular 230 Disclosure

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend in emails, please see <http://www.morganlewis.com/circular230>.

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as imparting legal advice on any specific matter.
© 2005 Morgan, Lewis & Bockius LLP. All Rights Reserved.

