

# Employee Benefits Briefing

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informed on employee benefits law matters

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## IRS SUSPENDS FORM W-2 REPORTING AND WITHHOLDING REQUIREMENTS FOR SECTION 409A DEFERRED COMPENSATION UNTIL FURTHER NOTICE

The Internal Revenue Service (IRS) recently announced in Notice 2005-94 a suspension of the new deferred compensation reporting and withholding requirements under Internal Revenue Code Section 409A. Future guidance from the IRS, however, may subsequently require an employer to issue an updated and corrected 2005 Form W-2 (on a Form W-2c) to account for an employee's taxable nonqualified deferred compensation under Section 409A. Individual taxpayers remain responsible for the payment of any tax owed under Section 409A, but the IRS will not assess penalties if the employee waits for future guidance to determine the taxes owed (interest charges will apply). While Notice 2005-94 applies to both employer-employee and payer-independent contractor relationships, this Benefits Briefing focuses only on employer-employee reporting and withholding.

As background, Section 409A imposes requirements that nonqualified deferred compensation plans must meet or the amounts deferred to those plans by or on behalf of employees are treated as income in the current year and subject to a 20 percent penalty tax. Section 409A also requires employers to disclose on the Form W-2 deferred compensation included in gross income for the year and subject to the 20 percent tax (Form W-2 boxes 1 and 12, code Z). Likewise, employers are required to withhold from employees based on tax owed under Section 409A. In addition, employers must report any deferrals (and earnings thereon) during the year by or for employees to nonqualified deferred compensation plans that meet the requirements of Section 409A (Form W-2 box 12, code Y). The reporting of nonqualified deferred compensation was to begin with the 2005 Form W-2, but the instructions to the Form did not provide sufficient guidance to assist employers in determining exactly what to report.

Notice 2005-94 suspends the reporting of nonqualified deferred compensation on the 2005 Form W-2, and the related withholding, until further notice. Note, however, that the IRS may require employers to correct a Form W-2 that does not include nonqualified deferred compensation information once it issues further guidance, expected in the first half of 2006. Other existing guidance regarding Section 409A and nonqualified deferred compensation, such as the need to make 2006 deferral elections before the end of 2005 and any applicable FICA withholding rules, are unaffected by this Notice and must be followed.

Employees still have an obligation to report and pay any applicable taxes on nonqualified deferred compensation subject to Section 409A. In the absence of employer-provided W-2 information, though, employees will not be penalized by the IRS if they delay the payment of the taxes until the forthcoming IRS guidance, but interest charges will apply.

We will keep readers posted as to IRS guidance on this issue in 2006. If you have any questions, please contact any benefits attorney with whom you work.

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