IRS Issues Interim 409A Reporting/Withholding Guidance

The IRS has just issued Notice 2006-100, which provides interim guidance on the federal tax reporting and withholding rules applicable to "nonqualified deferred compensation plans" governed by Section 409A of the Internal Revenue Code. The IRS had previously suspended reporting on 409A for 2005, but warned that it might later require retrospective corrective reporting and withholding. The new guidance now imposes reporting and withholding for amounts *includible in income* by reason of 409A for both 2005 and 2006, but generally continues the wait-and-see approach of earlier guidance for the reporting of amounts that qualify as *deferrals* under 409A.

Under Notice 2006-100, employers and other service recipients will generally have until January 31, 2007 to withhold (in the case of employees) and report on a Form W-2 or Form 1099 amounts that were includible in income in 2005 or 2006 because of a failure to comply with 409A and will generally have until February 28, 2007 to report these amounts to the federal government. Although the Notice does not coordinate this guidance with existing transition rules under 409A that in many cases give parties until the end of calendar 2007 to correct noncompliant arrangements, it seems reasonable to read Notice 2006-100 as saying that the reporting and withholding requirements apply only to amounts that are ultimately determined to be taxable under 409A. However, if a defective arrangement is not timely corrected there could be penalties and interest for a failure to withhold and report by the Notice 2006-100 deadlines.

Where reporting and withholding is required, Notice 2006-100 provides, among other things, that:

- The taxable amount for 2006 is determined for reporting/withholding purposes as of December 31, 2006. For example, for an account-balance plan, the relevant amount would be the vested December 31, 2006 balance. The IRS has still not given final guidance on how taxable stock options and SARs are to be treated, but for 2006 taxpayers are to measure the taxable amount, if any, by assuming a December 31, 2006 exercise.
- If the income event for amounts subject to 409A occurred in 2005 (because, for example, a discounted stock option was exercised in 2005), the 409A amount is required to be reported on a 2005 Form W-2 or 1099. The original or a corrected Form W-2 or 1099 must be filed by the same deadlines that apply to 2006 reporting.
- An employer can satisfy any 409A withholding requirements either by withholding the required amount from the employee's pay (or having the employee remit the required amount) by January 31, 2007 or by paying the withholding tax itself on behalf of the employee. An employer that takes the latter course must report its payment as additional compensation to the employee.

Contact Information

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