

December 9, 2005

### **IRS To Postpone Deferred Compensation W-2 Reporting Until 2006**

The IRS will not require employers to report deferred compensation subject to the new provisions of Internal Revenue Code §409A on employees' 2005 W-2 forms. In addition, employers will not be required to withhold tax from deferred compensation that fails to comply with §409A, or report deferred compensation payable to non-employees (e.g., outside directors) on Form 1099 for 2005.

Code §409A, enacted by the American Jobs Creation Act of 2004, substantially revised the tax treatment of deferred compensation arrangements. Among other provisions, the 2004 Act required that all deferred compensation subject to the new rules must be reported on Form W-2 for employees and Form 1099 for non-employees, whether or not the deferred compensation complies with the new rules. Accordingly, the IRS had announced that deferred compensation subject to §409A was to be included in Box 12 on 2005 W-2s, and created two new Box 12 codes: Code Y for deferred compensation that complies with §409A and Code Z for deferred compensation that is currently taxable and subject to the 20% penalty tax. Similar rules were announced for 2005 Form 1099s.

Employers and payroll service providers were finding it difficult to conform to the new reporting rules, particularly the requirement that the W-2 include income earned on deferred compensation from prior years, which most payroll systems are not designed to track. In response, the IRS is issuing Notice 2005-94, announcing that employers will not be required to report deferred compensation under the new rules on either Form W-2 or 1099 for 2005. However, the IRS notes that deferred compensation subject to FICA still needs to be reported in Box 11 of Form W-2 as in prior years.

The announcement also means that employers will not have to withhold tax on deferred compensation that is currently taxable because it fails to comply with §409A. The IRS intends to issue further guidance on reporting of taxable deferred compensation later in 2006, which could require employers to issue amended W-2s reporting taxable amounts. However, the notice also states that the IRS will not assert any penalties, including penalties for underpayment of estimated taxes, against employees or independent

contractors who fail to properly include deferred compensation in their 2005 tax returns, as long as they comply with the new guidance when it is issued, including filing amended tax returns if necessary.

*If you have any questions concerning the reporting or taxation of deferred compensation, please contact the Seyfarth Shaw LLP attorney with whom you work or any employee benefits attorney on the website at [www.seyfarth.com](http://www.seyfarth.com).*



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