

IRS Extends 409A Compliance Deadline Through 2008 and Provides Guidance on Reporting and Withholding for 2007

Extended Transition Relief

The Internal Revenue Service ("IRS") recently extended through 2008 the transition relief for compliance with the final regulations under Code section 409A. This extension replaces the transition relief published by the IRS in September with broader relief that allows employers to thoughtfully address any unresolved section 409A compliance issues.

IRS Notice 2007-86 extends the period for adopting amendments for nonqualified deferred compensation plans subject Code section 409A and allows continued good faith operational compliance in the interim. Specifically, the notice continues the good faith compliance period through 2008 with the following modifications:

1. Plans must be operated in compliance with section 409A guidance effective before 2008 (Notice 2005-1 but not the final 409A regulations);
2. Plans must be operated in accordance with a reasonable, good faith interpretation of section 409A (to the extent an issue is not already addressed in IRS guidance); and
3. Compliance with the final regulations will constitute reasonable, good faith compliance, but is not required until January 1, 2009. (Note: Compliance with the 2005 proposed regulations will not constitute reasonable, good faith compliance after 2007.)

This extension permits employers and plan participants to change the time and form of payment for amounts subject to section 409A in 2008. However, changes made in 2008 may not apply to amounts that would otherwise have been paid in 2008 or cause an amount to be paid in 2008 that would not otherwise be payable in 2008.

Payment elections linked to elections under a qualified retirement plan, 403(b) plan, 457(b) plan or certain foreign broad-based retirement plans continue to be

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permitted through 2008. In addition, through 2008, employment and change in control agreements can be revised to satisfy the requirements for exempting from section 409A severance payments made upon termination on account of "good reason."

Guidance on 2007 Reporting Requirements

On October 23, 2007, the IRS also provided interim guidance on reporting and wage withholding requirements under Code section 409A. The Notice generally extended the reporting and withholding relief for 2005 and 2006 (IRS Notice 2006-100) to the 2007 calendar year.

- **Reporting.** Employers are not required to report annual deferrals of compensation on Form W-2 (Code Y) or Form 1099-MISC for the 2007 calendar year if such amounts were not includible in income under section 409A. Employers, however, are required to report amounts includible in income due to violations of section 409A on Form W-2 in box 1 and box 12 (Code Z). Employers must also report these amounts as wages paid on line 2 of Form 941, Employer's Quarterly Federal Tax Return. For nonemployees, employers must report amounts includible in income under Code section 409A on Form 1099-MISC in box 7 and box 15b.
- **Withholding.** For tax withholding purposes, amounts includible in income due to violations of Code section 409A are treated as supplemental wages, regardless of whether the employer paid regular wages to the service provider during 2007. Additional income taxes imposed by Code section 409A, if any, do not increase the employer's withholding amount.
- **Calculating Income.** The Notice also provides interim guidance on calculating amounts includible in gross income under Code section 409A. The amount includible in gross income is the sum of (1) the total amount deferred under the plan that is not subject to a substantial risk of forfeiture (defined in Notice 2005-1 or the final regulations) as of December 31, 2007 and that has not been included in income during a prior year; plus (2) the total amount of deferred compensation paid or made available to the service provider under the plan during 2007.

The Notice further provides that employers who comply with the reporting and withholding requirements outlined in the Notice will not be liable for additional income tax withholding or penalties, nor will employers be required to file



corrected information returns or payee statements, if future IRS guidance changes the reporting and withholding requirements under Code section 409A.

The IRS extension of Code section 409A compliance provides welcome relief for plan sponsors of nonqualified deferred compensation plans. Although the IRS provided relief from the looming December 31, 2007 deadline, employers should make and implement necessary compliance changes as soon as possible.

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