



## Legal Alert: Reporting and Withholding Requirements for Deferred Compensation under Section 409A of the Internal Revenue Code

12/18/2008

As a general matter, employers and others are required to report, on Form W-2 or Form 1099-Misc (whichever is applicable), various amounts attributable to nonqualified deferred compensation arrangements under section 409A of the Internal Revenue Code. For example, compensation that is deferred during a year is reportable, and deferred compensation that is received – or that is otherwise taxable under section 409A – is reportable. In addition, in the case of employees, taxable amounts generally constitute wages subject to withholding.

Last year, for purposes of 2007 information returns only, the IRS waived the application of certain of these requirements and modified others. Earlier this month, on December 5, 2008, the IRS issued proposed regulations providing guidance concerning these and other issues relating to nonqualified deferred compensation; those proposed regulations would be effective for years beginning after they are finalized. Then, on December 10, 2008, the IRS released Notice 2008-115, which prescribes rules relating to the reporting and withholding requirements for nonqualified deferred compensation for calendar year 2008, and for subsequent years until further guidance is issued (such as when the proposed regulations become final).

### **Reporting Annual Deferrals on Form W-2 or Form 1099-MISC**

As in prior years, the instructions for Form W-2 provide that amounts deferred during the year be included in box 12, and identified with code "Y." Under the Notice, this code Y reporting in box 12 of Form W-2 is not required for 2008 or any future year until further notice. Likewise, in the case of a non-employee, such deferred amounts are not required to be reported in box 15a of Form 1099-MISC.

### **Reporting and Withholding for Amounts Includible in Gross Income under IRC § 409A**

In the case of an employee, amounts includible in gross income under IRC § 409A are reportable as "wages" in box 1 of Form W-2, and in box 12 using code "Z." These amounts are treated as "supplemental wages" for purposes of determining the amount required to be withheld regardless of whether the employer has paid the employee any regular wages during the year. However, no additional withholding is required for the additional income taxes

that are imposed under section 409A (such as the additional 20% tax). An employee may, therefore, be required to make estimated tax payments in order to avoid penalties for under-withholding.

For nonemployees, any amount includible in gross income under IRC § 409A that is not treated as wages is reportable as nonemployee compensation in box 7 of Form 1099-MISC and as section 409A income in box 15b. Nonemployees may also be required to make additional estimated tax payments in order to avoid underpayment penalties.

### **Calculation of Amounts Includible in Income under IRC § 409A(a)**

The amount of deferred compensation that is includible in gross income under section 409A(a) and that is required to be reported is any amount of deferred compensation that is actually paid or made available to the individual under the plan during the year, plus, if the plan fails to meet the requirements of section 409A, the portion of any additional amount deferred under the plan that, as of December 31 of the year, is not subject to a "substantial risk of forfeiture" and has not already been included in income. For purposes of timing of withholding deposits, taxable amounts are treated as having been paid as of the date on which they are either actually or constructively received, or, if not actually or constructively received during the year, on December 31 of that year.

The Notice also provides guidance with respect to computation of unpaid amounts that are required to be taken into account under particular types of nonqualified deferred compensation arrangements. For example, in the case of both "account balance plans" and "nonaccount balance plans" the computation generally is the same as applies for purposes of FICA taxes (even for nonemployees to whom FICA does not apply), and in the case of options and other stock rights that are subject to section 409A, the amount equals that which would be taxable if the right were exercised in full on December 31.

For purposes of the calculation of the additional tax, part of which is computed based upon the date of deferral, amounts that were originally deferred before 2005, but which became subject to section 409A due to a material modification of the plan after October 3, 2004, may be treated as having been deferred on January 1, 2005.

Finally, pending the issuance of further guidance, calculation of the amount includible in income under IRC § 409A(a) and the calculation of the additional taxes under IRC § 409A in accordance with the provisions of the December 8 proposed regulations is permissible, and will be treated as compliance with the requirements of the Notice.

If you have any questions regarding the deferred compensation provisions of Section 409A of the Code or other compensation or benefits issues, please contact Jeffrey Ashendorf, 212-453-5926, [jashendorf@fordharrison.com](mailto:jashendorf@fordharrison.com), or Stephen Zweig 212-453-5906, [szweig@fordharrison.com](mailto:szweig@fordharrison.com), or any member of Ford & Harrison's Employee Benefits practice group.