

TAX LAW UPDATE - November 2005

To Our Friends, Clients and Associates...

As you have heard from us (and others, no doubt!) the Treasury Department and IRS issued proposed regulations on deferred compensation under section 409A on September 29. There are several items of note contained in these proposed regulations and the highlights are covered below. We will also continue our analysis and provide additional commentary periodically. Taxpayers may now rely on these proposed regulations until final regulations are effective.

Plan Amendment & Documentation

Most important is that **the requirement for plan document amendments has been delayed until December 31, 2006** – assuming that plans are operated under a good faith interpretation of the proposed regulations and law. New plans can be drafted under the same good faith interpretation with the knowledge that amendments may be required after regulations are finalized.

However, there are a few deadlines that were NOT extended beyond December 31, 2005 in the proposed regulations. These include: the ability of plan sponsors to terminate plans and avoid application of 409A entirely; and the ability of plan participants to revoke deferral elections during the year. Also, deferral elections for compensation to be earned in 2006 (regardless of when paid) must be in place by December 31, 2005 – unless the compensation in question is a performance bonus and qualifies for a special election timing rule. For ease of administration and participant communication, most clients will want to structure ongoing deferral elections to occur at the same time for both salary and bonus compensation.

Information Reporting / Wage Withholding

The requirements for payroll *tax withholding* have generally not changed for deferred compensation. There is a new *information reporting* requirement (via Box 12 on the W-2) that now applies to all deferred compensation amounts, vested or not. However, the proposed regulations don't provide any additional guidance on these issues. The payroll industry has recently requested that Treasury delay the implementation of these new reporting requirements until 2006 – but the actual statute that created section 409A includes this reporting element, so until Treasury decides otherwise, plan sponsors should be working to make a good faith estimate of the required values and plan to report them on the 2005 Form W-2 for participants.

Modification of Payment Elections

The proposed regulations allow participants to change the form of their elected payouts in any fashion, as long as the change doesn't take effect for 12 months and serves to delay the initial receipt of payments by at least 5 years. Companies will want to carefully craft plan amendments to make best use of the flexibility provided by this provision.

Please let us know if you need more information on these issues. If you want to be added to our “E-Alert List,” please send a message to SarahR@mgmtcomp.com telling us which address to use.

