

Deferred Compensation Regulations

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Section 409A of the Internal Revenue Code of 1986, as amended revolutionized the tax law relating to nonqualified deferred compensation previously governed solely by actual or constructive receipt as to time that recognition would occur. Under Section 409A, deferral is only permitted if the plan and its implementation permit distributions at specified events such as separation from service or a change of control. The penalty for failure to meet the requirements of Section 409A is immediate recognition of the income deferred on vesting and a penalty tax of 20% of the income recognized (in addition to the regular income tax). Section 409A became generally effective as to deferrals that occur or vest after December 31, 2004.

For a more complete outline of Section 409A, see [Tax Treatment of Deferred Compensation](#).

The IRS has previously permitted the formal amendments of plans to comply with Section 409A to occur by December 31, 2006.

The IRS has now announced (Notice 2006-79) that amendment of such plans need not occur until December 31, 2007 provided that there is "reasonable, good faith compliance with the provisions of section 409A and the guidance" published by the IRS before that date. The IRS also announced that the final regulations are expected to be issued before the end of 2006 and will have an effective date of January 1, 2008. The delayed effective date is to permit the taxpayers and representatives time to analyze them and come into compliance.

Transition relief has also been extended through December 31, 2007 for changes in certain payment elections, payments linked to qualified plans, and substitution of non-discounted options and stock appreciation rights (SARs) for discount options and stock appreciation rights. *However, the latter transitional relief will not apply to "back-dated" options and SARs.*

Nor will this transitional relief excuse employers from the obligation of *reporting and withholding* on the deferred compensation amount required to be included in income in 2006 on account of non-compliance with Section 409A. The BNA Daily Tax Report, No. 195, page G-8, Oct. 9, 2006 reported that Daniel Hogans of the Treasury's Office of Tax Policy stated on October 5, 2006 that guidance in the form of final regulations would be out before the end of the year with respect to reporting and withholding of tax.