



WASHINGTON REPORT

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Subject: **Section 409A Regulations Update**

Prior Washington Reports: 06-118; 06-114; 06-96; 06-70; 06-44; 06-16; 06-06; 06-02; 04-173

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THE CONCLUSION OF THIS WASHINGTON REPORT.**

The proposed regulations under section 409A of the Internal Revenue Code, dealing with nonqualified deferred compensation arrangements, have not been finalized. Those final regulations, along with a new Notice which will address reporting and withholding matters, are expected to be issued within the next two to four months. Additional regulations are likely to be issued in 2007 and/or 2008. (See generally our Bulletins Nos. 06-118, 06-114, 06-96, 06-70, 06-44, 06-16, 06-06, 06-02, and 04-173.)

When the IRS issued Notice 2006-79 (see our *Bulletin No. 06-118*), it postponed the regulatory effective date for the 409A regulations from January 1, 2007 to January 1, 2008. This was in recognition of the fact that the Service had been unable to complete the regulations on a timely basis. The Notice provided a number of transition rules that should be helpful to employers in continuing to operate deferred compensation plans between now and the end of 2007.

The final regulations are currently under review and are being circulated for approval among senior IRS and Treasury officials. Unfortunately, this process encompasses timing uncertainty and offers the potential for significant delays. For example, although a number of officials at the Revenue Service have informally indicated that they expect the regulations to be completed in a relatively brief period of time, possibly before the end of 2006, others have predicted that issuance may be delayed into 2007. While the answer to the question of whether the regulations will be made final this year or next is uncertain, it seems sensible to predict that finalization will occur no later than early 2007.

Before the regulations are finalized, however, it is likely that the IRS will publish a new section 409A Notice, this one dealing with reporting and disclosure. Last year (on December 8), the IRS issued Notice 2005-94, suspending the reporting and withholding requirements with respect to section 409A for calendar year 2005. We anticipate that within the next week to month, i.e., before the end of November, the IRS will issue a new Notice again suspending part of the reporting requirements.

A requirement that nontaxable deferrals be reported annually was added by section 409A, but has yet to be implemented. Apparently it will again be deferred for another year. To illustrate, the new Notice will likely suspend the requirement that employers report the amount of each employee's 2006 deferral on his Form W-2 for that year. However, it is expected that this Notice, unlike Notice 2005-94, will require employers to report any amounts taxable under section 409A and to apply the appropriate withholding. It is further expected that the new Notice will provide some guidance on valuation issues connected with the requirement of withholding, but that the guidance will not be comprehensive in scope.

After the new Notice is issued and the regulations are finalized, the IRS will begin further work on additional parts of the section 409A regulations. These include regulations' sections devoted to tax amount calculations, difficult basis issues, deferred compensation for partners (which was reserved in the proposed regulations and will be reserved in the final regulations) and the three "funding" rules in section 409A(b) -- i.e., the rules dealing with off-shore trusts, financial health triggers, and the new at-risk rules for companies that also maintain a defined benefit plan. These additional regulations are expected to be proposed sometime in 2007, probably to be finalized by 2008.

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