

## **TAX UPDATE - January 2006**

### **To Our Clients, Business Partners and Friends...**

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Happy New Year! We hope this letter finds you doing well and that 2006 will be a great year for you and your business. Here are a few items of current interest in deferred compensation:

#### ***W-2 Information Reporting / Withholding***

The IRS was in a giving mood during the holidays when they suspended [via IRS Notice 2005-94, issued 12/8/05] the W-2 information reporting requirements under §409A for calendar year 2005. Of course, most of us were busy making a good faith effort to comply with §409A and report some information on W-2s by then... oh well, better late than never! The Service also wants everyone to remember that although the 2005 information requirements are suspended, the actual payroll tax withholding rules under §3121(v)(2) did NOT change.

#### ***Plan Amendment / Documentation under §409A***

As we previously reported, the requirement for plan document amendments has been delayed until December 31, 2006 – assuming that plans are operated in good faith under the proposed regulations and law. New plans can be drafted under the same good faith interpretation with the knowledge that amendments may be required. **We are still recommending that most plans in effect prior to January 1, 2005, not be amended until more guidance is received.**

#### ***Ongoing Deferral and Payment Elections***

The proposed regulations allow participants to change the form of their elected payouts in any fashion, as long as it doesn't take effect for 12 months and delays the receipt of payments by at least 5 years. The law and regulations in this area are still being clarified and companies will want to carefully craft new plans and amendments to make best use of this provision.

Elections to defer salary earned in 2006 must have been made by December 31, 2005; bonus deferral elections can qualify for a special timing rule – but must be made by June 30, 2006 at the latest. For ease of administration and communication, many companies will structure ongoing salary and bonus deferral elections to occur at the same time.

#### ***Roth 401(k) Accounts***

The IRS recently released final regulations detailing how Roth accounts work inside of a 401(k) plan. While too voluminous to address here, the bottom-line issues are this: Roth accounts require 401(k) plan amendment; they are included in the annual deferral limit [\$15,000 for 2006]; Roth contributions are income taxable currently; plan sponsors must permanently maintain separate accounting for Roth amounts; and the law authorizing Roth accounts expires on 12/31/2010, without further action by Congress. Add all this up and what do you get? Uncertainty among plan sponsors about whether it is worth the added administrative hassle and expense. We have a Roth 401(k) white paper available if you would like more information. Thank you for the ongoing chance to be of service to you.

