DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

November 7, 2005

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Dear   :

This letter responds to your letter dated September 9, 2005, in which you suggest that
the IRS revise Forms W-2 and 1040 to include additional information on deferred
compensation payments. The purpose of the revisions you are proposing is to provide
the Social Security Administration (SSA) with the information needed to distinguish
currently earned income from deferred compensation distributions in order to correctly
apply the SSA earnings test and thus, pay the correct amount of benefits.

Benefits paid to a social security beneficiary, who is younger than the full retirement
age, may be reduced if the beneficiary continues to work. Under the earnings test, if a
social security beneficiary earns more than a specified amount during a year, Social
Security benefits are reduced proportionately for that year. However, only income
earned in the current year is considered in applying the earnings test. Special wage
payments, which are for services performed in a prior year, are not to be considered in
applying the earnings test.

As your letter correctly notes, in order to properly apply the SSA earnings test, the SSA
must have the ability to distinguish current year post-retirement earnings from deferred
compensation earned in a prior year. I thought it might be helpful to you to receive the
current rules that require this distinction in reporting. All of this reporting is the
responsibility of the employer.

A nonqualified deferred compensation plan (NQDCP) is an arrangement established
and maintained by an employer for its employees that provides for the deferral of
compensation. Generally, nonqualified deferred compensation is subject to Federal
Insurance Contributions Act (FICA) taxes, which are comprised of Social Security and
Medicare taxes, when the related services are performed, even though the
compensation is not included in gross income until it is actually distributed.
Subsequently, when distributions are made from the NQDCP, FICA taxes are not
withheld.

After an employee retires and distributions are made from the NQDCP, the distributions
attributable to services performed in a prior year are reported in box 11 on Form W-2.

The purpose of box 11 is to provide the SSA with the information necessary to determine if any part of the total compensation reported on the Form W-2 was earned in a prior year. In addition, employers must complete the SSA Form SSA-131 if an employee has both made contributions to a NQDCP, and received distributions from the NQDCP, in the same year. The SSA uses the information from the IRS Form W-2 and the SSA Form SSA-131 to verify that they have properly applied the Social Security earnings test and paid the correct amount of benefits.

If Forms W-2 and SSA-131 are completed and filed according to the respective instructions, the SSA should have all the information necessary to correctly apply the SSA earnings test. Information from IRS Form 1040 is not used to apply the SSA earning test. We have no information on how SSA trains its staff in the use of Forms W-2 and SSA-131.

For your information and to help illustrate the matters discussed in the letter, we have enclosed copies of IRS Form W-2 (Wage and Tax Statement), Instructions for Forms W-2 and W-3, and Publication 957 (Reporting Back Pay and Special Wage Payments to the Social Security Administration).

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2005-1, §2.04, 2005-1 IRB 7 (Jan. 3, 2005). If you have any additional questions, please contact   at   .

                                        Sincerely,

                                        Catherine E. Livingston
                                        Assistant Chief Counsel, (Exempt
                                        Organizations/Employment Tax/Government
                                        Entities
                                        (Tax Exempt & Government Entities)

Enclosure (3):
        Sample IRS Form W-2
        W-2 Instructions
        Publication 957