February 12, 2007

The Honorable Charles Rangel
Chairman, House Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Rangel:

We are writing on behalf of the member companies of the American Benefits Council to express our opposition to two revenue raisers in the Senate-passed version of H.R. 2 that would impose new tax rules on compensation arrangements. We were pleased that the summary of the Chairman’s mark for today’s Ways & Means Committee mark-up does not include these provisions. We urge you to reject these revenue raisers in a House and Senate conference on H.R. 2 or any other bill.

The American Benefits Council is a public policy organization representing more than 250 members that are primarily major U.S. businesses providing employee benefits to active and retired workers. The Council’s membership also includes organizations that provide employee benefit services to employers of all sizes. Collectively, the Council’s members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Council’s members have raised significant concerns about both the policy and practical effects of sections 226 and 234 in the Senate-passed version of H.R. 2. Section 226 would expand Internal Revenue Code section 409A to impose dollar caps on nonqualified deferred compensation plans, including all earnings under those plans, equal to the lesser of “one times pay” or $1 million. Section 234 would expand Internal Revenue Code section 162(m) to deny employer deductions for certain compensation payments to both current and former top executives of publicly-held companies, including payments that are already scheduled to be made under legally binding contracts. Both of these revenue raisers are significantly flawed, as we discuss below.
The tax laws should not favor current cash payments to employees. Both of the revenue raisers would create significant disincentives for deferring compensation payments to employees and, therefore, favor compensation programs that maximize current cash payments. This is not a good tax policy and it runs counter to good business planning. Employers have legitimate cash-flow and long-term business goals that are not served by a system that imposes tax penalties on deferred compensation payments. Yet, the logical result of the Senate provisions -- in particular the dollar cap -- would be to force employers to significantly reduce or abandon incentive compensation, retirement and savings programs in favor of current cash. Consider, for example, an entrepreneur who recruits employees to help grow her business. Cash flow precludes that employer from paying higher current salaries and, instead, employees are promised bonuses or incentive compensation in the future based on the growth and success of the business. There is no sound reason for the tax laws to impose a dollar limit on those future payments, which is exactly the result under the Senate-passed provision.

The dollar cap would hit middle managers and erode retirement savings. Although the provisions have been described as addressing perceived problems with “executive” pay, middle management and other non-management employees likely would see the most drastic changes in their benefit programs under the dollar cap. Many of these middle-management programs are designed to complement the employer’s tax-qualified retirement plans by allowing employees to save for retirement on their total compensation. We are concerned that the disincentive to maintain deferred compensation programs ultimately would undermine support for the employer’s qualified plans.

The system should not impose tax on individuals where funds are at risk. There is no sound tax rationale for subjecting nonqualified plan dollars to income inclusion before they are actually paid or for imposing a tax penalty on these dollars, which is the result under the Senate-passed bill. Contrary to some erroneous news reports, these nonqualified plans are not secured like qualified plans. Employees are not guaranteed to receive the money in the event of the employer’s insolvency, for example. Taxing employees on amounts that are “at risk” and may never be paid is fundamentally unfair, which is the result under the Senate-passed provision if dollar caps are exceeded.

Current law imposes strict limits on nonqualified deferred compensation. Section 409A, which was enacted in 2004, already restricts the timing of deferrals and the timing of payments under deferred compensation arrangements and further restricts the ability to set aside amounts to secure such arrangements. The Treasury Department has not yet issued final regulations under section 409A and employers are still in the process of grappling with and implementing the
new law. Imposing additional, complex restrictions now would be particularly disruptive.

The expansion of §162(m) makes a bad provision worse. Section 234 of the Senate bill would expand the definition of “covered employee” as defined under section 162(m) to include anyone who was ever a covered employee. The expansion of section 162(m) would expand further a provision that experts unequivocally agree is “broken.” The staff of the Joint Committee on Taxation (JCT) recommended in 2003 that section 162(m) be repealed altogether. The recommendation was based on the JCT staff’s conclusion that the provision is “ineffective at accomplishing its purpose [and] overrides normal tax principles.” The JCT staff also noted that “[t]he concerns reflected in the limitation can better be addressed through laws other than the Federal tax laws.” To that end, the Securities and Exchange Commission has promulgated expansive new proxy disclosure rules on executive compensation. Those provisions should be given time to work rather than embark on an attempt to once again use the tax laws to address perceived corporate governance problems.

The expansion of §162(m) is retroactive. The section 162(m) proposal applies retroactively to amounts earned before 2007 and payments to which the employer is already contractually obligated. The lack of a binding contract exception is punitive. When Congress enacted the section 162(m) deduction limit in 1993, an exception was included for payments made under existing binding contracts.

*   *   *   *

In sum, we urge you to reject these revenue raisers. They are not good tax policy, will hurt middle managers and other non-executive employees, and will interfere with U.S. employers’ ability to structure their compensation programs in the manner that provides appropriate incentives and best meets their business needs.

Sincerely,

James A. Klein
President