



Nonqualified Deferred Compensation Legislation

The proposals in S. 1637 and H.R. 4520 on nonqualified deferred compensation are overly broad and raise serious concerns for employers.

This legislation goes well beyond the correction of perceived abuses. For example, an employee would be taxed immediately merely because he has a choice prior to retirement as to whether payments are made in a lump sum or installments.

The definition of a “nonqualified deferred compensation arrangement” is too broad. For example, there is no exception for stock-based compensation, including employee stock options. If enacted, the legislation could give the IRS authority to impose a radical change on the taxation of stock options.

The legislation has no exceptions for changes in compensation structures that are made on account of corporate acquisitions or reorganizations. Employees could be immediately taxed on compensation that they have not been paid merely because the timing or form of a future payout is changed to take into account the circumstances of a corporate event over which many affected employees will have no control.

The legislation is retroactive. The effective dates combined with the rules on timing of elections under both bills would preclude employees in existing bonus arrangements from filing deferral elections now that are clearly permissible under current law.

The legislation provides no transition time for employers to modify their compensation and bonus structures.

The legislation is not limited to the elective deferral of bonuses or incentive compensation. It unduly restricts supplemental pension arrangements, which are critical to the retirement and savings of managers who are well below the senior executive level (e.g., \$200,000 salary range).

Any “grandfather” of existing deferrals is illusory. Committee report language suggests that existing deferrals may lose any grandfather protection merely because an employee has an election prior to retirement between a lump sum or installment payouts or because the payouts are linked to the employee’s election under a tax-qualified plan.