January 23, 2007

The Honorable Harry M. Reid
United States Senate
528 Senate Hart Office Building
Washington, DC 20510

Dear Senator Reid:

The undersigned associations—representing thousands of businesses that employ tens of thousands of affected employees— are extremely concerned about several tax increases included in the Small Business and Work Opportunity Act of 2007. We strongly urge you to remove these provisions from the bill before it comes to the Senate floor.

In particular, there are two provisions that should be removed from the legislation – one relates to deferrals of nonqualified deferred compensation and the other to employer deductions of compensation. These revenue raisers would impose a dramatic shift in tax policy relating to the receipt of income. Practically speaking, the proposals will force employers to significantly reduce or abandon retirement and savings programs that benefit middle management employees in favor of current cash compensation. This flawed tax policy would result in a cash drain for many employers, less flexibility at a time when both public and private companies need to be more competitive, and added complexity in the administration of compensation arrangements.

In 2004, Congress adopted significant restrictions on nonqualified deferred compensation arrangements under Section 409A of the Internal Revenue Code. Two years after the enactment of those provisions, the Treasury Department has yet to release final regulations because the issues surrounding these plans are exceedingly complex. Including these new provisions in the Senate legislation only adds to the uncertainty about the application of Section 409A.

Ostensibly, these changes are aimed at perceived abuses by corporations that pay their CEOs and other top executives what is deemed to be excessive compensation. If CEOs and other top executives are the real target, these proposals miss the mark and will instead impact a much broader group of individuals. These employees often participate in nonqualified deferred compensation arrangements to save an equivalent percentage of compensation as is permitted under qualified retirement plans. Contrary to news reports, nonqualified plans are not funded or secured the way qualified plans are, meaning that an employee is not guaranteed to receive the money in the event of the employer’s insolvency, for example.

The provision to limit the annual amount of deferred compensation to the lesser of (i) the average annual includible compensation over five years or (ii) $1 million will directly and adversely affect middle management individuals. Many of the programs that allow middle managers to supplement their retirement savings by deferring annual
compensation until retirement will have to be substantially altered to comply with the proposed changes. Moreover, the projected revenue gains are likely to be ephemeral, since the top executives that are the target of these proposals will probably remain in the top tax bracket even after retirement.

The other provision would expand the definition of “covered employee” as defined under Section 162(m) of the Internal Revenue Code to include anyone who was ever a covered employee or anyone who served as CEO at any point during the year. The proposal applies retroactively to amounts earned before 2007 and payments to which the employer is already contractually obligated.

By expanding section 162(m), Congress is ignoring the recommendations of the Joint Committee on Taxation’s (JCT) staff’s 2003 recommendation to repeal the section altogether. The recommendation was based on JCT’s conclusion that the provision is “ineffective at accomplishing its purpose [and] overrides normal tax principles,” JCT also noted that “[t]he concerns reflected in the limitation can better be addressed through laws other than the Federal tax laws.”

Thank you in advance for considering our strong view that the new rules relating to deferred compensation should be allowed to work before considering any additional changes.

Sincerely,

American Bankers Association
American Benefits Council
American Council of Life Insurers
Association for Advanced Life Underwriting
ERISA Industry Committee
FEI’s Committee on Benefits Finance
FEI’s Committee on Taxation
HR Policy Association
National Association of Manufacturers
Securities Industry and Financial Markets Association
The Financial Services Roundtable
US Chamber of Commerce