

October 6, 2004

Deferred Compensation Legislation May Pass This Week

The proposed legislation modifying the treatment of nonqualified deferred compensation, which (like many things in Washington) languished during the summer, is suddenly moving forward again, and may be passed by Congress as early as the end of this week, with an effective date of January 1, 2005.

As we described in our June 2004 Management Alert on the proposed legislation ("Restrictions on Deferred Compensation Plans on the Horizon", available at <http://www.seyfarth.com/db30/cgi-bin/pubs/060904.pdf>), the deferred compensation provisions are part of a larger bill dealing with US export subsidies. Congress is under considerable pressure to pass this bill before adjourning on October 8 in order to relieve US companies from retaliatory tariffs imposed by the European Union, but until recently the House and Senate have been deadlocked over other controversial provisions of the bill. Now it appears the logjam may have been broken. On Monday evening, the chairman of the conference committee appointed to resolve the differences between the House and Senate versions presented a compromise "chairman's mark" of the bill, which is now moving toward passage.

The version of the deferred compensation restrictions contained in the chairman's mark is very similar to the version previously passed by the House. Some of the highlights of the compromise version are listed below. (For a more thorough discussion of the bill's provisions, see our prior Management Alert.)

- Employees could elect to defer incentive compensation up until six months before the end of the measurement period. This would apply to both annual bonuses and long-term incentive compensation. The prior version of the bill required all deferral elections to be made by the end of the preceding year, and was unclear on the treatment of multi-year LTIPs. This would mean that employees would have until June 30, 2005, to elect to defer their 2005 bonuses, rather than having to make the election by December 31, 2004. In addition, the IRS is specifically directed to issue guidance on the timing of deferrals for fiscal year companies.

- Most of the additional restrictions added by the Senate bill have been excluded, including the requirement that the investment options offered in a nonqualified plan could not be better than the options of the company's qualified 401(k) plan and the penalty tax on payments within one year after a change of control.
- If a nonqualified plan fails to meet the new requirements, only the affected employees are subject to tax – not all participants.
- The new provisions would apply to all amounts deferred after January 1, 2005. However, any material amendments made to an existing deferred compensation plan after October 3, 2004, such as adding a "haircut" withdrawal provision, would cause the pre-2005 plan to become subject to the new rules. The effect of the new law on 2004 bonuses that would otherwise have been paid in early 2005 is not clear, but the IRS is directed to give employees an opportunity to unwind prior deferral elections that are adversely affected by the new law.

Of course, any of these provisions could change as the bill moves towards passage. On the assumption that the legislation will be passed before Congress adjourns this week, we have scheduled a teleconference briefing on Tuesday, October 12, 2004, at 1:00 p.m. Central Time. For details and registration information, please visit www.seyfarth.com/events or contact Meridith Fee at mfee@seyfarth.com or 800-342-4432 x6981. (If the bill does not pass, the teleconference will be cancelled.)



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