SEYFARTH ATTORNEYS SHAW LLP

One Minute Memo™

New Pension Act Forbids Funding Deferred Compensation When Pension Plans Are At Risk

The Pension Protection Act of 2006, which was passed by Congress on August 3 (with the President expected to sign), amends Internal Revenue Code Section 409A to prohibit a public company from funding any deferred compensation arrangement for certain key executives and directors while its qualified pension plan is at risk, including making deposits into a rabbi trust or other arrangement that is subject to the claims of creditors. Any funding that violates the restriction will be immediately taxable, and subject to the 20% penalty tax under Code Section 409A. Moreover, any tax "gross-up" payments made to the executive or director to cover the tax penalties will be subject to the same 409A penalties, with no tax deduction for the employer.

The new law prohibits the funding of deferred compensation on behalf of the five executive officers whose compensation must be disclosed in the company's proxy, or any officer or director subject to Section 16 of the Securities Exchange Act of 1934, during any of the following periods:

- Any period during which the employer, or any member of its controlled group, is undergoing bankruptcy proceedings.

- Six months before or after the date an underfunded pension plan of the employer, or a member of its controlled group, is terminated in a distress or involuntary termination.

- Any plan year during which any qualified pension plan maintained by a controlled group member is in "at risk" status for funding purposes. The "at risk" rules are part of the new minimum funding standards created by the Act, which do not take effect until 2008.

The law applies to any assets that are actually transferred to a rabbi trust, or otherwise set aside exclusively for the payment of deferred compensation. Any subsequent earnings, or increase in the value of the transferred assets, is also taxed. In addition, the law applies to any deferred compensation arrangement that requires such a transfer or set aside, even if an actual transfer doesn't occur. This will require a review of all deferred compensation arrangements that require automatic funding. While the new rules clearly apply to transfers to a rabbi trust, it remains to be seen what other types of funding arrangements may also be included in IRS regulations.

If you have any questions concerning the new deferred compensation restrictions, or any other provision of the Pension Protection Act, please contact the Seyfarth Shaw LLP attorney with whom you work or any employee benefits attorney on the website at www.seyfarth.com. In addition, Seyfarth Shaw will sponsor a teleconference client briefing on the new Act on August 17, 2006. Visit www.seyfarth.com/events, or contact Craig Maas at cmaas@seyfarth.com or 312-460-6422, to register.

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