

**OVERVIEW OF NONQUALIFIED DEFERRED COMPENSATION PROVISIONS CONTAINED IN THE
AMERICAN JOBS CREATION ACT CONFERENCE AGREEMENT***

ITEM	CURRENT LAW	AMERICAN JOBS CREATION ACT OF 2004 (H.R. 4520)
Definition of Nonqualified Deferred Compensation	Current law provides no single definition. Treas. Reg. §1.404(b)-1T defines deferred compensation as any payment made more than 2½ months after the tax year in which the relevant services were rendered. Regulations under §31.3121(v)(2)-1(b) impose a special timing rule for employment taxes on deferred compensation plans that meet certain regulatory requirements (excluding welfare, stock plans, death benefits, and disability benefits).	New Code section 409A applies to any “plan,” “agreement,” or “arrangement” that provides for deferral of compensation, other than tax-qualified plans and tax-deferred annuities, IRAs, SEPs, SIMPLEs, 457(b) plans, and plans providing for vacation, sick leave, disability, compensatory time, and death payments. Code section 409A is not limited to elective arrangements. Code section 409A does not apply to stock options provided that the exercise price is not less than the fair market value of the shares on the date of grant and the option does not include a deferral feature beyond the right to exercise in the future. The provisions apply to stock appreciation rights (SARs) and supplemental nonelective pensions (SERPs), but the conference agreement gives Treasury the authority to issue regulations relating to SARs and changes in benefits forms under SERPs. It is expected that Treasury will apply Code section 409A to discounted stock options, but not to employee stock purchase plans

* The provisions on nonqualified deferred compensation discussed in this chart are included in the Conference Agreement on the American Jobs Creation Act of 2004 (H.R. 4520) amending the Internal Revenue Code to address international taxation and the World Trade Organization’s rulings on the FSC/ETI benefits. H.R. 4520 was introduced by House Ways and Means Committee Chairman Thomas (R-CA), and was passed by the House on June 17, 2004. S. 1637 was introduced by Senate Finance Committee Chairman Grassley (R-IA), and was included as a substitute amendment to H.R. 4520, which was passed by the Senate on May 11, 2004. The Conference Agreement on H.R. 4520 was passed by the House on October 7, 2004, and Senate passage is expected shortly.

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Definition of Nonqualified Deferred Compensation (continued)		under Code section 423(b). The conference report states that Code section 409A is not intended to apply to annual bonuses or other amounts payable within 2½ months after the close of the taxable year in which the relevant services were performed.
Timing of Deferrals	Case law interpreting the doctrine of “constructive receipt” supports an election to defer compensation that occurs any time prior to the date that amounts are due and payable. The IRS ruling position generally requires that deferral elections be made prior to the period in which the underlying services are performed, but this position was not a legal determination by the IRS and reflected only the conservative fact pattern on which the IRS would provide an individual ruling.	The timing of all deferral elections must continue to satisfy the rules of constructive receipt. In addition, Code section 409A generally requires deferral elections to be made prior to the taxable year in which the services are performed or as provided in regulations. A special 30-day grace period is provided for new participants in deferred compensation plans. For “performance-based compensation” where the performance period is 12 months or more, elections to defer may be made up to 6 months prior to the end of the services period. The conference report states it is intended that the term “performance-based compensation” will be defined by Treasury to include compensation to the extent that an amount is (i) “variable and contingent on the satisfaction of pre-established organizational or individual performance criteria” and (ii) “not readily ascertainable” at the time of the election. It also is intended that “performance-based compensation” may be required to meet some, but not all, of the Code section 162(m) standards, and Treasury has suggested that performance criteria may be subjective.

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Creditor Access and “Rabbi” Trusts	No current taxation if an employee is a general creditor with respect to an unfunded promise to pay compensation in the future. Compensation is “unfunded” even if amounts are irrevocably transferred to a trust as long as creditors may access the funds upon insolvency. Foreign trusts and arrangements are subject to the same standards as domestic trusts. Foreign rabbi trusts are specifically exempted from Treasury regulations governing U.S. persons who are beneficiaries of foreign trusts. See Treas. Reg. §1.672(f)-1	Code section 409A provides that a transfer of property under Code section 83 occurs and employees will be subject to current taxation on benefits as of the earlier of the date that the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a “change in the employer’s financial health” or the date on which assets are so restricted. An amount is treated as restricted even if it is available to satisfy the claims of general creditors. The conference report states that this provision will apply in the case of a plan that provides that a rabbi trust will become funded to the extent of all deferrals upon a change in the employer’s financial health even if the rabbi trust is available to creditors. This provision does not apply in the case of a change in control. Transfers to foreign rabbi trusts and similar arrangements will be taxable under Code section 409A, subject to the Treasury’s authority to write exceptions.
Payout Terms Including “Second Elections” and Other Changes	No current taxation until receipt of payments to the extent that the employee’s right to payment may be accelerated upon certain events not in the employee’s control or subject to substantial limitations, such as a financial hardship, a termination of employment, a	Distributions are allowed under Code section 409A only upon separation from service (as determined by Treasury), death, disability, a specified time or pursuant to a fixed schedule, a change in control (to the extent provided by Treasury), or the occurrence of an unforeseeable financial emergency. Aggregation rules apply; for example, a distribution event will not occur a if a participant separates from service from one member of a controlled group, but continues employment with another member of the same

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<p>Payout Terms Including “Second Elections” and Other Changes (continued)</p>	<p>change in control, or disability (as defined by the deferred compensation plan). Changes in the deferral period or changes in the form of payment (<i>e.g.</i>, from lump sum to installment) may be made prior to the time that payments are due and payable. [Many employers rely on favorable case law to allow changes in deferral and payout elections while an employee is still employed and in the tax year prior to the year that payments are scheduled to be made. As discussed above, the IRS ruling position historically has been more restrictive.]</p>	<p>controlled group. No accelerations are permitted except as provided in Treasury regulations. Plans may provide that minimal amounts may be automatically distributed upon a permissible distribution event for administrative convenience. Code section 409A allows a “second election” to delay, or change the form of, a payout provided that the “second election” is made at least 12 months prior to the scheduled payout date, does not take effect until 12 months after the date of the election, and results in an additional deferral of at least five years (except in the case of death, disability, or unforeseeable emergency). There is no requirement that the second election be made prior to a termination of employment. It is expected that Treasury will issue regulations regarding the extent to which changes in a stream of payments are permissible. In addition, any “key employee” of a publicly held company would be required to wait 6 months for the commencement of any payment triggered by a separation from service or death. For these purposes, a key employee is defined under Code section 416(i) as a top-50 officer with compensation in excess of \$130,000, a 5-percent owner, or a 1-percent owner with compensation in excess of \$150,000. This definition likely encompasses a broader group of officers than the definition of a Rule 16 insider for purposes of the Securities and Exchange Act.</p>

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<p>“Haircuts,” Penalty Withdrawals and Change in Control Payments</p>	<p>Regulations under section 451 are relied upon to avoid constructive receipt if elective withdrawal rights are subject to a penalty or “haircut” that is a substantial limitation on the employee’s ability to withdraw funds. The IRS allows plans to include a withdrawal right upon an unforeseen financial emergency without triggering constructive receipt and current taxation for all participants.</p>	<p>Code section 409A precludes “haircut” and other penalty withdrawal rights. Change in control payments and payments upon an unforeseeable financial emergency are permitted as discussed above. Note that the conference agreement directs Treasury to issue guidance defining “change in control” within 90 days after the date of enactment. It is intended that the definition will be similar, but more restrictive, than the definition used under Code section 280G.</p>
<p>Timing and Amount of Tax Imposed</p>	<p>Taxpayers on the cash method of accounting pay income tax at the ordinary income tax rates in the tax year in which amounts are actually or constructively received.</p>	<p>If Code section 409A is not satisfied, affected participants are immediately taxed on the amount deferred and are subject to a 20 percent penalty and interest at the underpayment rate plus 1 percent as if the deferred compensation had been included in the participant’s income on the earliest date that the employee was vested in the benefit. The penalty and interest on underpayments applies to amounts that become taxable because of a foreign trust or transfers that are contingent on the employer’s financial health.</p>

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Persons Affected	Current law applies to all employees and independent contractors on the cash method of accounting. Special limitations apply to deferred compensation arrangements sponsored by governments and tax-exempt organizations under Code section 457.	Code section 409A applies to any person receiving nonqualified deferred compensation for the performance of services, except that special distribution rules apply to “key employees” of publicly-held companies within the meaning of Code section 416(i) as discussed above. Note that there is no specific carve-out for non-employees (<i>i.e.</i> , outside directors and consultants are covered).
Effective Date	N/A	Amounts deferred (and related earnings on those amounts) <u>after</u> December 31, 2004, are subject to Code section 409A. Amounts deferred prior to January 1, 2005 are grandfathered subject to certain restrictions (see Grandfather Rules below). An amount is considered deferred before January 1, 2005, if it is earned and vested before that date, provided that there is no material modification to the arrangement after October 3, 2004. This means that if an employee has to continue working until 2005 in order to receive a bonus that he or she deferred through an election filed in 2004, that bonus is not earned and vested. Moreover, the conference report states that vesting employees in previously issued compensation awards prior to December 31, 2004 is a material modification to the arrangement that eliminates the grandfather protection. While this rule may be viewed as an “anti-stuffing” provision, the inability to vest employees in prior awards means that outstanding and

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Effective Date (continued)		unvested equity grants (e.g., SARs, discounted options) are subject to Code section 409A and likely will fail to meet these provisions. Thus, they likely will become immediately taxable unless there is administrative relief from Treasury. Treasury also is required to issue transition guidance (see Regulatory Authority below).
Grandfather Rules	N/A	Present law will continue to apply to amounts deferred prior to January 1, 2005, unless there is a material modification to the arrangement after October 3, 2004. The grandfather is broad. For example, a plan that has a “haircut” penalty withdrawal may continue to allow such a provision on a going forward basis with respect to pre-January 1, 2005 amounts deferred (and earnings on those deferrals) even though such a provision would violate Code section 409A on amounts deferred after December 31, 2004. A plan that does not have a “haircut,” for example, could not be amended to add such a provision because of the material modification rule.
Regulatory Authority	In 1978, the IRS and Treasury issued a proposed regulation, 1.61-16, which would tax currently any amount that an employee voluntarily deferred from salary or bonuses (other than qualified plans). Under the proposed regulation, the	Code section 409A does not explicitly repeal section 132 of the Revenue Act of 1978, but the moratorium is effectively eliminated. Treasury has authority to prescribe regulations necessary to carry out the proposal, including specific authority to write rules (i) valuing the amount deferred under a non-elective, defined benefit-type arrangement; (ii) defining change in control; (iii) exempting arrangements from the offshore trust rules if

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Regulatory Authority (continued)	assignment of income doctrine would apply at the time that the employee made the election to defer. In section 132 of the Revenue Act of 1978, Congress directed Treasury and IRS to tax deferred compensation arrangements under the principles in place on February 1, 1978 (just prior to the issuance of the proposed regulation). Treasury has stated that it would not finalize the regulation if given authority to write regulations in the future. Section 132 has not precluded the IRS from continuing to develop its own ruling positions (<i>e.g.</i> , Rev. Proc. 92-64 (setting forth a ruling position on rabbi trusts); Rev. Proc 92-65 (modifying the rulings position on the timing of deferral elections)).	they do not result in an “improper deferral”; (iv) defining “financial health” of the employer; and (v) disregarding any substantial risk of forfeiture where necessary to carry out the purposes of the legislation. With respect to this latter item, the conference report states that it is intended that substantial risks of forfeiture may not be used to manipulate the timing of income inclusion and that illusory risks should be disregarded. Treasury also has authority to write regulations addressing issues relating to SARs and SERPs. Treasury also is instructed to write rules within 60 days providing a limited period of time during which a plan adopted prior to December 31, 2004, may be amended to provide that a participant may terminate participation or cancel a deferral election with respect to amounts deferred after December 31, 2004, if the amounts being deferred would be subject to taxation under the statutory provisions.

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Annual Reporting	No tax reporting of deferred compensation prior to inclusion in employee's income other than deferrals subject to early inclusion for employment taxes under Code section 3121(v). Note that the Department of Labor has authority to require reporting of such arrangements.	Provisions would require annual reporting to the IRS of "amounts deferred" on the Form W-2 even if amounts are not currently includable in income. Treasury is authorized to write rules governing the extent to which the IRS reporting requirement will not apply to small deferral amounts and amounts that are not reasonably ascertainable.
Estimated Revenue Effect	N/A	Raises \$1.05 billion as estimated by the Joint Committee on Taxation.