



Summary of Deferred Compensation Provisions of the American Jobs Creation Act of 2003

July 28, 2003

Friday, Ways and Means Committee Chairman Bill Thomas introduced the American Jobs Creation Act of 2003. Included in the bill is a provision addressing nonqualified deferred compensation. The proposal would generally place restrictions on the timing of distributions and prohibit accelerations of distributions and the use of certain security devices (including financial health triggers and offshore trusts). The proposal would not generally limit the use of rabbi trusts. What follows is a summary of the nonqualified deferred compensation proposal.

Income Inclusion Under the proposal, a taxpayer would have to include in income all compensation deferred under a nonqualified deferred compensation plan (to the extent not subject to a substantial risk of forfeiture and not previously taxed) unless at all times during the year the plan satisfies specified requirements relating to timing of distributions and deferral elections. If previously deferred compensation becomes includible, there is also an interest charge relating back to the time the compensation was originally deferred.

Distributions The nonqualified deferred compensation plan must provide that distributions may not be made earlier than:

- separation from service (6 months after separation from service for key employees)
- disability
- death
- a specified time (or pursuant to a fixed schedule) specified under the plan as of the date of the deferral
- a change in ownership or control of the corporation or a substantial portion of its assets (but only as permitted by the IRS)
- an unforeseeable emergency (narrowly defined to include severe financial hardship from an unexpected illness or accident, casualty loss, or other unforeseeable circumstances), but only to the extent necessary to satisfy the emergency (and pay taxes on the amount distributed).

Further, the plan may not permit any acceleration of the specified time (or fixed schedule) for paying benefits.

Deferral Elections The plan must provide that compensation earned during the year may be deferred only if the election to defer is made during the preceding taxable year (or at such other time as may be provided in regulations). In the first year in which an employee becomes eligible to participate, the

election can be made within 30 days of eligibility, but only as to services subsequent to the election. The plan may permit a subsequent election to delay a distributable payment or change the form of payment, but only if the subsequent election is made at least 12 months before the first scheduled payment and only if the plan requires that payments be delayed at least five years from the date of the election.

Special Rules

Offshore Property in Trust. Amounts set aside in an offshore trust (or other arrangement specified by the IRS) for the purpose of paying deferred compensation would be taxable when set aside if the assets are outside the United States (or when the assets are subsequently transferred outside the United States).

Change in Employer's Financial Health. Deferred amounts would be taxable at the time a plan first provides that assets are restricted to the payment of benefits in connection with a change in the employer's financial health (or when the assets become so restricted).

Subsequent Earnings and Retrospective Interest An interest factor would apply to amounts taxed by reason of being offshore or secured against a change in financial health of the employer. Earnings on previously taxed offshore amounts and assets secured against a change in the employer's financial health would be immediately taxable.

No Inference The proposal would create no inference preventing the inclusion of deferrals in income pursuant to provisions of existing law.

Broad Regulatory Authority The IRS would be given broad regulatory authority to implement the proposal. However, this authority is limited to the scope of the proposal and does not extend as far as that sought by the Bush Administration in connection with the proposed repeal of section 132 of the 1978 tax act.

W-2 Forms The proposal would require W-2 reporting of compensation deferrals.

Effective Date The proposal would apply to amounts deferred in taxable years beginning after December 31, 2003.