

Senate Finance Committee Proposes Strict Limitations on Deferred Compensation

The Senate Finance Committee yesterday approved by unanimous voice vote a set of “revenue raisers” that include a strict new limitation on nonqualified deferred compensation. Some details are not clear because the bill language is reportedly still being drafted, but a published description indicates that the measure, if enacted as proposed, would:

- Limit deferrals by an individual for any year to the *lesser* of \$1 million or the individual’s average annual taxable compensation (determined, in general, using a five-year look-back period);
- Require that *earnings* (actual or notional) on previous deferrals themselves be subject to the limit. Only earnings on deferrals for years beginning after 12/31/06 would count for this purpose. The intended impact of this provision is not clear, but it could mean that *new* deferrals would eventually be subject to a limit much lower than \$1 million, or barred altogether;
- Subject *all* vested deferred amounts under a nonqualified deferred compensation plan that violates the new limit to the sanctions that apply under current-law Section 409A: acceleration of taxable income plus a 20% tax plus, in some cases, an additional tax in the nature of interest; and
- Take effect for taxable years beginning after 12/31/06 – in other words, retroactively to the beginning of *this year*. Taxpayers could unwind deferral elections that do not comply with the new rule.

A separate provision of the proposed legislation would broaden the scope of the public-corporation deduction limitation rules of Section 162(m) of the Code, which currently affects the deductibility only of certain “named executive officers” in office at year end, to include both current and former top officers.

Prospects for enactment of the new proposals are not clear. News reports suggest that action by the full Senate could be taken as early as next week. The House of Representatives has not passed any comparable provisions.

Contact Information

For questions regarding the new proposal, please contact any member of the Tax & Benefits Department.

