

Will Congress Cap Deferred Compensation?

As part of a compromise to resolve complicated minimum wage increase negotiations, Congress decided to provide a tax cut for small business as part of its new minimum wage proposal (“*The Small Business and Work Opportunity Act of 2007*”). However, because of a newly implemented House “pay-as-you-go” rule, no new tax cuts may be authorized without a corresponding revenue producer incorporated into the legislation. In determining how to raise the revenue, the Senate chose to continue the recent trend of punishing highly paid executives (who have been deemed by the politicians to make too much money).

As a result, proposed minimum wage legislation now includes a provision to limit the amount of nonqualified deferred compensation that any individual can accrue. The bill would apply a dollar cap on the annual accrual of nonqualified deferred compensation that is the lesser of \$1 million or the individual’s annualized includible compensation (which is the average compensation over five years). If the cap is exceeded, all amounts that are deferred under all plans (not just the amounts over the cap) are subject to ordinary income tax plus the 20 percent additional tax under section 409A on amounts deferred in 2007 and later including earnings on such amounts.

The bill would also amend the section 162(m), provision that generally limits deductions for employers for the compensation of certain employees (CEO and top four most highly compensated officers) of \$1 million or less to treat former employees and their beneficiaries as *continuing to be covered by the limits after employment*. In other words, once an employee falls within the group covered by section 162(m) the employee would continue to be covered by section 162(m) forever — even if the individual no longer satisfies the “top-paid executive” definition.

Congress would benefit from a lesson about the history of such tax strategies. Most economists

would attribute the micromanaging of employee compensation through the use of the tax code, and specifically section 162(m), as leading directly to the explosion of compensation in the form of stock options (which were not subject to the \$1 million dollar cap). Congress therefore inadvertently created the move towards stock options as an executive compensation tool.

This reliance on stock options only exacerbated the perception of executive pay being out of control relative to the rank and file because the stock market has rewarded option holders handsomely in the last couple of decades since this legislation was first passed. Now, with a Democratic Congress back in control, there is renewed determination to subject executives, who are characterized as making too much money, to additional tax. That this legislation will lead to a new way to compensate executives that in turn results in some new unintended consequence is something our elected representatives apparently fail to grasp — no matter how many times history has proven that this will inevitably occur.

Willis is working with the American Benefits Counsel to educate Congress regarding the negative impact of these proposals on U.S. business.

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